



February 26, 2016

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

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

Re: Regulation of NMS Stock Alternative Trading Systems, File Number S7-23-15

Dear Mr. Fields:

The Healthy Markets Association<sup>1</sup> appreciates the opportunity to provide our views on the Securities and Exchange Commission's proposal for the Regulation of NMS Stock Alternative Trading Systems.<sup>2</sup> Given the increasingly critical role that Alternative Trading Systems ("ATs") play in our capital markets, improving their operations and disclosures is essential to protecting investors and promoting fair and efficient markets. We applaud the Commission's recent efforts and urge it to further refine and adopt the Proposal without delay.

## Summary of Key Recommendations

- Expand the coverage to include ATs beyond those that trade NMS stocks;
- Consider eliminating conflicts of interest by prohibiting an ATs operator or an affiliate from trading on a principal basis in the ATs, or at a minimum, on terms any different than unaffiliated third-parties;
- Expand reporting of order and trading metrics so that market participants may better evaluate venue performance and conflicts of interest; and
- Modernize and mandate Rule 605 disclosure for all NMS ATs operators separate and distinct from any affiliated broker/dealer.

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<sup>1</sup> Healthy Markets is an investor-focused not-for-profit coalition working to educate market participants and promote data-driven reforms to market structure challenges. Our members, who range from a few billion to hundreds of billions of dollars in assets under management, have come together behind one basic principle: Informed investors and policymakers are essential for healthy capital markets. To learn more about Healthy Markets, please see our website at <http://www.healthymarkets.org>.

<sup>2</sup> *Regulation of NMS Stock Alternative Trading Systems*, 80 Fed. Reg. 80998 (Dec. 28, 2015) (the "Proposal").

## Background and the Need for Reforms

As the Commission noted in the Proposal, in the seventeen years since the adoption of Regulation ATS, “advances in technology for generating, routing, and executing orders” have fueled a rapid evolution in trading strategies and trading venues.

Today, there are currently over forty registered ATSs in operation.<sup>4</sup> Most of them are for the trading of equity securities, although ATSs have also expanded in recent years into other asset classes ranging from government securities, to fixed income securities,<sup>5</sup> to credit default swaps.<sup>6</sup>

Historically, trading volumes in these market centers was low. Then, in 1996, a 21(a) report by the SEC in 1996 found among other things, that Nasdaq Market Makers were utilizing private systems to quote and trade.<sup>7</sup> Over the next few years, the SEC responded by adopting the Display Rule<sup>8</sup> and Regulation ATS.<sup>9</sup> Reg ATS requires all ATSs to be registered as broker-dealers, file basic disclosures with the SEC about their operations, and meet other regulatory requirements.<sup>10</sup>

Yet, the SEC provided little guidance and specificity for ATSs about the substance of their disclosures. While Reg ATS requires disclosure of material facts related to the ATS, the exact specifics of what is required has been subject to widely varying interpretations. In the absence of clear guidance, many ATSs have essentially made their own interpretations of what needed to be disclosed—and to what degree of specificity.

Some ATSs have posted their Form ATS on their websites. Some have elected to share key information about their operations, subscribers, and even their trading statistics on their websites. Some have been more cautious, sharing key information with just their subscribers. While still others have elected to share little to nothing with the public. The result has been inconsistent disclosures across ATSs and by ATSs over time. Further, these disclosures are largely incomparable to those of other market centers, including registered exchanges.<sup>11</sup>

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<sup>3</sup> See generally, Proposal at 81000.

<sup>4</sup> Alternative Trading Systems with Form ATS on File with the SEC as of February 1, 2015, available at <http://www.sec.gov/foia/ats/atstlist0215.pdf>.

<sup>5</sup> Press Release, *Liquidnet Launches Fixed Income Dark Pool to Centralize Institutional Trading of Corporate Bonds*, Liquidnet, (September 28, 2015) available at <http://www.liquidnet.com/#/news/liquidnet-launches-fixed-income-dark-pool-to-centralize-institutional-tradi/>.

<sup>6</sup> Alternative Trading Systems with Form ATS on File with the SEC as of February 1, 2015, available at <http://www.sec.gov/foia/ats/atstlist0215.pdf>.

<sup>7</sup> Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the NASDAQ Market, available at <https://www.sec.gov/litigation/investreport/nd21a-report.txt>.

<sup>8</sup> *Order Execution Obligations*, 61 Fed. Reg. 48290 (Sept. 12, 1996), available at <https://www.gpo.gov/fdsys/pkg/FR-1996-09-12/pdf/96-23210.pdf>.

<sup>9</sup> *Regulation of Exchanges and Alternative Trading Systems*, 63 Fed. Reg. 70844 (Dec. 22, 1998) (“Reg ATS”).

<sup>10</sup> *Regulation of Exchanges and Alternative Trading Systems*, 63 Fed. Reg. 70844 (Dec. 22, 1998).

<sup>11</sup> See Proposal at 81000 (“Although ATSs and registered national securities exchanges generally operate in a similar manner and compete as trading centers for order flow in NMS stocks, each of these types of trading centers is subject to a separate regulatory regime with a different mix of benefits and obligations, including with respect to their obligations to disclose information about their trading operations.”).

