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July 28, 2017

Via Electronic Mail (rule-comments@sec.gov)

Mr. Brent J. Fields
Secretary
U.S. Securities & Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. SR-FINRA-2017-011; Self-Regulatory Organizations; Bats BYX Exchange, Inc; Bats BZX Exchange, Inc.; Bats EDGA Exchange, Inc.; Bats EDGX Exchange, Inc.; BOX Options Exchange LLC; C2 Options Exchange, Incorporated; Chicago Board Options Exchange, Incorporated; Chicago Stock Exchange, Inc.; Financial Industry Regulatory Authority, Inc.; Investors' Exchange LLC; Miami International Securities Exchange, LLC; MIAX PEARL LLC; NASDAQ BX, Inc.; Nasdaq GEMX, LLC; Nasdaq ISE, LLC; Nasdaq MRX, LLC; NASDAQ PHLX LLC; The NASDAQ Stock Market LLC; New York Stock Exchange LLC; NYSE Arca, Inc. and NYSE MKT LLC; Suspension of and Order Instituting Proceedings To Determine Whether To Approve or Disapprove Proposed Rule Changes To Establish Fees for Industry Members To Fund the Consolidated Audit Trail

Dear Mr. Fields:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to provide additional comments on the above-referenced proposals filed by the Self-Regulatory Organization ("SROs") that are the Plan Participants to the CAT NMS Plan. We thank the Securities and Exchange Commission ("Commission") for suspending effectiveness of the proposals and instituting proceedings to determine whether to approve or disapprove the proposals. We maintain the arguments that we made in our previous comment letter on the proposals, and we request that the Commission consider them as incorporated into this letter.[2] In addition, we add the following comments.

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] *See* Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA to Brent J. Fields, Secretary, Securities and Exchange Commission dated June 6, 2017 ("**SIFMA CAT Fee Filing Comment Letter**").

SIFMA Policy Discussion and Concerns on Regulatory Funding

These proposals should be considered in the context of two key statutory directives: (1) the requirements under the Securities and Exchange Act of 1934 ("Exchange Act") that SROs regulate their members;[3] and (2) the Exchange Act requirements that any fees SROs charge members must be reasonable and equitably allocated.[4]

There is a historical precedent of broker-dealers paying fees to SROs to help fund regulation of the markets. The Commission has expressly taken the position that SROs may recover regulatory costs through the collection of fees from member firms.[5] FINRA's Bylaws provide specifically for member funding,[6] which makes sense because FINRA remains a member organization whose function is to provide regulatory services. In their current role as commercial entities, exchanges operate under the statutory requirement that they must satisfy their SRO obligations, and they have continued the practice of charging fees to their members to help offset their regulatory expenses.

Despite the historical practice, there is nothing in the Exchange Act that specifically mandates broker-dealer funding of SROs. And even under current rules and practices, the SROs do not have an unlimited right of recovery of regulatory costs. As we have stated previously, the SROs already receive a significant amount of regulatory fees from members, while providing no information on how that money is spent or how the amount received relates to the amount spent.[7] Accordingly, we reiterate our argument that the Commission should not approve any fee for the CAT until the SROs demonstrate that it is necessary in addition to existing fees that are already levied upon their members.

SIFMA's Regulatory Concerns with the Proposed CAT Funding Models

With respect to the SROs proposals, there are three items we will address in more detail below. First, we contest the "comparability" standard that the SROs have included in the CAT NMS Plan. Second, we contest the fee structure proposed for Alternative Trading Systems ("ATSs"). Third, we contest the application of the fee proposals to options market makers.

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[3] *See* 15 U.S.C. 78f(b)(1); *see also* 15 U.S.C. 78o-3(b)(2).

[4] *See* 15 U.S.C. 78f(b)(4); *see also* 15 U.S.C. 78o-3(b)(5).

[5] *See e.g.*, Securities Exchange Act Release No. 50700 (November 22, 2004), 69 FR 71256, 71257 (December 8, 2004)("**SEC Concept Release Concerning Self-Regulation**").

[6] *See* FINRA By-Laws, Schedule A, Section 1(a).

[7] *See* **SIFMA CAT Fee Filing Comment Letter** at 2.

