



December 5, 2017

Via Electronic Mail

The Honorable Walter J. Clayton
Chairman
U.S. Securities & Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Action on Equity Market Structure / Near-Term Priorities

Dear Chairman Clayton:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ submits this letter to the Securities and Exchange Commission (“Commission”) as part of SIFMA’s continuing advocacy on equity market structure. For many years, SIFMA and its members have been vocal advocates and thought leaders on equity market structure issues. The U.S. equity markets are the deepest, most liquid and most efficient in the world, with investors enjoying extraordinarily low transaction costs, narrow spreads, fast execution speeds and, for retail investors, ample opportunities for price improvement. Nevertheless, SIFMA and its members continuously consider and analyze the legal, commercial and policy issues around equity market structure, and we believe equity markets can benefit from enhancements to reflect the changing nature of the markets. In 2014, SIFMA’s Board of Directors convened a broad-based task force of members from across the country and across the industry, including retail and institutional dealers and asset managers, to develop a series of tangible and actionable market structure reforms. Earlier this year, in response to a public request by then-Acting SEC Chairman Michael Piwowar pursuant to the Regulatory Flexibility Act, SIFMA submitted comments² suggesting a review of Regulation NMS under the Securities Exchange Act of 1934 (“Exchange Act”).

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 SIFMA to Brent Fields, “Notice of Meeting of Equity Market Structure Advisory Committee Meeting; List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act” (March 29, 2017)

SIFMA has been joined recently by other commentators in examining equity market structure, which have issued constructive and actionable recommendations for addressing current issues in equity market structure. Those commentators include the following:

- In 2015, the Commission established the Equity Market Structure Advisory Committee (“EMSAC”). The EMSAC has been extremely effective in providing industry perspective and input to the Commission on critical equity market structure issues.
- In July 2016, the Committee on Capital Markets Regulation (“CCMR”) – an independent and nonpartisan research organization dedicated to improving the regulation of U.S. capital markets – issued a report on the U.S. equity markets, also with specific recommendations on equity market structure.
- In October of this year, the U.S. Department of the Treasury (“Treasury Department”) issued a comprehensive report on capital markets policy with specific recommendations on equity market structure and regulatory structure and process, among other topics.

SIFMA hopes that your tenure as Chairman of the Commission will include a comprehensive review and modernization of the regulations and policy governing the U.S. equity markets. As we urged in our March 2017 letter, the Commission should address major issues such as SIP reform and a review of Regulation NMS. SIFMA looks forward to engaging with the Commission on these important issues.

A comprehensive review of Regulation NMS will require a great deal of the SEC’s resources and attention as well as that of a broad range of market participants. Accordingly, and with the acknowledgment that there are a number of existing priorities and obligations on your regulatory agenda, we encourage the Commission to act as promptly as possible on the most critical among them so that appropriate attention can be turned to a review of Regulation NMS. As addressed in this letter, the Commission should move forward on addressing access fees, potentially by proposing a pilot program, adopt the Commission’s outstanding rulemaking proposals on transparency and disclosure and extend the term of the EMSAC.

I. Reduction of Access Fee Caps

Many exchanges use a “maker-taker” pricing model to attract trade executions. Under a “maker-taker” model, “takers” of liquidity (who purchase or sell shares at a quoted price) are charged a fee and “makers” (who provide resting quotes) receive a rebate of a portion of the take fee when their bids or offers are executed. The rebates create an incentive for market makers to provide displayed liquidity while increasing costs for participants who cross the spread to execute their transaction. Exchanges receive the difference between the taker’s fee and the rebate paid to the maker. Exchanges generally charge takers at or near the highest access fee allowed, the access fee cap, under Regulation NMS – which is \$0.003, or 30 cents per 100 shares (“30 mils”).

The access fee cap has not been adjusted since 2005 when Regulation NMS was adopted, and it has become outdated and no longer reflects the market’s prevailing economics. Despite the narrowing of spreads and decreases in commissions, the access fee cap has remained at 30 mils. The exchanges continue to charge the full 30 mils permitted under the cap, and the relatively high level of access fees

available at <https://www.sec.gov/comments/265-29/26529-1674696-149276.pdf> (“SIFMA March 2017 Letter”).

has led to them becoming a disproportionate amount of overall transaction costs. In particular, the exchanges' access fees are several times higher than corresponding fees on off-exchange venues, and the rebate amounts are identical across all stocks regardless of liquidity.