We monitor transparency in the operations and trading of ATSs.<sup>12</sup> Last year, in conjunction with KOR Group, we reviewed the level of disclosure and transparency across ATSs in a number of key respects, and scored them on our proprietary ATS Transparency Index™.<sup>13</sup> We found dramatic differences across the market, as illustrated in following table (as of May 2015):<sup>14</sup>

ATS	Composite	Public Form ATS	Public Statistics	Public 4552 Data	Order Type Disclosure	Fees Disclosed	Technology	Order / Fill Characteristics	Conflicts	Block Trading Statistics	Other Trading Statistics	Broker-Owned Pool Details
IEX ATS	2.2											
BIDS Trading LP	1.5											
SuperX	1.1											
Level ATS	0.8											
Bloomberg Tradebook	0.6											
UBS ATS	0.6											
Liquidnet Negotiated	0.5											
KnightMatch	0.3											
Barclays LX	0.1											
POSIT	(0.1)											
SIGMA X	(0.3)											
Crossfinder	(0.3)											
Instinet Continuous Block Cross	(0.5)											
Instinct X (MLXN)	(0.8)											
JPMX	(0.9)											
MS POOL	(1.0)											
Apogee	(1.3)											
Interactive Brokers ATS	(1.3)											
LightPool	(1.3)											

Healthy Markets ATS Transparency Index™ (May 2015)

Unfortunately, sparse regulatory obligations have allowed for a disturbing proliferation of abusive practices while simultaneously creating an un-level playing field between ATSs and their natural competitors, exchanges. Since 2011, regulators and prosecutors have brought numerous enforcement cases against some of the oldest, largest, and most-respected ATS operators, including: Barclays,<sup>15</sup> Credit Suisse,<sup>16</sup> eBX, LLC (Level),<sup>17</sup> Goldman Sachs,<sup>18</sup> ITG,<sup>19</sup>

<sup>12</sup> For more information regarding our ATS Transparency Initiative, please see our website at <http://www.healthymarkets.org/ats-audit-and-transparency/>.

<sup>13</sup> For more information on the ATS Transparency Index™, please see our website at <http://www.healthymarkets.org/ats-transparency-index>.

<sup>14</sup> We are in the process of updating our index, and expect to release a comprehensive report on ATS Transparency practices in March 2016.

<sup>15</sup> *In the Matter of Barclays Capital, Inc.*, Exch. Act Rel. 34- 77001 (Jan. 31, 2016); Press Release, A.G. Schneiderman Announces Landmark Resolutions With Barclays And Credit Suisse For Fraudulent Operation Of Dark Pools; Combined Penalties And Disgorgement To State Of New York And Sec Of Over \$154 Million, New York State Office of the Attorney General (Feb. 1, 2016), available at <http://www.ag.ny.gov/press-release/ag-schneiderman-announces-landmark-resolutions-barclays-and-credit-suisse-fraudulent>.

<sup>16</sup> *In the Matter of Credit Suisse Securities (USA) LLC*, 34-77002 (Jan. 31, 2016); *In the Matter of Credit Suisse Securities (USA) LLC*, 34-77003 (Jan. 31, 2016); Press Release, A.G. Schneiderman Announces Landmark Resolutions With Barclays And Credit Suisse For Fraudulent Operation Of Dark Pools; Combined Penalties And Disgorgement To State Of New York And Sec Of Over \$154 Million, New York State Office of the Attorney General (Feb. 1, 2016), available at <http://www.ag.ny.gov/press-release/ag-schneiderman-announces-landmark-resolutions-barclays-and-credit-suisse-fraudulent>.

Liquidnet,<sup>20</sup> Pipeline,<sup>21</sup> and UBS.<sup>22</sup>

In September 2015, we released *The Dark Side of the Pools*, wherein we provided a comprehensive review of all the significant regulatory actions at that time, and offered a number of recommendations to investors. A copy of that Report is attached as **Exhibit 1**.<sup>23</sup>

A cursory review of the cases finds a panoply of troubling conduct, including:

- trading ahead of or against subscribers' orders;
- selectively sending indications of interest ("IOIs") to algorithmic trading firms, which allowed those firms to execute against subscribers in the pool, but also enabled those firms to trade away—and ahead—of the ATS's subscribers;
- sending subscribers' orders to other market centers without telling those subscribers;
- allowing the ATS operator's smart order router ("SOR") to use subscribers' order information when making unrelated order routing decisions;
- failing to police their pools as advertised, including by rating their own trading desk and HFT firms as less predatory than the objective criteria would indicate;
- providing misleading information about the trading characteristics of the pool and its major participants;
- allowing employees or third-parties who have no role in ATS operations or oversight to have access to customers' confidential trading information;
- failing to construct the National Best Bid and Offer ("NBBO") as advertised;
- accepting and executing sub-penny orders in violation of Rule 612;
- failing to monitor and restrict trading by subscribers in violation of the Market Access Rule; and
- violating the fair access requirements.

## Summary of the Proposal

The Proposal seeks to remedy some of the obvious shortcomings in the existing regulatory regime by requiring increasingly detailed public disclosures by ATS operators. Building upon the existing Reg ATS framework, the Proposal outlines a detailed process wherein operators of ATSs that trade NMS stocks ("NMS Stock ATSs") would be required to file Form ATS-N, as well

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<sup>17</sup> *In the Matter of eBX, LLC*, Exch. Act Rel. No. 34-67969 (Oct. 3, 2012) (regarding the operations of Level).□

<sup>18</sup> *In re Goldman Sachs Execution & Clearing, L.P.*, Letter of Acceptance, Waiver, and Consent, No. 20110307615-01, (Jun. 3, 2014), available at <http://disciplinaryactions.finra.org/Search/ViewDocument/36604>. This matter was handled by the Financial Industry Regulatory Authority (FINRA), as opposed to the SEC and New York Attorney General.

