

Via E-Mail

March 30, 2023

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File No. S7-29-22, S7-30-22, S7-31-22 & S7-32-22

Dear Madam Secretary:

I am writing on behalf of the Council of Institutional Investors (CII). CII is a nonprofit, nonpartisan association of United States (U.S.) public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about \$4 trillion in assets, and a range of asset managers with more than \$40 trillion in assets under management.¹

This letter is in response to the Securities and Exchange Commission’s (SEC or Commission) proposals entitled “Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders” (NMS Proposal),² “Order Competition Rule” (Competition Proposal),³ (3) “Disclosure of Order Execution Information,”⁴ and (4) “Regulation Best Execution” (BestEx Proposal)⁵ (collectively, the Proposals).

¹ For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

² Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, Exchange Act Release No. 96,494, 87 Fed. Reg. 80,266 (Dec. 29, 2022), <https://www.federalregister.gov/documents/2022/12/29/2022-27616/regulation-nms-minimum-pricing-increments-access-fees-and-transparency-of-better-priced-orders>.

³ Order Competition Rule, Exchange Act Release No. 96,495, 88 Fed. Reg. 128 (Jan. 3, 2023), <https://www.federalregister.gov/documents/2023/01/03/2022-27617/order-competition-rule>.

⁴ Disclosure of Order Execution Information, Exchange Act Release No. 96,493, 88 Fed. Reg. 3,786 (Jan. 20, 2023), <https://www.federalregister.gov/documents/2023/01/20/2022-27614/disclosure-of-order-execution-information>.

⁵ Regulation Best Execution, Exchange Act Release No. 96,496, 88 Fed. Reg. 5,440 (Jan. 27, 2023), <https://www.federalregister.gov/documents/2023/01/27/2022-27644/regulation-best-execution>.

CII Policies

CII has a long-standing, membership-approved policy entitled “**Guiding Principles for Trading Practices, Commission Levels, Soft Dollars and Commission Recapture**” that we believe is particularly relevant to examining some of the provisions of the Proposals.⁶ That policy states in relevant part:

. . . We have the power to assert our authority in these matters through our contractual arrangements with money managers and brokers. We also have the broader duty to communicate the interests and desires of the institutional investor community to regulators, to the public and to the industry regarding trading practices and commissions.

Like any other expense of the plan, trading costs need to be managed to minimize the cost and ensure that maximum value is received. But current brokerage industry practices . . . may be antithetical to the fiduciary obligation of obtaining best execution, and hold too much potential for conflicts of interest and abuses.

Clarity and transparency of disclosure of all money management and brokerage arrangements is essential, and it is up to plan sponsors to require it. Simple reliance on brokers, money managers and consultants for volunteered information is insufficient to discharge the obligations of plan fiduciaries. Plan sponsors should require . . . affirmative representations that fiduciaries are pursuing best execution in their trading practices.

To the extent that any money manager or plan sponsor is . . . directing brokerage to obtain commission recapture, it is the duty of fiduciaries to ensure that all such practices are engaged in for the exclusive benefit of the plan and its members.⁷

While the Proposals appear to be designed primarily to benefit individual investors, the following comments are an initial attempt to apply our policy language and related prior public positions to some of the provisions of the NMS Proposal, the BestEx Proposal, and Order Competition Proposal that appear to potentially have a significant impact on institutional investors.

NMS Proposal

Consistent with our policy on **Guiding Principles for Trading Practices, Commission Levels, Soft Dollars and Commission Recapture**, CII has long raised concerns that the structure of stock exchange access fees and rebates may present conflicts of interest for broker-dealers affecting their order routing decisions and lowering the execution quality for institutional

⁶ See CII, Policies on Other Issues, **Guiding Principles for Trading Practices, Commission Levels, Soft Dollars and Commission Recapture** (Adopted March 31, 1998), https://www.cii.org/policies_other_issues#principles_trading_commission_softdollar.

