BMO Capital Markets

March 31, 2023

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

Re: Order Competition Rule, Securities Exchange Act Release No. 34-96495; File NO. S7-31-22

Dear Ms. Countryman:

BMO Capital Markets Corp. ("BMO CMC") welcomes the opportunity to provide comments to the Securities and Exchange Commission ("Commission") with respect to the proposed amendment to the regulation governing the National Market System ("NMS") under the Securities Act of 1934 ("Exchange Act") to add a new rule designed to promote competition as a means to protect the interests of individual investors and to further the objectives of the NMS.

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

Executive Overview

In today's market microstructure, institutional orders have little opportunity to engage with retail order flow. The proposed order competition rule sets out to enhance competition for the execution of retail investors' marketable orders.

In summary, we believe markets could benefit from:

- Reforming retail competition by creating a space for retail and institutional orders to interact without intermediation.
- Retail auctions as a viable mechanism for the natural engagement of retail and institutional order flow, with some revisions to the auction design.

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

- Non-mandatory auctions, with guidance on "held orders," and updates to 605 which would allow market forces to determine the usage and success of retail auctions.

The Opportunity for Enhanced Retail Competition

The current retail environment, which democratizes investing with zero-commissions and offers excellent execution quality, has reduced both explicit and implicit trading costs for the benefit of retail investors. Judging today's retail execution experience through the lens of the past, we would agree with the common refrain that "retail has never had it better"; we would ask, however, could they have it better in the future?

Wholesalers and retail brokers have forged strong partnerships over decades of collaboration and refinement of their trading businesses, providing value to each other and the retail investing public. Their success and current business model have made it difficult for institutions to broadly interact with retail flow. Congress recognized the importance of competition among orders when they mandated the establishment of an NMS: "Investors must be assured that they are participants in a system which maximizes the opportunities for the most willing seller to meet the most willing buyer."[2]

Today, institutions have narrow access to retail counterparties, making it difficult to be that "willing buyer or willing seller."[3] For institutions, retail flow is attractive primarily because the retail trader is less likely than a market maker or other intermediary to hedge or unwind their position while the institution is still trading. Conversely, if an institutional trader buys stock from a market maker, that market maker will eventually cover, trading in the same direction as the institutional investor. Put simply, when two natural investors trade with each other, the risk transfer has a longer duration, as opposed to the more short-term risk transfer when trading against a market maker. Retail counterparties reduce risk and residual size that institutions must trade and should be expected to reduce implementation shortfall costs.

A new mechanism such as retail auctions would create space for retail orders to interact with a broader cross section of the market, including institutional investors' flows. Allowing venues to compete for this order flow—and having the transparency in reporting of routing behavior and execution quality—should enhance the competitive market with execution efficiency benefits accruing to all participants.

Retail Auctions as the Mechanism for Engagement

Auctions serve as an efficient mechanism for buyers and sellers with common interests to meet – retail auctions should be no different. However, we recognize that there are some unknowns in how the concept of retail auctions would impact our equity markets.

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[2] H.R. Rep. 94-123, 94th Cong., 1st Sess. 50 (1975). The quotation from the text of the House Report concludes a cogent description of the importance of maintaining the proper balance between competition among markets and competition among orders that is worth quoting in full: Critics of this development [multiple trading of stocks] suggest that the markets are becoming dangerously fragmented. Others contend that the dilution of large market dominance is the result of healthy competitive forces which have done much to add to the liquidity and depth of the securities markets to the benefit of the investing public. The Committee shares the opinion that our markets will be strengthened by the infusion of market maker competition in listed securities with the concomitant increase in capital availability and diminution of risk which results from increased competition among specialists and market makers.

[3] Certain retail orders are exposed to institutional investor orders through exhaust programs or if trading through a broker dealer with both sources of customer order flow.

The current retail environment is stable, and there are commercial arrangements for retail broker-dealers that protect them and their customers against poor executions as a result of disruptions in the market. In addition, the revenue generated though payment for order flow is important to the business model for some retail brokers who offer commission-free trading. The introduction of mandatory retail auctions risks disrupting the existing and stable retail environment.