<sup>19</sup> *In the Matter of ITG, Inc. and AlterNet Securities, Inc.*, Exch. Act Rel. 34-75672 (Aug. 12, 2015).

<sup>20</sup> *In the Matter of Liquidnet, Inc.*, Exch. Act Rel. 34-72339 (June 4, 2014).

<sup>21</sup> *In the Matter of Pipeline Trading Systems LLC, Fred J. Federspiel, and Alfred R. Berkeley III*, Exch. Act Rel. No. 34-65609 (Oct. 24, 2011).

<sup>22</sup> *In the Matter of UBS Securities LLC*, Exch. Act. Rel. 34-74060 (Jan. 15, 2015).

<sup>23</sup> A copy of this Report is also available at <http://www.healthymarkets.org/dark-side-of-the-pools/>. While this Report was completed prior to recent settlements with Credit Suisse and Barclays regarding their operations of Crossfinder, Light Pool, and LX, the nature of the violations in those cases is, in many instances, similar to prior cases. However, the facts in each case are unique, and we urge market participants to examine the each case to determine whether it may impact their order routing decisions or processes.

as amendments thereto, which would contain a number of specifically enhanced disclosures. ATS-N and any amendments to it would also be made public.

Furthermore, an ATS could not begin operations until the SEC affirmatively determines the Form ATS-N “effective.” Subsequent amendments would be automatically deemed effective,<sup>24</sup> unless the SEC takes affirmative action to find them ineffective.<sup>25</sup> In making these determinations, the SEC could deem filings ineffective for a number of reasons, including that it finds the filings “materially deficient with respect to their accuracy, currency, or completeness.”<sup>26</sup> The Proposal provides a “non-exhaustive” list of examples of materially deficient filings.<sup>27</sup> The SEC could also deem filings ineffective for a number of reasons unrelated to the sufficiency of the filings themselves,<sup>28</sup> including that the would-be ATS operator is not appropriately registered as a broker-dealer.<sup>28</sup>

The Proposal would also allow the SEC to effectively shut down an NMS Stock ATS by suspending, limiting, or revoking its exemption from being an “exchange.” Lastly, the Proposal would require all ATSs (not just NMS Stock ATSs) to maintain written safeguards and procedures to protect their subscribers’ confidential information.<sup>29</sup>

## Proposed Scope of ATS Reforms

The bulk of the Proposal applies exclusively to NMS Stock ATSs. The SEC should broaden the scope of its Proposal to more comprehensively cover ATSs other than just NMS Stock ATSs. The purposes underlying the Proposal apply nearly equally with respect to ATSs trading other assets.

Enhancing and making public all ATS disclosures would aide market participants and regulators.<sup>30</sup> For example, investors would likely be equally concerned with an ATS operator offering preferential treatment (through speed, informational access, or otherwise) to its affiliated proprietary trading desk in an OTC Stock ATS as it would be for an NMS Stock ATS.

Similarly, we believe the SEC should be empowered to suspend, limit, or revoke an ATS’s exemption from the definition of an “exchange”, irrespective of the assets traded on the ATS. Thus, the SEC should revise Reg ATS to condition the exemption from exchange definition for all

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<sup>24</sup> Proposal at 81029.

<sup>25</sup> Proposal at 81029.

<sup>26</sup> Proposal at 81025.

<sup>27</sup> Proposal at 82015 (including as examples incomplete disclosures of an order type’s time-in-force limitations, failure to describe exceptions to its priority rules, failure to disclose multiple subscriber classes, inconsistent information about whether it uses SIP or prop feeds for NBBO and matching, and disclosures revealing that the ATS is “apparent” in violating the federal securities laws).

<sup>28</sup> See Proposal at 81024.

<sup>29</sup> Proposal at 81086.

<sup>30</sup> In fact, these efforts would greatly aid brokers seeking to fulfill their regulatory obligations to evaluate execution venues to which they are not connected. See Financial Industry Regulatory Authority, *Best Execution: Guidance on Best Execution Obligations in Equity, Options and Fixed Income Markets*, Regulatory Notice 15-46, at 9 (Nov. 2015) (“However, firms are required to evaluate the execution quality of the venues that they have access to and, to the extent information is reasonably available, regularly assess whether other venues to which a firm is not connected may provide the opportunity for best execution.”).

ATs on compliance with all relevant terms, while also building in a process to suspend, limit, or revoke the exemption.

That is not to say that the exact parameters of the reporting requirements for ATs should be identical regardless of the assets traded. Market characteristics across asset classes are different, and those differences may render some information that is extremely material for one asset class irrelevant for trading in another asset class. But those circumstances are generally rare, and the substantive details of the Proposal could largely translate to disclosures by ATs trading other asset classes beyond just NMS stocks.

While ATs in other asset classes may be in their relative infancy, the Commission should not feel compelled to wait to implement basic investor protections until after similar abuses come to light.