⁷ *Id.*

investors.⁸ That continuing concern leads us to generally support the MNS Proposal provisions described as “Lower Access Fee Cap”⁹ and “Exchange Fees and Rebates Determinable at the Time of Execution.”¹⁰ We agree with SEC Chair Gary Gensler that when “[t]aken together, this transparency and change to access fee caps would drive efficiency, competition, and fairness in our markets” to the benefit of long-term institutional investors.¹¹

Lower Access Fee Cap

CII generally supports the proposed reduction in the access fee cap to \$0.001 per share from the current level of \$0.003, for securities priced at greater than \$1 per share.¹² It is our understanding that this current “cap” has come to be used as the standard rate charged to access quotes at most exchanges, and some or all of those fees are then often “rebated” to liquidity providers.

The Commission estimates the average “net capture” (access fees collected minus rebates paid out) is only \$0.0002 per share, which means that over 90% of the access fees collected are paid out in the form of rebates.¹³ The existing system disadvantages institutional investors because we believe rebates create the kinds of conflicts of interest identified in our policy.

More specifically, when an institutional investor sends a broker an order, the broker is incentivized to route that order to a trading center or exchange where the broker may pay a lower fee or garner a greater rebate, even when the investor could receive a better execution on another market. Therefore, we believe the proposed reduction in the access fee cap could reduce trading costs for long-term investors and help to reduce the impact of rebates and fee avoidance on order routing and the quality of execution.

⁸ See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, CII to Brent J. Fields, Secretary, Securities and Exchange Commission 2 (May 10, 2018), <https://www.sec.gov/comments/s7-05-18/s70518-3621501-162362.pdf> (“We are particularly troubled by evidence cited by the Commission that ‘shows lower execution quality, in terms of reduced probability of execution or increased time to execution, for non-marketable limit orders on exchanges that pay high rebates [and] [t]hus broker-dealers may route orders to exchanges that have the best quoted prices but are suboptimal for customers in other ways because orders are either less likely or take longer to execute.’”).

⁹ See 87 Fed. Reg. at 80,358 (proposed § 242.610(c) *Fees for access to quotations*).

¹⁰ See *id.* (proposed § 242.610(d) *Transparency of fees*).

¹¹ Chair Gary Gensler, Statement on Minimum Price Increments, Access Fee Caps, Round Lots, and Odd-Lots (Dec. 14, 2022), <https://www.sec.gov/news/statement/gensler-tick-size-20221214>.

¹² See 87 Fed. Reg. at 80,326 (“The proposal would lower the access fee cap from \$0.003 per share (30 mills) to \$0.001 per share (10 mills) for NMS stocks priced \$1.00 or greater”); 87 Fed. Reg. at 80,266 (proposed § 242.610(c)(1)(ii): “If the price of a protected quotation or other quotation is \$1.00 or more, the fee or fees cannot exceed or accumulate to more than: \$0.001 per share for an NMS stock that has a minimum pricing increment greater than \$0.001”).

¹³ See 87 Fed. Reg. at 80,326 (“As shown in Table 11 below, the Commission estimates that the reduction in the access fee cap would lead to a decrease in the total access fees collected and rebates distributed of approximately \$3.8 billion per year, amounting to a 73% reduction in access fees paid or an 80% reduction in rebates distributed.”).

Exchange Fees and Rebates Determinable at the Time of Execution

We also generally support the proposed requirement that exchange fees be set so that the amount of the fee or rebate allocated to a particular trade is known at the time of the trade.¹⁴ It is our understanding that currently exchanges use volume-based tier schedules that depend on the current month's trading volume.¹⁵ As a result, the per-transaction fee or rebate cannot be known when the trade occurs. This significantly impedes the ability of institutional investors and other market participants "to evaluate the total price of a trade at the time of execution and . . . [the] ability to evaluate best execution and order routing."¹⁶

More specifically, we agree with the Commission's analysis that the proposed requirement could, consistent with our policy, provide the following benefits to institutional investors and other market participants:

[A]llowing market participants to determine the applicable fees and rebates at the time of execution could help improve investor execution quality by providing certainty as to the net fee and rebate price applicable at a given exchange at the time that an order is routed to that exchange.

Having fees and rebates determinable at the time of execution could make it easier for broker-dealers to pass such fees and rebates on to the end customer. Currently, it is difficult for a broker-dealer to pass on fees and rebates to individual customers because the level of fees and rebates is not determinable at the time of execution and the tier into which a broker-dealer falls, which determines total fees and rebates, is based on total broker-dealer activity and not an individual trade.

