March 31, 2023

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

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

Ms. Countryman:

As an individual investor, I strongly support this proposal and believe it would reinforce the goal of fair, efficient, and transparent markets.

I am concerned about the current rule that allows brokers to send orders directly to a wholesaler's internal systems. PFOF presents a huge conflict of interest as well as an information advantage that impedes the fairness of markets. The wholesaler's ability to internalize order flow and take the other side of the trade using their own shares, their control over how, when, and where orders are executed, and the likelihood the orders are going to a lightly-regulated Single-Dealer Platform (SDP) are all factors that hinder market fairness and transparency. Also, brokers who do not accept PFOF route orders differently and consequently see superior execution quality.

Title 15 U.S.C. 78k-1 of the U.S. legal code on the objectives of the SEC states that the maintenance of fair and orderly markets must assure "fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets." How can there be fair competition if there is no competition at all? If wholesalers pay for the order flow, the competition is eliminated and the market is no longer fair.

I am concerned about the existence of SDPs and their lack of regulation. Orders sent to an SDP trade only against the market maker who is operating that SDP, and this SDP allows and/or facilitates a plethora of practices that present a potential conflict of interest or unfair advantage. (naked short sale practices, an incredible amount of information about incoming orders, collection of data about traders and trading patterns for future use).

Broker-dealers love to point out their price improvement, but this price improvement they claim to provide is meaningless.

From We the Investors (WTI) commentary letter:

WTI did an early analysis of the Herfindahl-Hirschman Index[1] (HHI) in our WTI SEC Presentation. We found that the off-exchange OTC market met the DOJ definition of a "highly concentrated market"[2] throughout 2019 - 2022. Edwin Hu and Dermot Murphy performed a more comprehensive analysis in their June 2022 paper[3]. They had several important findings:

1. *Most importantly, they found "more internalization is associated with worse price improvement" and "reducing internalization could potentially lead to decreased spreads, increased depth, and better price improvement in stocks with highly concentrated internalizer markets."[4]*
2. *Overall, spreads are wider in the presence of internalizers, even when there is robust internalizer competition, and wider still when there is insufficient competition.*
3. *Interestingly, they also found that the highest internalized stocks were subjected to more extreme price movements. They calculated that "the size of extreme price movements is about 53.6 basis points larger in the highest internalization quintiles compared to the lowest quintiles. This last result suggests that the increase in adverse selection on public* exchanges, which is induced by the diversion of retail order flow, also increases stock price fragility."

Further, the article "The Good, the Bad & the Ugly of Payment for Order Flow" by BestEx Research supports these findings:

In marketing the benefits of the PFOF arrangement for retail investors, wholesalers and retail brokers implicitly assume that if not for wholesalers, retail investors' cost would be the current NBBO spread. This rests on two assumptions:

1. No liquidity exists inside the NBBO on exchanges and other liquidity sources

2. The NBBO spread would remain the same even after retail flow moved to exchanges

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[1] U.S. Department of Justice, "Herfindahl-Hirschman Index", (July 31, 2018), Available at https://www.justice.gov/atr/herfindahl-hirschman-index
Note: HHI is "a commonly accepted measure of market concentration" that "takes into account the relative size distribution of the firms in a market. It approaches zero when a market is occupied by a large number of firms of relatively equal size and reaches its maximum of 10,000 points when a market is controlled by a single firm."
[2] Ibid.
Note: When a market is classified as a "highly concentrated market" the primary result is increased scrutiny of any merger that would "increase the HHI by more than 200 points" by both the DOJ and FTC.
[3] Hu, Edwin and Murphy, Dermot, "Competition for Retail Order Flow and Market Quality", SSRN, (June 8, 2022). Available at https://ssrn.com/abstract=4070056 or http://dx.doi.org/10.2139/ssrn.4070056 ("Hu-Murphy Paper")
[4] Ibid.

Each of these assumptions is incorrect. First, there is substantial liquidity hidden within the NBBO that firms providing execution services to institutional brokers frequently locate to improve execution. And second, the NBBO itself would significantly narrow if non-toxic retail order flow moved to exchanges and the information asymmetry between wholesalers and "regular" HFT market makers were eliminated. In the sections to follow, we estimate how much price improvement retail investors could expect to receive in an alternative market structure and how those savings compare to the current savings provided by wholesalers.[5]

The article later compares price improvement to store discounts:

we liken price improvement on retail market orders is akin to getting a 30% discount on an item after the shopkeeper raises the price by 40%. Retail investors end up paying 10% more for their market orders.[5]

Commentary letters opposing this proposal often argue that without PFOF, brokers may have to return to charging commissions to replace these payments. As a retail investor I would gladly pay commissions if it means my order goes to a lit auction with true price discovery instead of going to a wholesaler with a conflict of interest and possibly to an SDP where the wholesaler's advantages create even further conflict of interest.

I fully support sending order flow to auctions that have various market participants competing to execute their orders. Wholesalers should *not* be the first to receive orders; there must be equal opportunity to fill the order. I also very strongly support the Trade-At rule as discussed in the alternatives section of the OCR Proposal, and support all the reasoning for its benefits provided by WTI.

Sincerely,

Lana Young

[5] Mittal, Hitesh, and Kathryn Berkow. "The Good, the Bad & the Ugly of Payment for Order Flow." *BestEx Research* , https://f.hubspotusercontent10.net/hubfs/4982966/BestEx%20Research%20PFOF%2020210503.pdf?_hsmi=140073413&_hsenc=p2ANqtz-_e5iDuf5zpykzr-v-I5oKRkLirO8zJun1IgjMzz8l0vB76ZQ7eNWW9FIRBVCvurn6DKpKpWPprts8nOSyCgICuTRb_3A.