## Proposed Filing Requirements

The Proposal repeatedly highlights the discrepancy between the filing requirements of ATs and those for registered exchanges. As the Proposal puts it:

Unlike national securities exchanges, ATs are not approved by the Commission, but are instead required only to provide notice of their operations by filing a Form ATS with the Commission 20 days before commencing operations as an ATs. Form ATS is “deemed confidential when filed,” and it only requires an ATs to disclose limited aspects of the ATs’s operations. ATs are neither required to file proposed rule changes with the Commission nor otherwise publicly disclose their trading services, operations, or fees.<sup>31</sup>

The Proposal then expresses the SEC’s concern “that the current regulatory requirements ... for ATs, particularly those that execute trades in NMS stocks, may no longer fully meet the goals of furthering the public interest or protecting investors.”<sup>32</sup> And, as the Proposal notes,<sup>33</sup> the SEC has received numerous requests to enhance ATs disclosures and harmonize the regulatory regimes for exchanges and ATs over the years.<sup>34</sup>

In response to these justifiable concerns and urging, the Proposal appears to effectively create a filing process that is remarkably similar to those of registered exchanges. For example, similar to the SEC’s review process for exchange applications, a firm seeking to operate a NMS Stock ATs would first be required to file a Form ATS-N and wait for the SEC to declare the filing “effective.”

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<sup>31</sup> Proposal at 81001.

<sup>32</sup> Proposal at 81001.

<sup>33</sup> See, e.g., Proposal at 81011.

<sup>34</sup> See, e.g., Letter to Mary L. Schapiro, Chairman, Commission, from Sen. Edward E. Kaufman, United States Senate, (Aug. 5, 2010)(urging the SEC to “harmonize rules across all market centers to ensure exchanges and ATs are competing on a level playing field that serves the interests of all investors.”); see also Letter to Elizabeth M. Murphy, Secretary, Commission, from Janet M. Kissane, Senior Vice President, Legal & Corporate Secretary Office of the General Counsel, NYSE Euronext, at 3 (Feb. 22, 2010)(“ATs now represent a significant share of trading volume in NMS stocks . . . the time is ripe to move to a framework that has now consistent regulatory requirements when the trading activity at issue is essentially the same.”).

<sup>35</sup> In this way, the SEC would interject itself as a gatekeeper to firms seeking to operate NMS Stock ATSs. This would allow the SEC to scrub both the applicant and the substance of the application itself, and deny firms that have failed to meet the necessary requirements.

While asserting that “it is important that Form ATS-N contain detailed disclosures that are accurate, current, and complete,”<sup>36</sup> the Proposal highlights a “non-exhaustive” list of circumstances that would suggest “materially deficient” filings:

- Form ATS-N discloses an order type, “but does not describe the key attributes of the order type, such as time-in-force limitations that can be placed on the ability to execute the order, the treatment of unfilled portions of orders, or conditions for cancelling orders in whole or in part,”<sup>37</sup>
- Form ATS-N “describes some of its priority rules, but fails to describe conditions or exceptions to its priority rules, or fails to describe any priority overlays,”<sup>38</sup>
- “Form ATS-N states that the NMS Stock ATS has only one class of subscribers but the Commission or its staff learns through discussions (during the review period) with the NMS Stock ATS or otherwise that the NMS Stock ATS in fact has several classes of subscribers,”<sup>39</sup>
- “Form ATS-N states that two classes of subscribers are charged the same trading fees but the Commission or its staff learns through discussions with the NMS Stock ATS or otherwise that in fact one class receives more favorable fees than the other,”<sup>40</sup>
- “Form ATS-N includes inconsistent information, such as a statement in one part of the form that the entity uses private feeds to calculate the NBBO, but in another part of the form it indicates that it uses the Securities Information Processor (“SIP”),”<sup>41</sup> and
- “one or more disclosures reveals non-compliance with federal securities laws, or the rules or regulations thereunder.”<sup>42</sup>

It is important to note that the SEC’s review for compliance with the federal securities laws would be a “red flag” review,<sup>43</sup> comprised largely of scanning for readily apparent violations. These apparent violations could include that the ATS operator has failed to register as a broker-dealer or with a self-regulatory organization,<sup>44</sup> or that the ATS would accept sub-penny orders, in violation of Rule 612 of Reg NMS.<sup>45</sup>

At a minimum, the SEC should perform some level of regulatory review to protect investors and promote fair and efficient markets. That said, we worry that this review may devolve into other market centers seeking to have the SEC preserve their market positions and effectuate their

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<sup>35</sup> Notably, the SEC’s review of a firm’s Form 1, is concluded with an “approval,” as opposed to a declaration of “effectiveness.” This distinction is important, especially considering the potentially dramatic impact SEC “approval” may have on liability for firms engaging in activities described in the respective filings.

<sup>36</sup> Proposal at 81025.

<sup>37</sup> Proposal at 81025.

<sup>38</sup> Proposal at 81025.

<sup>39</sup> Proposal at 81025.

<sup>40</sup> Proposal at 81025.

<sup>41</sup> Proposal at 81025.

<sup>42</sup> Proposal at 81025.

<sup>43</sup> Proposal at 81025.

<sup>44</sup> Proposal at 81025.

<sup>45</sup> Proposal at 81026.

rent-seeking. These concerns are heightened by the SEC’s current evaluation of a high-profile exchange application has become hyper-contentious,<sup>46</sup> political,<sup>47</sup> and slow. We urge the Commission to be mindful of this risk, and work to promptly evaluate and act on initial filings.