Access fees create potential conflicts of interest. Passing on fees and rebates to end customers could eliminate such distortions and lead to improved overall order execution for end customers. Additionally, the ability to pass on the fees and rebates to end customers might also make customers more aware of these fees and rebates so that they can better inform their broker-dealers how to route with respect to fees and rebates which could also lead to better execution for end customers.

. . . .

Making fees and rebates determinable at the time of execution could also enable the customers of broker-dealers to better discuss transaction fees and rebates with their broker-dealers, and potentially request data on such fees. Doing so could improve broker-dealer accountability and lead to better outcomes for customers.¹⁷

¹⁴ *Id.* at 80,358 (proposed § 242.610(d): "A national securities exchange shall not impose, nor permit to be imposed, any fee or fees, or provide, or permit to be provided, any rebate or other remuneration, for the execution of an order in an NMS stock that cannot be determined at the time of execution."); *See, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel, CII to Vanessa A. Countryman, Secretary, Securities and Exchange Commission 18 (Sept. 7, 2022),

[https://www.cii.org/files/issues_and_advocacy/correspondence/2022/September%207%202022%20Reg%20Flex%20Letter%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2022/September%207%202022%20Reg%20Flex%20Letter%20(final).pdf) (" . . . we would respectfully request that the SEC consider proposing that stock exchange rebate fee schedules be structured so that the total rebate benefit received is more transparent and investors can understand the amount of rebate relating to their order at the time of trade execution.")..

¹⁵ *See* 87 Fed. Reg. at 80,269 ("The fees included in these schedules are largely calculated based on volume in a given month and are therefore calculated at month's end.").

¹⁶ *Id.*

¹⁷ 87 Fed. Reg. at 80,329-30 (emphasis added and footnotes omitted).

Similarly, we agree with the Commission’s analysis that in combination:

Making fees and rebates determinable at the time of execution, along with the reduction of the access fee cap could also increase price efficiency by helping minimize potential conflicts of interest. The inability for broker-dealers to determine access fees and rebates at the time of execution makes it difficult to effectively pass them on to their customers. To the extent that order routing decisions are affected by potential conflicts of interest, these potentially conflicted decisions could harm efficiency by leading to inefficient trading decisions and thus an inefficient incorporation of information into stock prices.¹⁸

BestEx Proposal

Consistent with our policy on **Guiding Principles for Trading Practices, Commission Levels, Soft Dollars and Commission Recapture**, which includes two references to “best execution,” we generally agree with Chair Gensler that a “best execution standard at the Commission level . . . would lead to better execution for retail and institutional investors.”¹⁹ We, however, have concerns with two provisions of the BestEx Proposal and their potential impact on brokers’ potential best execution obligations for institutional investors: Proposed exemption for an institutional customer; and omission of a proposed requirement for order-by-order decision making.

Exemption for an Institutional Customers

Proposed Rule 1100(b) would exempt from the Commission’s best execution standard “[a] broker or dealer, or a natural person who is an associated person of a broker or dealer . . . when . . . [a]n institutional customer, exercising independent judgment, executes its order against the broker or dealer’s quotation.”²⁰ The Commission explains the basis for this exemption as follows:

[U]nder the second exemption, the broker-dealer would be acting solely as a buyer or seller of securities in transactions directly with an institutional customer. In the corporate and municipal bond and government securities markets, for example,

¹⁸ *Id.* at 80,335-36.

¹⁹ Chair Gary Gensler, Statement on Best Execution (Dec. 14, 2022), <https://www.sec.gov/news/statement/gensler-best-execution-20221214>; see Paul Mulholland, Compliance, Pros and Cons of the SEC Market Structure Proposals, planadviser (Mar. 24, 2023), <https://www.planadviser.com/pros-cons-sec-market-structure-proposals/> (“David Lauer, the CEO of Urvin Finance, said that the SEC taking on Reg BE is a positive because Reg BE is not being enforced properly by FINRA, and SEC data show that many firms are not achieving best execution [and]. “We have accepted good enough execution as good enough in this industry,” when the standard is supposed to be best execution”). Editorial Staff, Flash Friday: Gensler to Securities Industry: I Hear you, But . . ., Traders Magazine (Mar. 3, 2023), <https://www.tradersmagazine.com/flashback/flash-friday-gensler-to-securities-industry-i-hear-you-but/> (“Gensler said when he arrived at the SEC he was surprised to learn there was no in-house **best execution rule** [and]“I frankly thought it was way too important not to have the SEC speak to it”); see also Letter from Jeffrey P. Mahoney, General Counsel, CII to Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 17 (“CII generally agrees with SEC Chair Gensler that investors would benefit if the SEC proposes its own best execution rule.”).

