3/23/2023

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

RE: Equity Market Structure Proposals (File Numbers S7-29-22, S7-30-22, S7-31-22, and S7-32-22)

Dear Ms. Countryman,

We're offering comments on the Commission's four December 2022 proposals to amend Regulation National Market System (file numbers above).

ModernIR is the leader in quantitative equity-market analytics for US-listed companies, and our sister organization, Market Structure EDGE LLC, is the only trading decision-support platform derived from quantitative market-structure measures of supply and demand. We're a longtime market-structure voice.

While we appreciate the Commission's interest in responding to an outcry from the retail investment community over the so-called meme-stock scenario, none of these proposals addresses the root meme-stock cause, which is market-making exemptions to short-locate rules.

So long as broker-dealers engaged in bona fide market-making may create stock to fill orders, meme-stock risk will persist. We recognize that the purpose of exemptions is to maintain a continuous auction. But at some point, the Commission needs to consider whether the cost to reliable and rational market behavior is worth these exemptions.

We'll next offer a specific view on each of the four proposals.

Regulation Best Execution, file number S7-32-22. Defining a standard has merit. But the forced fixation on price is unconstructive. Further, the more complex the meter in a market-maker model such as Reg NMS, the greater the concentration risk that develops. We used to have 60-70 underwriters per IPO. Today, there are 3-4, and secondary support following IPOs – vigorous trading, research, capital-raising – has all but vanished because there are no economics left to fund it. My profession, investor relations, formed around that secondary market.

Of the 4,000 or so brokers regulated by FINRA, just nine, the data we measure suggest, dominate customer orders (versus proprietary orders), executing nearly 90% of them. Those firms' orders become the measure of best-execution, quashing innovation and competition. We suggest the Commission abandon this proposal.

Order Competition Rule, file number S7-31-22. Perhaps the aim is to give proprietary traders the chance to buy these retail orders and offer them for sale at exchange Retail Liquidity Programs, which will be more attractive against a sharp drop in fee caps (and by extension, rebates, though it may not happen). But it will introduce yet more artifice (labyrinthine trade-monetization detracting from the market's core purpose) into a marketplace that's already critically dependent on artifice. It will become an end unto itself, and the SEC will in the future receive the recrimination now directed at other targets of retail vitriol.

And while we think Payment for Order Flow feeds arbitrage rather than investment, retail orders resultingly get the best prices in history for the lowest cost (free). Plus, there's no historical antecedent demonstrating success in treating constituents disparately, though it could well be argued in court that this effort is at odds with the Fair and Equitable principle of the Exchange Acts. We don't support this proposal.

Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, file number S7-30-22. Transparency is good. But investment horizons and liquidity corelate to spreads. The smaller the spread, the shorter the horizon, the thinner the liquidity. The greatest enemy of short-termism in any market is a sizable spread.

And the Exchange Acts require fair and equitable treatment for all constituents, including issuers. We have more to say below, but issuers are not served by decimal points. The last thing CEOs and CFOs of public companies want to see is a litter of quotes in tenths and hundredths of pennies. Consider the optics.

It's instructive that a core tenet of Reg NMS is a prohibition on sub-penny quoting. That the Commission would impose sub-penny quotes rather than prohibit sub-penny trades is curious and insinuates dependency on arbitrage. Sub-penny increments – which by simple math amount to tens of billions of dollars annually across the market – accrue solely to the benefit of market participants with an investment horizon of a day or less. That's antithetical to the purpose of taking a company public.

We recognize that the Commission has made this concession to the trading community for the maintenance of a continuous auction in tiny increments (trade-size barely clings to 100 shares across the S&P 500, our data show). But it's at odds with the purpose of the equity capital markets, which is to match risk-taking investors with innovative enterprises.

Sure, the Tick Study from some years ago offered dim data on wider spreads. But no other rules changed. Suppose that study had suspended the trade-through rule? Suppose wider leeway on best execution were granted, to accommodate smaller broker-dealers unable to meet regulatory requirements who instead send orders to a compliant firm (largely the bulge bracket)?

As to liquidity, the best way to promote it is to suspend the trade-through rule (Rule 611), which fragments liquidity, pushes investment into ETFs and equity derivatives, and promotes arbitrage. To wit, look at the staggering notional daily value in zero-days-to-expiration options, which are wholly disconnected from underlying assets (because there's nothing to settle).

And finally, the relentless assault on the difference between bids and offers drives ever more order flow toward midpoint pricing – harming Active Investment, which alone public companies can target with outreach, and promoting Passive Investment tracking benchmarks.

In fact, defining all trades toward a similar construction, which variable spreads and smaller round lots do, turns stocks into products rather than stories. That's inequitable. We recommend dropping this proposal.

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Disclosure of Order Execution Information, file number S7-29-22. Expanding Rule 605 disclosures we suppose promotes transparency. But like the Best Execution proposal, it will drive yet more broker-dealers from the market and further concentrate risk in the hands of the few. If we want a vibrant community of market-makers supporting our vast equity market structure, we need fewer requirements, not more of them. Eradicate caveat emptor, and we no longer have a market. We have a machine. We fail to see how this proposal does anything but harm issuers, and discrimination against issuers is prohibited by the Exchange Acts. We recommend dropping it.

In sum, what's the objective? What are the success measures? Or we might simply say: Why do these things? Concluding observations:

1. **Omission of Issuer and Investor interests.** These proposed rules disadvantage long-term investors and harm liquidity for US-listed issuers. Ostensibly, the US public capital markets serve issuers and investors. It can't exist without both. Where the term "issuer" means a public company, there is not a single reference in 1,654 pages. And spreads of tenths and hundredths of pennies are categorically at odds with investment horizons of years, the general aim of the kind of investment dollars that shaped equity markets here into the envy of the world. Another requirement of rulemaking is that it reflect equitable allocation of fees and dues. Public companies are paying vastly more for public stock-listings than they did 25 years ago, yet no single market platform has even 20% of trading volume, the CBOE Volume Summary consistently shows. If the Commission is promoting rules that create free trading for retail investors and vast revenues for broker-dealers and exchanges, while the costs for issuers continue to go higher, it's starkly inequitable treatment. Perhaps the issuer community might be persuaded to support one or two of these proposals if the Commission moved to cut listing fees for issuers – without which there are zero trades – to 20% of current levels, reflecting the average trading-share of the listing exchanges.

2. **Too Much Complexity.** The Regulation National Market System final rule is 524 pages. The Market Data Infrastructure Rules are 900 pages. These four proposals en toto are 1,650 pages. The Buttonwood Agreement was two sentences. Why do we need 3,000 pages of regulation? The Congressional Act creating the Commission directs rulemaking to promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market (later the words "and a national market system" were added), and protect investors and the public interest. Regulations covering 3,000 pages make the rules the principal purpose of the market. Two sentences make capital-formation the central purpose. Your proposals are at odds with the central market purpose and the language of the Securities Act.

We appreciate both the opportunity to express these important perspectives – especially on behalf of issuers – and the Commission's careful consideration of them.

Yours Sincerely,

Tim Quast
President and founder

Supporting Signatories:

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