With respect to amendments, the Proposal would essentially deem them all effective, unless the SEC affirmatively finds them otherwise, after a notice and hearing. The Proposal suggests that the ATS-N amendments would also be subject to a “red flag” review.<sup>48</sup> The Proposal further explains that the SEC’s declaration of “effectiveness” is not an “approval.” Nevertheless, we worry that this process may be used to inappropriately inoculate ATS operators from liability. This concern is heightened by a recent court decision in the Southern District of New York wherein the judge found that the SEC’s review and approval of exchanges’ activities essentially made those activities legal.<sup>49</sup>

The “effectiveness” determination appears to strike a good balance between requiring ATS accountability and promoting investor transparency on the one hand, while not creating a bottleneck or unintended consequences for potential litigants on the other. If such a process had already been in place, a number of the SEC’s recent enforcement cases would likely have never existed: the misconduct may have never begun.

## Proposed Requirements for When and Why Amendments Must be Filed

The Proposal directs NMS Stock ATSS to amend their ATS-N filings:

1. In Advance: “at least 30 calendar days prior to the date of implementation of a material change to the operations of the NMS Stock ATS or to the activities of the broker-dealer operator or its affiliates that are subject to disclosure on Form ATS–N”<sup>50</sup>;
2. Periodically: “within 30 calendar days after the end of each calendar quarter to correct any other information that has become inaccurate for any reason and has not been previously reported to the Commission as a Form ATS–N Amendment”<sup>51</sup>; and
3. Promptly: “to correct information in any previous disclosure on Form ATS–N after discovery that any information filed in a Form ATS–N or Form ATS–N Amendment was inaccurate or incomplete when filed.”<sup>52</sup>

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<sup>46</sup> IEX and its supporters have traded numerous volleys with IEX’s opponents, including Citadel, NYSE, and BATS. For a more thorough review of the debate, please see the comment file, available at <https://www.sec.gov/comments/10-222/10-222.shtml>.

<sup>47</sup> It was recently reported that conservative activist, Grover Norquist, the founder of Americans for Tax Reform, is pressing Republican Presidential candidates to weigh in support of IEX’s exchange application. Patrick Temple-West, *Grover Norquist: Republican presidential candidates need to support IEX*, Politico, (Feb. 10, 2016).

<sup>48</sup> Proposal at 81030.

<sup>49</sup> *In Re Barclays Liquidity Cross and High Frequency Trading Litigation*, 14-MD-2589, at 8 (S.D.N.Y. Aug. 26, 2015). The judge further held that exchanges were absolutely immune from actions arising from the sales of proprietary data feeds and offering of order types, as it found that those activities were sufficiently regulatory in nature. *Barclays*, at 18-20.

<sup>50</sup> Proposal at 81027.

<sup>51</sup> Proposal at 81029.

<sup>52</sup> Proposal at 81029.



The timing and types of these filings is similar to the current ATS filing requirements, although the advanced warning for “material” changes has been pushed out another 10 days. While 20 days may be adequate, we also believe that 30 days still seems to strike an appropriate balance between an ATS’s ability to innovate, while also providing market participants and regulators adequate time to evaluate and respond, if necessary.

The definition of what constitutes a “material change” is critical to making this regime work. The SEC currently provides little guidance as to what constitutes a “material change,” other than noting that it includes, “any change to the operating platform, the types of securities traded, or the types of subscribers.”<sup>53</sup> This level of generality has been of little comfort to ATS operators seeking to comply.

The Proposal shines some much-needed light on this blindspot--at least for NMS Stock ATSs--by revising the standard and outlining a far-more specific, non-exhaustive list of examples of “material” changes. Under the Proposal, “a change to the operations of an NMS Stock ATS, or the disclosures regarding the activities of the broker-dealer operator and its affiliates, would be material if there is a substantial likelihood that a reasonable market participant would consider the change important when evaluating the NMS Stock ATS as a potential trading venue.”<sup>54</sup>

The Proposal then provides numerous examples of likely “material” changes:

1. a broker-dealer operator or its affiliates beginning to trade on the NMS Stock ATS;
2. a change to the broker-dealer operator’s policies and procedures governing the written safeguards and written procedures to protect the confidential trading information of subscribers pursuant to Rule 301(b)(10)(i) of Regulation ATS;
3. a change to the types of participants on the NMS Stock ATS;
4. the introduction or removal of a new order type on the NMS Stock ATS;
5. a change to the order interaction and priority procedures;
6. a change to the segmentation of orders and participants;
7. a change to the manner in which the NMS Stock ATS displays orders or quotes; and
8. a change of a service provider to the operations of the NMS Stock ATS that has access to subscriber confidential subscriber trading information.<sup>55</sup>

Given the weedy nature of some of these examples, we expect NMS Stock ATS operators to interpret “material” in this context extremely broadly, and thus provide 30 days advanced warning for nearly all changes.

We urge the SEC to resist the temptation to arbitrarily create tiers of materiality. The consumers of ATS disclosures vary widely in business models and sophistication. And when

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<sup>53</sup> Proposal at 81005, n.75 (citing 17 C.F.R. 242.301(b)(2)(ii)).

<sup>54</sup> Proposal at 81028.

<sup>55</sup> Proposal at 81028.

measuring materiality in this and other contexts, the Commission has always appreciated that some “material” factors may be more or less important to different market participants. The SEC should not wade into this nettlesome territory, nor should it substitute its priorities and relative rankings of importance for those of diverse market participants.