At the outset, however, we must point out that our ability to provide a thorough analysis of the proposals is hindered because the SROs have provided no real data to support the proposals. Rather, the SROs have simply established a fee structure that imposes a vast majority of the CAT costs to the broker-dealer community and then presented the plan as a fait accompli. To the extent the proposals include any analysis, the data provided is based on models that were considered in 2014, when the CAT NMS Plan was being prepared.

At this point, there are key questions that the SROs must answer to allow market participants an opportunity to provide for a true analysis of the fee proposals. Specifically,

- What are the real costs to build and operate the CAT? And how have they been calculated?
- What are the terms of the contract between the SROs and Thesys to build and operate the CAT?
- What will be the usage costs for CAT when it is built and operable?

Absent this information, it is impossible for market participants to determine if the proposed funding models are either reasonable or equitable. Accordingly, we request that the Commission direct the SROs to provide the necessary information, including any underlying data that was relied upon in the development of the funding models, in order to provide market participants with the opportunity to better assess and if needed, propose equitable alternatives.

Comparability Standard

The lack of data is reflected in the comparability standard that the SROs have devised in the CAT Plan. Rather than considering the true impact of reporting or usage in the building and operation of the CAT, the SROs have simply determined that the CAT fees should be "comparable" between the largest exchange complexes and the largest broker-dealer complexes and among the SROs themselves.

The notion of "comparability" is one that the SROs have created themselves in order to suit their own purposes. This standard is not reflected in the Exchange Act or any rules thereunder. It is in fact incorporated in the CAT NMS Plan, but the standard is permissive, not mandatory.

Yet the SROs argue that their proposal is the only model permissible because it is the only model that achieves "comparability" satisfactory to the SROs. The fact that the SROs have created a self-serving standard and then assert that it is axiomatic does not mean that it satisfies the requirements of the Exchange Act.

Fees for Alternative Trading Systems

In our previous comment letter, we raised issues about the application of the fee proposals to ATSs, notably, the competitive concerns.[8] By classifying ATSs as "Execution Venues," the Plan Participants impose significant annual costs on even the smallest ATS (e.g., $155,200), particularly in comparison to the number of reportable events they will generate and subsequently be processed by the CAT. In contrast, exchanges that are Tier 2 Execution Venues will create significantly more reportable events than Tier 2 ATSs, especially Tier 2 options exchanges. And yet, while one of the main cost drivers for the CAT is message traffic, the fees assessed on Tier 2 ATSs will be nearly the same amount as Tier 2 exchanges and options exchanges, regardless of an ATS' actual contribution to the overall CAT cost structure.

According to information provided with the proposals, there are 40 equities execution venues that would fall into Tier 2, only four of them are exchanges. The result is that the SROs will collect 90% of the Tier 2 fee from broker-dealers, some of which have a market share that is a fraction of even the smaller exchanges.[9] As we stated previously, these allocations cannot be justified with statements such as that it is "simpler" to structure the fees in this manner or "too difficult" to do otherwise.[10]

For the reasons stated above, the SROs cannot simply claim that any changes to the execution venue allocation would violate the so-called "comparability" standard. This aspect of the proposal will impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. The CAT fee for ATSs will create a significant burden on smaller ATSs and a create a substantial barrier to entry for new ATSs. Yet, this burden and barrier on ATSs will not apply to exchanges, which can simply leverage their statutory fee authority on broker-dealers to recoup their expenses.

Fees for Options Market Makers

The listed options markets function much differently than the equities markets. The options markets are quote-driven, in contrast to the order-driven equities market. As a quote-driven market, pricing is based on the bids and offers of market makers, which fill orders from their own inventory or match them with other orders. Quotes are critical to price discovery in the options markets, but most quotes will not result in an executed order.

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[8] *See* **SIFMA CAT Fee Filing Comment Letter** at 4.

[9] For example, the smallest Tier 2 ATS has a market share of 0.0000002%, whereas the smallest Tier 2 Exchange has a market share of .01%; *see* Securities Exchange Act Release No. 80785 (May 26, 2017), Appendix, *available at* https://www.sec.gov/rules/sro/finra/2017/34-80710-appendix.pdf.

