

## MEMORANDUM

**TO:** Equity Market Structure Advisory Committee (EMSAC)  
**FROM:** EMSAC Customer Issues Subcommittee  
**DATE:** April 3, 2017  
**SUBJECT:** Customer Issues Subcommittee Status Report

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The Customer Issues Subcommittee has been focused on buy-side issues including ATS disclosure, research unbundling required by MiFID II, and other buy-side concerns including conflicts of interest as a result of exchange rebates and market data fees. To further explore these issues, the Customer Issues Subcommittee held a Buy-Side Roundtable<sup>1</sup> on March 30, 2017. The discussions of the recent Buy-side Roundtable are summarized below.

### **ATS Disclosure**

- Buy-side roundtable participants expressed support for the proposed Form ATS-N<sup>2</sup>. Given the high percentage of buy-side orders executed on ATSs, most participants felt additional disclosure was necessary to understand how alternative trading systems operate. The specific aspects of Form ATS-N that were seen as most valuable included details on ATS matching engine logic, classification of subscribers, and interaction of the broker-dealer with their ATS.
- Concerns were raised by some participants regarding the potential for the compliance burden associated with Form ATS-N to stifle innovation. However, the majority of participants expressed their belief that the value of transparency outweighed the impact on innovation.
- Participants also discussed additional ATS transparency initiatives including adding ATS MPIDs to the tape to allow for more quantitative analysis of execution quality. While this level of transparency was discussed in the industry in 2010, changes to the ATS landscape including increased ATS volume and lower average trade size on ATSs may warrant a reexamination of this initiative. Concerns associated with this level of transparency including reverse engineering and front running would have to be addressed.

### **Impact of MiFID II Changes to Research Payments on U.S. Soft Dollar Regime**

- Buy-side participants recommended guidance/rule-making to address two main issues associated with MiFID II changes:

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<sup>1</sup> Representatives from the buy-side included Dave Cushing, Wellington Management, Matt Lyons, The Capital Group, Nick Nielsen, Marshall Wace, and Bill Stephenson, Franklin Templeton

<sup>2</sup> See Regulation of Alternative Trading Systems, File. No S7-23-15.

- Ensure that the safe harbor established under Section 28(e) of the Securities Exchange Act of 1934 allows for firms to pay for research out of separate Research Payment Accounts as defined by MiFID II that are funded out of client's custodian accounts.
- Exemptive Relief/rule-making from Investment Advisers Act Section 202(a)(11)(C) to allow broker-dealers to receive "hard dollars" without invoking the "special compensation" clause that would require them to become investment advisers. Buy-side participants are concerned that failure to provide such relief would limit U.S. broker dealer counterparties and prevent U.S. broker dealers from trading with them on a principal basis.

### **Fees - Exchange Rebates & Market Data**

- The majority of the buy-side participants felt that addressing exchange rebates was the most important U.S. equity market structure issue currently facing the markets due to the conflicts of interest associated with exchange rebates. It was suggested that exchange rebates be addressed ahead of any discussion of possible repeal of Rule 611.
- The EMSAC-recommended Access Fee pilot was discussed and concerns were raised about the lack of a bucket with no rebates and the exclusion of inverted markets. It was suggested that the Access Fee Pilot should be instituted via SEC rule-making rather than through an SRO NMS Plan.
- Other perspectives noted that there is the potential for conflict of interest as long as there is variability in exchange fees and that a cost plus model with exchange costs on FIX messages would increase transparency into costs.
- Exchange market data fees and port fees were also raised as a concern in terms of their impact on competition within the broker-dealer market. Discussion included the role of rebates and the economics of exchanges exclusive right to sell their market data.

### **Tick Size Pilot**

- Participants discussed the progress to date of the Tick Size Pilot and suggested a one year check-in (October 2017) with criteria for success established prior to analysis.

The next steps of the Customer Issues Subcommittee are to review input received at the Buy-Side Roundtable with a goal of presenting recommendations for EMSAC approval at the next quarterly meeting.