Lastly, the Commission may be well-advised to expressly permit a process for more rapid action (i.e., under 30 days) by an ATS in the event of some external emergency, such as extreme market events. These circumstances should be rare and only granted upon express approval of the Commission, upon a finding that such action is necessary to protect investors and promote fair and efficient markets.

As revised, we do not believe that these filing requirements would be unduly burdensome for ATSs, and believe that all ATSs -- not just NMS Stock ATSs -- should comply with them.

## Proposed Substantive Disclosures

The Proposal greatly enhances the details of required disclosures, as well as makes them public. This is a great step forward for investors and other market participants, including brokers, who would be better equipped to fulfill their responsibilities to consider trading venues as part of their best execution obligations. As detailed below, the Proposal makes great strides towards alerting market participants as to the risks they may face when interacting with a trading venue. Unfortunately, the Proposal simultaneously fails to equip investors or other market participants with the tools necessary to meaningfully evaluate those risks. Thus, under the Proposal, investors and market participants may be left in an untenable conundrum where they would be aware that they may be victimized, but would not know by how much.

In the interest of better protecting investors and promoting more fair and efficient markets, below we (i) offer comments on the qualitative disclosures included in the Proposal, (ii) recommend the adoption of some restrictions on trading by ATS operators and their affiliates, and (iii) recommend the adoption of significant additional quantitative disclosures.

### ATS-N: Part I

The Proposal would require an NMS Stock ATS to disclose its name, the identity of the broker-dealer operator, including any “doing business as” name, as well as the ATS’s Market Participant Identifier (MPID).<sup>56</sup> We agree that this basic information is critical to market participants and should be disclosed. Again, we see no reason why market participants and regulators would not benefit from these disclosures in other types of ATSs as well.

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<sup>56</sup> Proposal at 81038.

## ATS-N: Part II

Part II of the ATS-N serves two distinct purposes. First, it would require NMS Stock ATSs to disclose basic, general information about their broker-dealer operator and the the ATS. For example, Part II would require the broker-dealer to disclose its legal status (i.e., whether it is a corporation, partnership, etc.)<sup>57</sup> and information sufficient to confirm that it is appropriately registered with the SEC and FINRA.<sup>58</sup> The ATS operator would also attach (or include the URL to) its Schedule A from its Form B-D (related to owners and officers a) as Exhibit 2A and Schedule B from its Form B-D (related to indirect owners) as Exhibit 2B.<sup>59</sup> Similarly, the ATS would be required to disclose the physical address of its matching system, its mailing address, and its website.<sup>60</sup> None of this information seems difficult to locate, nor does its disclosure appear to be in any way controversial.

There are two areas that the SEC should consider revising. First, the Proposal should be revised to clearly demand the disclosure of all relevant addresses, not just the matching system and mailing address. Second, the SEC should remove the bizarre exception for an NMS Stock ATS run out of a personal residence.<sup>61</sup> As revised, we support these disclosure requirements. That said, we expect this information is likely of limited utility for market participants who are more likely concerned with other matters.

Second, Part II of ATS-N would also “require an NMS Stock ATS to attach, as Exhibit 1, a copy of any materials currently provided to subscribers or other persons, related to the operations of the NMS Stock ATS or the disclosures on Form ATS-N.”<sup>62</sup> Further, “[t]o the extent that the NMS Stock ATS discloses information on standardized materials provided to certain subscribers, whether an individual or on group basis,” the ATS would be required to make this information available to all subscribers as an attachment to Exhibit 1.<sup>63</sup> While we are concerned with various interpretations of what constitutes “standardized materials,” we expect that this would and should include any reporting metrics, including order and execution statistics, that may be provided to customers, including those prepared at the request of specific firms.<sup>64</sup> This

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<sup>57</sup> Proposal at 81039.

<sup>58</sup> Proposal at 81039 (detailing that it would require the disclosure of the broker-dealer’s “SEC File Number, Central Registration Depository (“CRD”) Number, effective date of the broker-dealer operator’s registration with the Commission, the name of the national securities association with which it is a member, and the effective date of broker-dealer operator’s membership with the national securities association (e.g., FINRA).”).

<sup>59</sup> Proposal at 81040.

<sup>60</sup> Proposal at 81039.

<sup>61</sup> Proposal at 81039.

<sup>62</sup> Proposal at 81039.

<sup>63</sup> Proposal at 81040.

<sup>64</sup> Given the rise of increasingly sophisticated transaction cost analysis, as well as the varieties of firms that may be subscribers to an ATS, we expect that ATS operators may become somewhat overwhelmed by performing similar, but yet different analyses for firms. To help alleviate the burdens on ATSs and promote more meaningful comparisons across firms and venues, we separately urge the SEC to significantly revise its reporting obligations under ATS-R as well as Rules 600, 605, and 606, some of which is detailed below. Further, we urge the Commission to more effectively integrate its data and analytical reporting regime with FINRA’s already successful collection of ATS data.

information may also assist firms seeking to compare fee structures offered by an ATS and across different trading venues.

To the extent that this information may include statistics or data that may be requested by a firm to help with their cost and best execution analyses, we note that this approach is far-less valuable for market participants than a greatly-enhanced, comprehensive disclosure requirement for this information. Because the Proposal does not include any of that critical information for investors and other market participants, this requirement is essential. However, if the Proposal were to be revised to include enhanced order and execution statistics (as we recommend below), then the need for this other information is greatly lessened. Thus, the Proposal could better restrict the information to be provided for pursuant to Exhibit 1 to marketing materials and fee information.