SIFMA has been on the record for some time on the need to lower the access fee cap. In 2014, we issued recommendations on equity market structure that included a recommendation that, as a first step, the cap on access fees should be lowered to no more than 5 cents per 100 shares.³ SIFMA reiterated that position in the SIFMA March 2017 Letter, stating that lowering or eliminating access fees would benefit investors by reducing the transaction costs associated with the maker-taker pricing model that are ultimately borne by them. In addition, we suggested an access fee pilot as an alternative, specifically noting the pilot framework recommended by the EMSAC.⁴

SIFMA continues to recommend that the Commission directly reduce the access fee cap. If the Commission decides to propose an access fee pilot, the pilot should follow the framework recommended by EMSAC, in particular by operating the pilot through Commission rulemaking rather than an NMS Plan. However, we also urge the Commission to learn from complications with past pilots, such as the Tick-Size Pilot, by only using public data and establishing a prescribed list of objectives and criteria to evaluate success. In its recent capital markets report, the U.S. Treasury recommended that the Commission adopt the access fee pilot to study the impact reduced access fees would have on investors' execution costs or available liquidity.⁵ In addition, the CCMR supported adopting the EMSAC's access fee pilot to evaluate the impact of a reduction in access fees and liquidity rebates on market quality and trading behavior.⁶ Other potential areas for study include whether inverted venues ought to be included in such a pilot, and whether to adopt a tiered approach where the level of access fee cap reduction would vary depending on the liquidity profile of each security.

II. Transparency Proposal – Disclosure of Order Handling Information

On July 13, 2016, the Commission proposed amendments to Rules 600, 605, 606, and 607 of Regulation NMS to provide investors with more and consistent information to better assess a broker-

³ See SIFMA Equity Market Structure Recommendations, *available at* <https://www.sifma.org/resources/submissions/sifma-equity-market-structure-recommendations/>

⁴ U.S. SEC Equity Market Structure Advisory Committee, "Recommendation for an Access Fee Pilot (July 8, 2016) *available at* <https://www.sec.gov/spotlight/emsac/recommendation-access-fee-pilot.pdf>. EMSAC recommended a two-year pilot to test varying access fee caps to reset the access fee cap. The proposal recommends selecting a sample of 100 common stocks and ETFs, with individual market capitalization greater than \$3 billion, and placing them in the following four buckets: (1) control bucket, (2) 20 mil access fee cap, (3) 10 mil access fee cap, and (4) 2 mil access fee cap. The EMSAC additionally suggests measurement criteria and objectives to measure the impact of lower access fees on liquidity provisioning and taking.

⁵ See U.S. Department of the Treasury, "A Financial System That Creates Economic Opportunities – Capital Markets" at 62-63 (October 6, 2017) *available at* <https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf> ("Treasury Report").

⁶ See Committee on Capital Markets Regulation report, "The U.S. Equity Markets: A Plan for Regulatory Reform" (July 2016) ("CCMR Report") *available at* http://www.capmktreg.org/wp-content/uploads/2016/10/08_08_FINAL_DRAFT_EMS_REPORT-1.pdf.

dealer's order routing practices.⁷ Currently, Rule 606 requires broker-dealers to publicly disclose aggregated order routing information for customer orders on a quarterly basis and certain customer-specific order routing information for the previous six months upon request.⁸ Rule 606 does not currently mandate broker-dealers to disclose their order routing information for large, institutional sized orders. In its proposal, the Commission stated that standardized order handling information regarding specific and aggregated order handling information would assist market participants in comparing the routing services of broker-dealers and the merits of competing trading centers and provide customers with information on how broker-dealers handle conflicts of interest.

Along with many market participants, SIFMA supported this transparency proposal with suggestions for changes. To provide more useful disclosure, SIFMA specifically recommended that:

- The distinction between retail-based and institutional-based disclosures should be based on "held" and "not held" order types;
- Rule 606 disclosures should apply to all orders, not just "customer" orders;
- The subjective categorization of order routing strategies should be replaced with the objective criteria of grouping market orders, marketable limit orders, and limit orders; and
- The public disclosure of institutional order handling information should break out the aggregated data by segmenting directed orders from non-directed orders.

We urge the Commission to incorporate our suggestions and to adopt the rules promptly.⁹ In its Capital Markets report, the Treasury similarly recommended that the Commission finalize these rules.¹⁰ The EMSAC additionally supports adoption of the order handling proposal, with a few additional suggestions, including SIFMA's recommendations.¹¹ Further, CCMR supports the proposal, with several amendments, to increase the transparency of equity markets by enhancing and standardizing investor disclosures.¹²

⁷ See Disclosure of Order Handling Information, Securities Exchange Act Release No. 78309 (July 13, 2016), 81 FR 49432, 49434 n.5 (July 27, 2016) available at <https://www.sec.gov/rules/proposed/2016/34-78309.pdf>.

⁸ A "customer order" is an order for NMS securities with a market value of less than \$200,000 for stocks or \$50,000 for options.

⁹ See Letter from SIFMA to Brent Fields, "Disclosure of Order Handling Information", File No. S7-14-16 (October 17, 2016) available at <https://www.sifma.org/wp-content/uploads/2017/05/sifma-submits-comments-to-the-sec-on-disclosure-of-order-handling-information.pdf>.

¹⁰ Treasury Report at 62.

¹¹ EMSAC, "Recommendations Regarding Modifying Rules 605 and 606", (November 29, 2016) available at <https://www.sec.gov/spotlight/emsac/emsac-recommendations-rules-605-606.pdf>.