²⁰ 88 Fed. Reg. at 5,555 (proposed § 242.1100(b)) (emphasis added).

institutional customers often handle and execute their own orders. Institutional customers in these markets commonly request prices from broker dealers for particular securities (prices for any given security are often not quoted and made widely available) and exercise their own discretion concerning the execution of a particular transaction. In these instances, a broker-dealer is simply responding to the institutional customer's request (e.g., through widely known request for quote ("RFQ") mechanisms) and the institutional customer is exercising independent discretion over the handling and execution of its orders. Accordingly, the Commission believes that the broker-dealer in these circumstances should be exempted from the best execution standard under proposed Rule 1100.²¹

We do not believe the Commission's basis is sufficient for us to conclude that the proposed exemption is either necessary or "appropriate."²² More specifically, we are concerned that the proposed exemption may result in some institutional investors, particularly smaller institutional investors with less market power, not obtaining the best execution they desire, as reflected in our policy. We, therefore, would respectfully request that the Commission carefully reconsider the need for the proposed exemption and if the exemption is deemed necessary, consider narrowing the scope of the exemption or making it conditional.

We note that the BestEx Proposal's request for comments numbers: 14,²³ 16,²⁴ 17,²⁵ 19,²⁶ and 20²⁷ describe potential approaches that could be considered to narrow the scope of the exemption or making it conditional. If the exemption is retained, we believe all of those approaches, and others suggested by commenters, should be carefully considered before a final rule is issued.

Order-by-Order Decision Making

Proposed Rule 1101 requires that "[a] broker or dealer that engages in any transaction for or with a customer or a customer of another broker or dealer shall establish, maintain, and enforce written policies and procedures reasonably designed to comply with the best execution standard . . ."²⁸ Proposed Rule 1101(a) then goes on to provide a list of the requirements for those policies

²¹ *Id.* at 5,452 n.114.

²² *Id.* at 5,453.

²³ *Id.* ("Should the Commission define 'institutional customer' for purposes of proposed Rule 1100?").

²⁴ *Id.* ("Should the exemption concerning institutional customers in proposed Rule 1100 be limited to situations where the broker-dealer seeking the exemption has a reasonable basis to believe that the institutional customer (i) has the capacity to evaluate independently the prices offered by the broker-dealer and (ii) is exercising independent judgment in deciding to enter into the transaction, such as is provided for in FINRA Rule 2121 concerning suitability for institutional customers?").

²⁵ 88 Fed. Reg. at 5,454 ("[S]hould an institutional customer be required to make an affirmation to the broker-dealer concerning its exercise of independent judgment in evaluating the quality of execution of its transaction with the broker-dealer?").

²⁶ *Id.* ("Should a broker-dealer seeking the exemption in proposed Rule 1100 in transactions with institutional customers be required to disclose to the institutional customer that it is not required to comply with the best execution standard of proposed Rule 1100 for the relevant transactions?").

²⁷ *Id.* ("Should the proposed exemption concerning institutional customers in Rule 1100 be limited to only certain types of securities or only certain types of trading protocols where the institutional customer is executing against the broker-dealer's quote?").

²⁸ 88 Fed. Reg. at 5,555 (proposed § 242.1101).

and procedures.²⁹ Omitted from the list is a requirement that a broker analyze and make routing decisions on an order-by-order basis. We are disappointed by that omission. As explained in our September 2022 letter to the Commission on this topic:

CII believes an SEC proposal imposing an “order-by-order” best execution requirement on all brokers for all types of orders would likely help to enforce the best execution standard in a more consistent way for all market participants, including institutional investors. We, therefore, respectfully request that the SEC consider proposing the creation of a new best execution rule with provisions that provide the SEC the ability to enforce a standard requiring that each investor is entitled to receive the best execution of its orders on an order-by-order basis.³⁰