In proposed Rule 615, the Commission prohibits restricted competition trading centers from internalizing a segmented order until the order has been exposed to competition at a specified limit price in a qualified auction operated by an open competition trading center, **except** in the following scenarios:

- paragraphs (b)(2) and (b)(3) of Proposed Rule 615 would provide exceptions for larger orders ($200,000 or more) and orders that are executed at favorable prices for individual investors (orders executed at the NBBO midpoint or better);
- paragraph (b)(4) would provide an exception for limit orders that have a limit price that is equal to or more favorable for the segmented order than the NBBO midpoint (i.e., non-marketable segmented orders with a limit price that is equal to or lower than the midpoint for buy orders and equal to or higher than the NBBO midpoint for sell orders); and
- paragraph (b)(5) would provide an exception for orders sized less than one share and for the fractional component, if any, of a segmented order if no qualified auction is available to execute the fractional share or fractional component.

Generally, the Commission permits segmented orders in NMS securities sent from a natural person who trades less than 40 times per day to be exempt from auctions under the following conditions:

- Orders are executed at NBBO mid or better;
- Orders have a value > $200,000;
- Orders are received when an auction facility is not running;
- Orders are not marketable to the NBBO Mid; or
- Orders for fractional shares if no auction mechanism exists for the fractional shares.

Efficient markets are built on choice, transparency, and the quest for better quality executions. Auctions as an option but not a mandate would provide retail broker dealers with new routing choices as they seek better quality executions for retail investors.

Choice is the Viable Alternative for Retail Competition

Retail auctions could be a viable option for retail orders to maximize their execution quality. However, rather than mandating that covered orders be sent to an auction, we believe the Commission could allow for retail auction mechanisms to exist as a non-mandated option, and allow for market forces to determine their success. In addition, we believe the proposed auction process may result in some retail orders missing execution at the best prices if the stock ticks away. However, this risk currently exists, with current retail execution times ranging from 30 milliseconds to 1 second for large orders.[4] We propose

[4] Retail execution quality statistics report wide ranging execution speeds for market orders and marketable limit orders. See retail BD executional quality stats https://us.etrade.com/trade/execution-quality (Feb23); https://www.schwab.com/execution-quality (Q322); https://www.tdameritrade.com/tools-and-platforms/order-execution.html?TID=NA&ef_id=EAIaIQobChMIiJ6A6Nvv_QIV6idMCh1togJcEAAYASAAEgKA8vD_BwE:G:s&s_kwcid=AL!2521!3!516568924246!e!!g!!td%20ameritrade%20execution%20quality&CID=PSTRA&dclid=CL28nunb7_0CFZ1

reducing the duration of the auction to between 10 and 100 milliseconds[5] to help mitigate the risk of adverse market moves during the auction period. The flexibility in auction duration would allow market centers to compete on their auction designs. The lower end of the time spectrum reduces the risk that prices move adversely; on the longer time horizons, there could be a more iterative process and possibly the opportunity to innovate and randomize the precise time the auction is run.

To increase the likelihood of retail broker dealers choosing to route to the auctions, the Commission could provide guidance that a "held order" does not violate the immediate execution requirement when retail brokers are routing to these auction mechanisms. Providing retail brokers with express relief that participation in auctions does not conflict with the immediate execution requirement, the Commission would remove a barrier to experimentation and usage.

Conclusion

Retail auctions, in conjunction with the Disclosure of Order Execution Information (Enhanced 605 reporting) will allow market forces to determine the use of retail auction facilities without forcing adoption.

Providing the space for natural liquidity to interact with minimal intermediation could improve execution outcomes for both retail and institutional investors. Auction models that bring retail and institutional investors together align with the Reg NMS mandate for the "most willing" buyer to meet the "most willing" seller. Critically, allowing market forces to ultimately determine the success or failure of such a mechanism should sidestep the litigation that is commonly believed to occur should adoption be mandated.

With slight modifications to the auction design and improved execution quality reporting we believe there is an effective solution that could mitigate risks and improve the quality of executions for all market participants.

BCQkdt0oLng (Q422); and a wholesaler retail execution quality stat https://www.twosigma.com/businesses/securities/execution-statistics/ (Q422)

[5]In a similar auction type venue, firm-ups are sent within 3-20 milliseconds; see https://www.pdqenterprises.com/wp-content/uploads/2019/04/CODA-Micro-ProductSheet04.24.19.pdf. There is very little reason that an auction mechanism would need to take 300 milliseconds to facilitate a match between buyers and sellers.

Sincerely,

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