October 13, 2017

By E-mail and FedEx

Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F. Street NE
Washington, D.C. 20549

Re: Equity Market Structure Advisory Committee Recommendation for Access Fee Pilot, File No. 265-29

Dear Chairman Clayton:

This letter is being submitted by (1) Nasdaq on behalf of NASDAQ Stock Market LLC, Nasdaq BX, Inc., and Nasdaq PHLX LLC, (2) NYSE Group on behalf of New York Stock Exchange LLC ("NYSE"), NYSE Arca, Inc., NYSE American LLC, and NYSE National, Inc., and (3) CBOE on behalf of Bats BZX Exchange, Inc., Bats BYX Exchange, Inc., Bats EDGA Exchange, Inc., and Bats EDGX Exchange, Inc. (collectively, the "Exchanges"). The Exchanges are submitting this letter to reiterate their concerns about the impact of an Access Fee Pilot on issuers and investors.[1] The Access Fee Pilot recommended by the Securities and Exchange Commission's ("Commission") Equity Market Structure Advisory Committee ("EMSAC") is a poorly designed solution attempting to solve a problem that has not been articulated.[2]

The Exchanges' view is that U.S. investors have better access to markets and information, spreads are narrower, and other trading costs for average investors are lower than they have been before. Thus, the Exchanges do not believe that a clear problem has been quantified, and that the arbitrary introduction of an ill-defined Access Fee Pilot only imposes additional federal price controls on a competitive equity market, does not improve the interests of average investors, and creates new winners and losers without solving an actual problem. As discussed further below, the Exchanges believe that it would be more appropriate to conduct a broader review of the impact of remuneration on

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1 The Exchanges have previously expressed their concerns regarding an Access Fee Pilot. See Statement of Stacey Cunningham, Chief Operating Officer, NYSE, to EMSAC on August 2, 2016; Letter from Joan C. Conley, Senior Vice President and Corporate Secretary, Nasdaq, to Mr. Brent Fields, Secretary, Commission, dated May 24, 2016; Letter from Elizabeth King, General Counsel and Corporate Secretary, NYSE, to Mr. Brent J. Fields, Secretary, Commission, dated May 13, 2016; Statement of Thomas Farley, President, NYSE, to EMSAC on April 26, 2016; and Statement of Thomas Farley, President, NYSE, to EMSAC on May 13, 2015.

2 The EMSAC Recommendation for an Access Fee Pilot is available here: https://www.sec.gov/spotlight/emsac/recommendation-access-fee-pilot.pdf.

routing and trading, as well as a review of Regulation NMS – which was what EMSAC was charged with doing – rather than prematurely implement a pilot that touches on only one aspect of Regulation NMS.

Broadening the scope of any pilot to include all forms of remuneration is consistent with U.S. Department of Treasury ("Treasury") recommendations contained in its October 7, 2017 *Report to the President: "A Financial System That Create Economic Opportunities* **--***Capital Markets*.[3] The Treasury Report sets forth core principles for evaluating and modernizing a capital market system that already is the deepest and most liquid in the world. In the Report, Treasury recommends that the Commission consider changes to equity market structure designed to foster robust secondary equities markets that serve average investors and support public companies of all sizes. The Report's reference to an Access Fee Pilot is premised on its stated concern "that maker-taker markets and payment for order flow may create misaligned incentives for broker-dealers." The Exchanges, therefore, believe that any Commission pilot would be a missed opportunity if it studied only exchange access fees and failed to also study all remuneration that "may create misaligned incentives for broker-dealers."

As proposed by EMSAC, under the Access Fee Pilot, exchanges would be further limited in the transaction fees they can charge, which would conveniently reduce the direct costs to intermediaries paying fees to access displayed liquidity. However, by mandating a reduction of only the fees charged by exchanges, it would impose a burden on the ability of exchanges to compete with off-exchange dark venues because exchanges would be further limited in the funding they use to provide incentives for posting better displayed prices. The current proposal would thus merely favor the intermediaries whose fees would be reduced at the expense of issuers, investors, liquidity providers, and exchanges. Indeed, market makers are a key component to the efficiency and success of our markets and the incentives and economics that support liquidity provision must be carefully considered and understood. Harming this critical component of our markets could have unintended cascading and irreversible effects. Importantly, we are not aware of compelling data that warrants this course of action.

Other Critical Aspects of a Meaningful Market Review

If the Commission proceeds with an Access Fee Pilot, the Exchanges submit that the following are prudent and appropriate measures that should be in place before any changes to access fees are implemented on a pilot basis. These measures would also be complimentary to a holistic review of Regulation NMS.

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[3] See United States Department of the Treasury, *A Financial System That Creates Economic Opportunities: Capital Markets*, Report to President Donald J. Trump (2017) (available at: https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf) ("Treasury Report").