¹² See CCMR Report. CCMR's specific recommendations relevant to the proposal include: "(3) Retail brokerages should be required to provide disclosures regarding execution quality for their customers. Relevant disclosures should include percent of shares with price improvement, effective/quoted spread ratio, and average price improvement. (4) The SEC should require broker-dealers to provide institutional customers with standardized reports that provide order routing and execution quality statistics. (5) Trading venue disclosures should include information about execution speeds to the millisecond. (6) Statistical information for disclosures pursuant to Rule 605 and Rule 606 and disclosures regarding

III. Transparency Proposal – Regulation ATS and Form ATS-N

In 2015, the SEC proposed to amend Regulation ATS to increase public information about ATSs that trade NMS stocks¹³. The proposed rule would: require an ATS to publicly disclose information about its operator and the ATS's operations; give the SEC authority to approve an ATS's disclosure and revoke its ability to operate under certain circumstances; and require ATSs to maintain written safeguards and procedures to protect subscribers' confidential trading information.

SIFMA generally supports the proposal with several adjustments to appropriately balance the benefits of public disclosure and commercial confidentiality.¹⁴ We support the disclosure of potential conflicts of interest, disclosures related to types of orders and order handling procedures, and disclosures addressed to the confidentiality of subscriber information. However, the public should not have access to all details proposed to be required by Form ATS-N. Disclosing proprietary information to the public does not meet the policy goal of allowing subscribers to easily compare entities with one another. Furthermore, some of the information required by Form ATS-N is maintained as part of the books and records of the ATS as a regulated broker-dealer and therefore available to the regulators at any time. We urge the Commission to finalize the proposal in a way that does not require ATSs to publicly disclose sensitive, proprietary or non-material information.

To better protect confidential proprietary information, SIFMA recommends that:

- The final rule clearly defines the materials related to the operations of the NMS rather than have any overly broad request for any materials.
- The disclosures include routine marketing materials but not include sensitive information like specifications, configurations, subscriber agreements, or one-off or proprietary analyses prepared for an individual customer.
- The final rule should tailor the disclosures about affiliates so that it focuses only on the direct activities of NMS Stock ATS.
- Disclosures should not include information about a broker-dealer operator's or its affiliate's use of smart order routers or algorithms to send or receive orders.
- Details of an NMS stock ATS's outsourcing arrangements should not be included.

The Treasury Department also recommended that the SEC adopt the amendments to Regulation ATS to promote improved information about ATS operations.¹⁵ Similar to SIFMA, the Treasury recommended that the SEC revise aspects of the proposal that would require public disclosure of confidential information and only require disclosure of confidential information when it can demonstrate that the information would improve its ability to oversee the industry. CCMR also supports

institutional orders should be submitted in only one format to facilitate comparison across trading venues and among broker-dealers.”

¹³ Regulation of NMS Stock Alternative Trading Systems, Exchange Act Release No. 76,474, 80 Fed. Reg. 80,998 (Dec. 28, 2015), <https://www.sec.gov/news/pressrelease/2015-261.html>

¹⁴ Letter from SIFMA to Brent Fields, “Regulation of NMS Stock Alternative Trading Systems”, File No. S7-23-15 (March 7, 2016) available at <https://www.sec.gov/comments/s7-23-15/s72315-29.pdf>.

¹⁵ See Treasury Report at 66.

the proposed amendments to Reg ATS and Form ATS-N with the caveat that the disclosures on new Form ATS-N are published in a standardized format that facilitates comparison across various ATS operators.¹⁶

IV. Equity Market Structure Advisory Committee (EMSAC)

SIFMA recommends the Commission renew the EMSAC charter, which will terminate on January 9, 2018.¹⁷ As mentioned above, the EMSAC has proven to be an important forum for providing industry perspective and input to the Commission on critical equity market structure issues, which is currently lacking in NMS plans. The EMSAC develops constructive and actionable recommendations for current issues in equity market structure, including the ones discussed above. Allowing EMSAC to terminate would unnecessarily disrupt these productive efforts.

SIFMA has previously recommended that the Commission: (i) renew the EMSAC for a two-year term; (ii) address issues such as market data, the quality of operation of the Security Information Processors, and NMS Plan governance; and (iii) expand the broker-dealer representation in the EMSAC membership.¹⁸ We reiterate those recommendations now as a relatively easy way to reinforce the process for debate around equity market structure issues going forward.

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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 me at 202-962-7383 or tlazo@sifma.org.

Sincerely,



Theodore R. Lazo
Managing Director and
Associate General Counsel

¹⁶ CCMR Report at 63-64.

¹⁷ See Securities Exchange Act Release No. 34-81358 (August 9, 2017).

¹⁸ See Letter from SIFMA to the Honorable Jay Clayton, "File No. 265-29: Equity Market Structure Advisory Committee" (June 29, 2017) available at <https://www.sec.gov/comments/265-29/26529-1831539-154561.pdf>.

cc: The Honorable Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner
Brett Redfearn, Director, Division of Trading and Markets