[10] *See* **SIFMA CAT Fee Filing Comment Letter** at 4.

The options markets also include significantly more products than the equities markets. For each underlying security, there may be hundreds of options series, with the options exchanges themselves determining the number of series that trade. In aggregate, there are nearly one million options series being quoted at any given time.

Options market makers are required by exchange rules to provide continuous quotes in all of those series. Further, to be a successful options market maker, a firm must provide quotes on all of the 15 registered options exchanges. Under this structure, a single options market maker may average approximately 200 million quote updates per day. These quotes are vital for options price discovery and to allow market makers to satisfy their obligations under exchange rules. Yet, the number of options messages does not tell the whole story. On any given day, only about 100,000 options series actually trade. And of those, only about 15,000 trade in 100 contracts or more.

The difference between the options and equities markets is reflected in the SROs proposed funding models – but only in pricing for the exchanges. The SROs explicitly recognized the differing quoting behavior between the equities and options markets to justify bifurcating the two types of execution venues.[11] Further, the SROs allocated only 6.25% of the total recovery to Options Execution Venues, regardless of the number of reportable events generated.[12] Citing the importance of maintaining "the greatest level of fee equitability and comparability based on the current number of Equity and Options Executions Venue",[13] this allocation decision can only be seen as a means to minimize the total cost burden for the options exchanges at the expense of the options market makers that provide liquidity.

Yet the proposed funding model does not apply the same recognition and methodology to options market-makers and industry members generally. Rather, the SROs have chosen to fully reflect the impact of options quoting activity on options market makers by tiering them based on their aggregate message traffic. This is in contrast to the market share methodology that is employed to allocate the costs to the exchange-based execution venues. The SROs have not properly justified why it is appropriate to apply different methodologies to industry members and execution venues. Therefore, in light of the regulatory requirements on options market makers and the type of market in which they operate, the proposal is inequitable and will impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

In addition, the Suspension Order states that "the Commission wishes to consider further whether the proposed rule changes will result in an undue or inappropriate burden on competition under Section 6 and Section 15A or lead to a reduction in market quality contrary to

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[11] *See e.g.,* Securities Exchange Act Release No. 80710 (May 17, 2017), 82 FR 236639, 23645 (May 23, 2017).

[12] *Id*. at 23648.

[13] *Id*. at 23656.

the funding principles expressed in the CAT NMS Plan."[14] Today, a handful of market makers quote aggressively across fifteen options exchanges, while other registered market makers do not quote aggressively (thus creating fewer messages) but do respond aggressively to auction price improvement mechanisms. The proposed structure of the funding model could result in more firms using auction mechanisms to reduce their quoting activity, thereby reducing the number of messages that are sent to the CAT, and the related CAT reporting fee. However, this result would be detrimental to the market since listed options are a quote driven market, and curtailment of liquidity by market makers would lead to a reduction in market quality for investors.

<u>Conclusion</u>

All of this ends in a result that we warned in our July 2016 letter, a fee structure designed by for-profit market participants determined to further their own commercial interests. The Plan Participants have constructed a payment mechanism that is intended to benefit their own bottom line at the expense of their competitors, which also happen to be subject to the Participants' regulation. As such, this is not a case where commercial parties can negotiate reasonable terms. Instead, the Plan Participants are imposing unreasonable fees on their competitors/regulatees, that broker-dealers have no choice to pay or else be subject to regulatory action by the Participants.

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SIFMA greatly appreciates the Commission's consideration of the issues raised above and would be pleased to discuss these comments in greater detail with the Commission and the Staff. If you have any questions, please contact either me (at [redacted] or [redacted]) or Timothy Cummings (at [redacted] or [redacted]).

Sincerely,

Theodore R. Lazo
Managing Director and
Associate General Counsel

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[14] *See* Securities Exchange Act Release No. 80710 (June 30, 2017), 82 FR 31656, 31667 (July 7, 2017).

cc: The Honorable Jay Clayton, Chairman
The Honorable Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner

Gary Goldsholle, Deputy Director, Division of Trading and Markets
David S. Shillman, Associate Director, Division of Trading and Markets