First, the Commission should strengthen and articulate the Duty of Best Execution to mitigate the inherent conflict of interest between a broker and its customer concerning the quality and costs of executing trades. If the EMSAC is correct that broker-dealers are unduly swayed by exchange access fees or liquidity rebates, they may not be fulfilling their existing Duty of Best Execution, and the duty should be updated to include explicit guidance on proper treatment of fees and rebates. That clarity must exists to ensure appropriate broker conduct during any Access Fee Pilot; in fact, to the extent conflicts of interest are identified as the problem to which the Access Fee Pilot is directed, strengthening the Duty of Best Execution could ameliorate the problem and render the pilot unnecessary. European regulators have strengthened the comparable standards applicable to brokers and dealers under MIFID II.[4]

Second, the Commission should improve disclosure and better deter potential conflicts of interest by improving the execution quality and routing practices disclosures required under SEC Rules 600, 605 and 606. As already proposed by the Commission,[5] broker-dealers would be required to provide institutional customers with specific disclosures related to the routing and execution of their orders, and also require broker-dealers to make aggregated information about their handling of customers' institutional orders publicly available. The proposed rule changes would also require that retail customers receive additional information about their orders, including the disclosure of the net aggregate amount of any payment for order flow received, payment from any profit-sharing relationship received, transaction fees paid, and transaction rebates received by a broker-dealer from certain venues; and descriptions of any terms of payment for order flow arrangements and profit-sharing relationships." The EMSAC recommended additional enhancements to those rules.[6]

Treasury recommends "that the SEC adopt a final rule implementing the changes it proposed in 2016 to Exchange Act Rules 600 and 606."[7] The Exchanges agree that these changes should not only be adopted as a final rule, but also be implemented before a pilot begins. A necessary part of any pilot is measuring data, and the proposed changes to Rules 600 and 606 would allow for the Commission, the exchanges, and the public to better measure whether fee changes have any impact on routing decisions. But to do so, there needs to be a baseline set of data against which to measure, which could be achieved only if the proposed rules relating to order handling information are final and implemented before a pilot begins.

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[4] See, e.g., Articles 27 and 28 to Markets in Financial Instruments Directive (2014/65/EC) ("MIFID II"), available here: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02014L0065-20160701.

[5] See Securities Exchange Act Release No. 78309 (July 13, 2016), 81 FR 49432 (July 27, 2017) (File No. S7-14-16).

[6] Available at: https://www.sec.gov/spotlight/emsac/emsac-recommendations-rules-605-606.pdf.

[7] See Treasury Report at 62.

Third, consistent with the Treasury recommendations, the Commission should adopt amendments to Regulation ATS proposed in 2015 that ensure disclosure of conflicts of interest and enhance the operational transparency of ATSs.[8] If, as noted above, the policy objective of a Pilot is to address potential conflicts of interest, then the Commission and public must understand the potential conflicts present in the 40 percent of trades executed off-exchange. As Treasury notes, the opaque operations of ATSs has contributed to numerous prosecutions and settlements for ATS malfeasance. Those conditions have persisted despite existing requirements of disclosure to the SEC, indicating that the scrutiny provided by public disclosure would assist regulators in identifying questionable practices or violations by ATSs.

Key Pilot Components

If the Commission proceeds with an Access Fee Pilot before conducting a more comprehensive review of Regulation NMS, such pilot should address the following.

Remuneration and Off Exchange Conduct. A pilot solely limiting exchanges' transaction fees is designed solely to limit the payment of incentives to broker-dealers to send order flow to exchanges. The Exchanges believe that any pilot that intends to study misaligned incentives for broker-dealers should also study the impact of all forms of remuneration and incentives used to attract order flow to ATSs and broker-dealers, which may conflict with broker-dealers' obligations to its customers. The pilot should therefore include measures that will allow the Commission to study ATS and broker-dealer remuneration.

Unless the Commission designs its pilot to study all forms of remuneration, and not just access fees paid to exchanges, the pilot data will be incomplete. If the Commission and academics are truly to learn about trading – the 60 percent executed on exchanges and the 40 percent that occurs off exchanges – and the impacts from this pilot, there must be benchmarking and measurements of changes that occur on all venues. The Commission should therefore require that ATSs and broker dealers report their remuneration practices. These remuneration practices are tied to any pilot that limits exchange transaction fees because, as previously stated, limiting exchanges' ability to provide incentives to post liquidity (i.e., pay rebates) will cause liquidity to further flow into private bilateral platforms and other dark trading venues.

In addition, because the pilot will reduce direct costs to intermediaries and the pilot is intended to study the potential mis-alignment of incentives, broker-dealers should be required to provide data showing how the lower costs to intermediaries are returned to customers.

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[8] See Securities Exchange Act Release No. 76474 (November 18, 2015), 80 FR 80998 (December 28, 2015) (File No. S7-23-15).