This approach would also mitigate a risk that NMS Stock ATSs may respond to this new requirement by essentially ceasing to provide subscribers with important information and statistics, so that they may avoid having to make such information publicly available. While it is difficult to quantify this risk, our experience suggests that this reaction may occur, and the result would clearly be the opposite to what the SEC intends: **investors would get less information, not more**. Accordingly, the most appropriate way to structure Exhibit 1 may be to revise it to include all marketing materials, manuals, and fee information, but not customized statistics and information, provided that such statistics and information are otherwise made publicly available pursuant to a greatly expanded quantitative disclosure mechanism. As revised, Exhibit 1 will enhance consistency of information flow to subscribers and the public, and should be adopted.

Again, these disclosure requirements are equally valuable for those seeking to evaluate NMS Stock ATSs as other ATSs. Accordingly, the SEC should consider expanding the Proposal to apply these requirements to all ATSs, not just NMS Stock ATSs.

## **ATS-N: Part III**

### **Overview of Part III Framework and Recommendations**

Part III of the new ATS-N is the heart of the Proposal. The types of relationships and activities that are subject to these disclosure requirements have underpinned the majority of regulators' recent enforcement actions, and generate some of the greatest concerns for market participants.

Part III is intended to inform market participants about:

1. the operation of the NMS Stock ATS and its broker-dealer operator, as well as any arrangements the broker-dealer operator may have regarding the operation of its NMS Stock ATS; and

2. any potential conflicts of interest the broker-dealer operator may have with respect to the operation of its NMS Stock ATS.<sup>65</sup>

The Proposal correctly recognizes the significant potential conflicts of interest between the ATS and its operator, and acknowledges that these conflicts of interest are heightened when an ATS operator or an affiliate trades in the ATS or has access to the pools' subscribers' information.

Although the Proposal states that the Commission "considered" mitigating these conflicts of interest by (1) "requiring NMS Stock ATSs to operate on a stand-alone basis", or (2) "imposing new requirements designed to limit potential conflicts," the Proposal does neither.<sup>66</sup> Instead, the Proposal summarily concludes that the Commission determined that these alternatives "could be significantly more intrusive and substantially affect or limit the current operations of ATSs" more than simply enhancing disclosures.<sup>67</sup> Thus, rather than substantively limit ATSs' conduct, the SEC instead chose to simply enhance some limited elements of ATS disclosures.<sup>68</sup>

**We believe that the Commission should more fully evaluate potential substantive restrictions on ATS operators' relationships with ATSs.** In particular, the SEC should consider eliminating the unavoidable conflict of interest that arises from an operator's (or its affiliate's) principal trading activities within the ATS or if it is informed by others' trading activities within the ATS. While these practices may lead to increased fill rates and ultimate transaction volumes for an ATS, they also come at the cost of exposing ATS subscribers to profound conflicts of interest that may manifest themselves in numerous--and potentially difficult-to-detect--ways.

There are numerous reasons why **the limited enhancements to disclosures outlined in the Proposal may be insufficient to address these concerns.** Two key reasons are that market participants may not be able to appreciate the nature of a disclosed conflict of interest and, even if they do, they may nevertheless feel compelled to use the ATS.

An ATS operator's disclosures may not provide adequate notice to market participants as to the exact nature of the conflict of interest arising from trading by it or an affiliate in the pool. This inadequacy of disclosure is heightened by the absence of any quantitative disclosures regarding

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<sup>65</sup> Proposal at 81043.

<sup>66</sup> Proposal at 81043. Despite the profound nature of this conflict of interest, and its importance to market participants, the Commission appears to have not engaged in significant consideration of either of these resolutions. This was in spite of the fact that the Proposal expressly acknowledges that requiring ATSs to operate on a stand alone basis "would eliminate any potential conflicts of interest." Proposal at 81043. Somewhat inexplicably, the entirety of the Commission's analysis appears to have been relegated to about ½ of a page out of more than 150 pages used in the Federal Register. Proposal at 81130-31. This extremely limited analysis offers no statistics or quantitative support in either direction. There is no analysis of transaction costs to investors. There is no discussion of relative shifts in market shares. There is, quite simply, nothing more than naked conjecture that if this conflicts of interest was prohibited, some ATS operators may stop operating ATSs. Yet, even this conjecture offers no insight as to how or to what degree that may impact market participants. Ultimately, the core of the Commission's justification to ignore this alternative rests on its assertion that to require ATSs to operate on a stand alone basis would "discourage broker-dealers from creating and operating innovative NMS Stock ATS platforms, and instead drive them to execute their own proprietary trades internally on their other broker-dealer systems. In addition, if they were no longer able to trade on a proprietary basis or route customer orders to their own NMS Stock ATS, many broker-dealers may choose to file a cessation of operations report and shut down the operations of their NMS Stock ATS." Proposal at 81130.

<sup>67</sup> Proposal at 81043.

<sup>68</sup> Proposal at 81043.

the size or degree of such conflicted activities. For example, investors would likely find it very important to know if:

1. the ATS operator's primary revenues associated with the ATS were from its own trading, as opposed to commissions / avoidance of transaction fees, or
2. trades executed by an ATS operator had relatively high toxicity metrics.

