

**Draft submitted by the Market Structure Subcommittee for discussion by the IAC**

[date]

Mr. Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549

Re: Transaction Fee Pilot for NMS Stocks (File No. S7-05-18)

Dear Mr. Fields,

We write to express the support of the SEC's Investor Advisory Committee on the proposed Transaction Fee Pilot.<sup>1</sup>

The proposing release carefully and accurately describes the concerns that market participants and commentators have raised with respect to the "maker-taker" fee and rebate model as well as the arguments in favor of the model. Like many others who have written in support of the proposal,<sup>2</sup> we believe it would be useful to have data from which to assess the consequences of reducing the maximum fee or eliminating rebates.

We wish to make three comments on the proposal. First, we strongly support the inclusion of a "no rebate" bucket (identified as Test Group 3 in the proposal). The inclusion of Test Group 3 will help to establish the effect of rebates on order routing and may also produce evidence of the market-clearing level of transaction fees that are sufficient to compensate exchanges for the cost of providing execution services (but not incentive payments). As such, we believe a study with the "no rebate" group will be meaningfully more informative than one without. Finally, we think including the "no rebate" group underscores the fact that the purpose of the Pilot is not to consider imposing price controls, but instead to consider requiring fees (of whatever size) to be structured so as to minimize complexity and agency costs.

We also note that some commentators advocate permitting companies to opt out of the pilot. We oppose the suggestion. Allowing an opt-out could introduce a bias into the test if the companies opting out differed in some important way from those that did not. This would reduce the reliability of any results generated by the Pilot.

We do, however, recognize that the Pilot will impose costs on market participants and hope it can be structured as simply as possible. To that end, we urge the SEC to consider consolidating Test Groups 1 and 2 so that there will be only three buckets. While we appreciate the SEC's desire to have a bucket that limits total fee income to the approximate amount of net income

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<sup>1</sup> Transaction Fee Pilot for NMS Stocks, Securities Exchange Act Release No. 82873 (March 14, 2018), 83 Fed. Reg. 13008 (March 26, 2018), at <https://www.federalregister.gov/d/2018-05545>.

<sup>2</sup> Comments on Proposed rule: Transaction Fee Pilot for NMS Stocks, at <https://www.sec.gov/comments/s7-05-18/s70518.htm>.

under current arrangements (Test Group 2), we are not persuaded that having two test groups with separate fee caps, one at \$.0015 and one at \$.0005, rather than one with, say, a \$.0010 fee cap, will generate enough additional information to justify the additional effort.

Finally, we wish to offer our thoughts on an argument against the proposal offered by the NYSE and some of its listed companies.<sup>3</sup> They are concerned that differences in the fee/rebate structures among the test groups will produce different levels of market liquidity, thereby disadvantaging some listed companies relative to others. Implicit in the argument is that the current fee/rebate structure subsidizes liquidity to the benefit of listed companies and investors without offsetting market distortions. Supporters of the proposals, including several institutional investors, disagree with that premise. In their view, rebates increase broker agency costs by giving brokers an incentive to route non-marketable limit orders so as to maximize expected rebates rather than to maximize the probability and speed of execution.

The Pilot is intended to produce data that can help resolve that very debate. From our perspective as an advisory committee, the core issue is how the SEC will decide whether to further regulate trading center pricing models—based solely on theoretical arguments or on a combination of theory and data. We believe the latter is preferable when there is genuine doubt about the effects of a regulatory change.

We also wish to observe that the SEC has other tools available to address agency costs between brokers and their customers and suggest that the SEC consider them in parallel with the Pilot. For example, it might be possible to alleviate agency problems by requiring brokers to supplement the order routing information now disclosed under Rule 606 of Regulation NMS<sup>4</sup> with more detailed information provided to the SEC.

More generally, we note that Regulation NMS was adopted more than a decade ago and equity markets have changed considerably since that time. It would be useful to consider whether aspects of the regulation, including the order protection rule,<sup>5</sup> have led exchanges, broker-dealers, and market professionals to act in ways that were unanticipated and may not be in the best interests of investors. If so, midcourse corrections to the regulation may be in order.

We appreciate the opportunity to share our thoughts and would of course be willing to discuss any of these issues further.

Respectfully submitted,

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<sup>3</sup> See, e.g., Letter from the New York Stock Exchange (May 31, 2018), at <https://www.sec.gov/comments/s7-05-18/s70518-3755194-162578.pdf>, Letter from Halliburton (July 2, 2018), at <https://www.sec.gov/comments/s7-05-18/s70518-3991550-167197.pdf>.

<sup>4</sup> 17 C.F.R. §242.606.

<sup>5</sup> 17 C.F.R. §242.611.