Issuer Impact. A pilot should be designed to measure the costs to issuers and their shareholders. It is well understood that reduced access fees will result in reduced rebates, and as a result, displayed liquidity on exchanges will decrease and spreads will widen. Because companies whose securities are forced to participate in the pilot will incur costs in terms of worse prices and lower liquidity, the Exchanges believe that issuers should have a voice in whether they would be included in the pilot. No issuer should have its securities included in the Pilot against its will.

Length of Pilot. The Exchanges recommend that the proposed pilot last no more than one year rather than two as EMSAC recommended. Based on our current experience with the Tick Pilot, the industry appears to have reached a consensus that two years is unnecessarily long, and that the second year of a pilot will add little incremental value. An abbreviated pilot period will also mitigate the potential harm imposed on issuers and investors by the pilot. Including the lead time required to adopt and implement a pilot, the pilot itself, and then the post-pilot study and implementation period, even a one-year pilot may actually require three to four years from start to finish. The Exchanges also recommend the development of criteria for determining that the Pilot has or will harm investors or issues sufficient to justify early termination of the Pilot.

Benchmark and Measures of Change. To support the policy objectives of a Pilot, the Commission should also pre-announce the measures for benchmarking and tracking the impact of the pilot. The Exchanges support the EMSAC measurement criteria: Quoted, Effective Spreads, and Realized Spreads; Displayed and Hidden liquidity at various depths; Volatility; Trading volume; Routing behaviors; and Price Improvement; Locked and Crossed Markets; Pricing Changes; and Order Type Changes. However, in order to truly assess market-wide impact, it is critical to apply all of the above measures not only to trading on exchanges, but also to trading in all off-exchange venues. The pilot should also measure gross shifts in trading from exchange to off-exchange venues and among off-exchange venues.

Selected Securities. Selection of the securities subject to the Pilot is incredibly important to the success of the Pilot and the safety of the U.S. equities markets. It has been suggested, for instance in Treasury Report, that any action taken with respect to remuneration provided for market making should avoid inclusion of less active stocks due to concerns that liquidity in such stocks could be negatively impacted. The Exchanges agree with this notion and believe it is equally applicable to the selection of securities for any Access Fee Pilot because a fee cap will directly impact such remuneration. However, if less active stocks are omitted, it is difficult to envision the securities that should be selected, as the most active stocks are by most conceivable measures not an area in need of market structure adjustment.

A True Holistic Review of Regulation NMS

The Exchanges believe that any review of Regulation NMS should be conducted in a comprehensive and measured manner that includes all market participants (including the markets themselves) and that testing changes to only one aspect of Regulation NMS would not serve that purpose. Indeed, the Exchanges do not believe that an Access Fee Pilot can be separated from other initiatives, but rather, that such a pilot must be considered in the context of a comprehensive review of Regulation NMS in its entirety. This is best accomplished through a vehicle that allows all market participants to provide feedback to specific questions under standardized and transparent timeframes (as opposed to attempting to opine on an EMSAC discussion when the agenda is released a few days before the meeting).

As stated above, the Treasury Report supports a broader review of Equity Market Structure. In addition to studying the potential for mis-aligned incentives between broker-dealers and customers, the Treasury Report also recommends considering changes to the Order Protection Rule, the Minimum Tick Increment Rule, and SEC Rules 600 and 606, all critical elements of Regulation NMS. When combined with Treasury's recommendations for changes to the Duty of Best Execution and to operational transparency under Regulation ATS, the Treasury Report is itself best understood as a holistic review of equity market structure and a recommendation for further holistic study of Regulation NMS by the SEC.

As has been widely acknowledged, Regulation NMS has multiple inter-connected pieces. With a pilot focused solely on exchange access fees, the data will likely not yield results that contribute usefully to overall strengthening of the markets. The Exchanges also note that the current access fee cap under Regulation NMS was conceived and adopted in the context of a major market structure reform and was particularly tied to the Order Protection Rule. It seems illogical to conclude that new access fee caps should be adopted without simultaneously considering the Order Protection Rule and the many other market structure topics that have been debated and opined on by EMSAC, Treasury, and others.

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The U.S. equities markets are the envy of the world because they are singularly effective at attracting and allocating capital to innovative companies that create millions of jobs and trillions of dollars of shareholder value. The Commission must be laser-focused on these issuers and the impact that any pilot has on them and their efficient, effective, and continuous access to capital. Otherwise, the Commission risks damaging the issuers and the markets it is entrusted to steward. Capital formation and issuer protection are conspicuously absent from the policy goals of the EMSAC Access Fee Pilot Recommendation. The Exchanges encourage the Commission to step in and remedy that oversight.

Respectfully submitted,

Chris Concannon
President and Chief Operating Officer
CBOE

Thomas Wittman
CEO
The Nasdaq Stock Market LLC

Thomas W. Farley
President
NYSE

cc: Honorable Michael S. Piwowar, Commissioner
Honorable Kara M. Stein, Commissioner
Mr. Brent J. Fields, Secretary