Consistent with our view, CII would support requiring the “reasonable alternative” described in the BestEx Proposal providing for order-by-order documentation for all transactions.³¹ As indicated by the Commission, we believe this reasonable alternative could:

[O]ffer two benefits beyond the benefits of the proposed rules. First, it might improve the quality of the broker-dealer’s regular review of its execution practices compared to the proposed rules. Because the broker dealer would analyze orders on a case by-case basis, it might identify routing practices that could be changed to improve customer order execution quality. Second, it might improve regulators’ ability to oversee the broker dealer’s efforts to provide best execution to its customers relative to the proposed rules as such records would be available to regulators during examinations of the broker-dealer or upon request.³²

While we acknowledge that this proposed reasonable alternative might “impose considerable costs” on some brokers,³³ we note that the reality in today’s markets is that routing and execution decisions are made by brokers in real time on an order-by-order basis. And we believe the aforementioned benefits to institutional investors of requiring an order-by-order documentation of those decisions could exceed the costs.

Order Competition Proposal

CII is supportive of the goal of the Order Competition Proposal, which is to provide greater opportunity for retail and institutional orders to interact in the public market.³⁴ As Chair Gensler has explained:

²⁹ *Id.* (proposed § 242.1101(a)).

³⁰ Letter from Jeffrey P. Mahoney, General Counsel, CII to Vanessa A. Countryman, Secretary, Securities and Exchange Commission at 17.

³¹ 88 Fed. Reg. at 5,539 (“Require Order-by-Order Documentation for Conflicted or All Transactions”).

³² *Id.*

³³ *Id.*

³⁴ *See* 88 Fed. Reg. at 130 (“the Commission has been guided by this goal of benefiting investors by enhancing competition [and] [t]he overriding objective . . . is to maximize the opportunity for a wide range of market participants to participate in auctions on terms that will promote the best possible prices for the orders of individual investors”).

[E]veryday individual investors don't have the full benefit of various market participants competing to execute their marketable orders at the best price possible. For example, individual investors don't necessarily get the best prices that they could get if institutional investors, like pension funds, could systematically and directly compete for their orders.³⁵

And we agree with the Commission's determination that "institutional investors that currently submit their own marketable orders on national securities exchanges and other trading centers potentially could trade at better prices if given an opportunity to interact with the marketable orders of individual investors in fair and open auctions."³⁶ The end result could be, as described in the Order Competition Proposal, "increased competition to supply liquidity to marketable orders of individual investors, which in turn would lower transaction costs for individual investors, potentially enhance order execution quality for institutional investors, and improve price discovery."³⁷

That said, we generally agree with SEC Commissioner Hester M. Peirce that "institutional investors may not expend much effort to participate" in the new auction mechanisms created by the Order Competition Proposal.³⁸ In particular, for many institutional investors, the risk of potentially revealing their identities and trade interest to even a single dealer by participating in the proposed new auction mechanisms³⁹ could materially outweigh any potential benefits of receiving the executions. Therefore, we encourage the Commission to consider various ways to incentivize the interaction of retail and institutional investors. Both types of investors share a common objective – to trade at fair and transparent prices, not to capture momentary price changes – and they can both benefit from a greater ability to have their orders interact for their mutual benefit.

Thank you for your consideration of CII's views. If we can answer any questions or provide additional information about this letter, please do not hesitate to contact me.

³⁵ Chair Gary Gensler, Statement on Proposal to Enhance Order Competition (Dec. 14, 2022), <https://www.sec.gov/news/statement/gensler-order-competition-20221214>.

³⁶ 88 Fed. Reg. at 130.

³⁷ *Id.* at 178.

³⁸ Commissioner Hester M. Peirce, Statement, Ordering Competition (Dec. 14, 2022), <https://www.sec.gov/news/statement/peirce-order-competition-20221214>.

³⁹ 88 Fed. Reg. at 187 ("The trading interest of investors who submit IOCs to an SDP for liquidity are only exposed to the single dealer operating a platform [and] [i]n contrast, submission of the same order to an exchange or an ATS may alert many other market participants to the underlying trade interest, triggering reactions.").

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Sincerely,

A handwritten signature in cursive script that reads "Jeff Mahoney". The signature is written in black ink and is positioned to the right of the word "Sincerely,".

Jeffrey P. Mahoney
General Counsel