Yet none of this is required by the Proposal. The Proposal calls for no disclosures about the size or scale of potential conflicts of interest. This may be exacerbated by similar-sounding qualitative disclosures by ATSs who engage in very different activities.

For example, suppose Alpha ATS has an affiliate that trades in the ATS on a principal basis. Suppose further that it has connectivity and access to more information, faster than any subscriber. Now suppose that 90% of the Alpha ATS family's profits associated with running the ATS from its principal trading in the ATS. That might be concerning.

Now suppose Beta ATS also has an affiliate that trades in the ATS on a principal basis. Beta's affiliate has connectivity that is the same as its top-tier subscribers. Let's further suppose that a mere 5% of the Beta ATS family's profits associated with running the ATS are attributable to its affiliates' principal trading. The disclosures required pursuant to the Proposal for both Alpha ATS and Beta ATS could easily be identical. However, investors and routing brokers would likely view these two venues very differently. Alpha ATS may likely be viewed as somewhat predatory in nature whereas Beta ATS would likely pose significantly less risk. What is missing is the scale of the conflicts of interest.

Further, even if a market participant appreciates the nature of the disclosed conflict of interest, and even if it finds the disclosure repugnant, the firm may nevertheless feel legally and procedurally compelled, such as by their best execution obligations or contract, to continue to access and use the ATS. That is because the market participant may be compelled by regulation or contract to monitor and access significant pools of liquidity--even if those pools are conflicted.

In fact, it is partially for these reasons that the Commission has consistently prohibited exchanges from associating with individual broker-dealer members. However, in the absence of a decision to revisit this issue, we urge the SEC to adopt detailed qualitative disclosures along the lines of the Proposal, but then supplement these disclosures with greatly expanded quantitative reporting on a monthly basis (discussed below).<sup>69</sup> We further urge the SEC to adopt a limitation wherein an ATS operator or an affiliate that trades in the ATS must do so on terms **no more favorable** (such as via faster connections or with greater information) than an

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<sup>69</sup> As we describe in detail later, the SEC should not seek to simply re-create expanded data reporting for ATSs. Rather, the SEC should simply dictate terms for additional disclosures pursuant to the already-successful reporting regimes, including the FINRA ATS Data reporting mechanism. See FINRA Rule 4552. For more information about this data set, please see <https://ats.finra.org>.

unaffiliated subscriber to the ATS. This limitation would be a necessary, but insufficient condition for permitting this type of facially conflicted trading in the ATS.

The risks posed by an ATS operator or its affiliate trading on a principal basis in an ATS are fundamentally different in nature than the risks and conflicts of interests inherent in an ATS's decisions to route orders. While these potential conflicts of interest may still be significant, comprehensive disclosures may nevertheless be sufficient to protect investors. These disclosures should include both qualitative discussions, as well as detailed quantitative reporting.

For the purposes of Part III, an NMS Stock ATS operator would be required to make a number of disclosures related to "affiliates", which is defined to mean "with respect to a specified person, any person that directly, or indirectly, controls, is under common control with, or is controlled by, the specified person."<sup>70</sup> This is similar to the language used in the analogous Form 1 used for exchange applications, and seems appropriate. The Proposal then redefines the term "control" to make it clear that the broker-dealer ATS operator is responsible for the actions of the ATS. Although the Commission sought comment on whether it should modify the longstanding 25% ownership threshold that currently serves as a presumption of control, the SEC should decline to unnecessarily muddy these waters. Market participants are well-accustomed to the 25% threshold, which is consistent with other areas of the securities laws, the Bank Holding Company Act, and even the Volcker Rule.

Lastly, we can identify no credible argument as to why the information sought by Part III would not be important to market participants using all types of ATSs. Accordingly, we urge the SEC to expand the Proposal to cover all ATS types, not just NMS Stock ATSs.

### **Part III: Items 1 & 2**

Item 1 of ATS-N would require an NMS Stock ATS to disclose whether the broker-dealer operator or any of its affiliates operates or controls any non-ATS trading center that acts as an OTC market maker or executes orders in NMS stocks internally (including on a principal or agency basis).<sup>71</sup> For each identified non-ATS trading center, the ATS operator would be required to make a number of disclosures related to the nature of the interactions between or preferences regarding the non-ATS trading center and the ATS. This information would include disclosures regarding the maintenance and terms of interactions for a proprietary trading desk. Similarly, Item 2 of ATS-N would require similar disclosures as Item 1, but for any other NMS Stock ATSs.<sup>72</sup> Collectively, these qualitative disclosures are essential to alerting market participants to potentially significant advantages and conflicts of interest for the ATS, and we urge the SEC to adopt them.

### **Part III: Item 3**

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<sup>70</sup> Proposal at 81044.

<sup>71</sup> Proposal at 81045.

<sup>72</sup> Proposal at 81045.

Item 3 would require an NMS Stock ATS to disclose whether its operator or any affiliate offers subscribers “any products or services used in connection with trading on the NMS Stock ATS (e.g., algorithmic trading products, market data feeds).”<sup>73</sup> If so, the NMS Stock ATS would be required to “describe the products and services and identify the types of subscribers (e.g., retail, institutional, professional) to which such services or products are offered, and if the terms and conditions of the services or products are not the same for all subscribers, describe any differences.”<sup>74</sup> While we generally agree with this approach, this requirement should be refined somewhat to cover products or services used in connection with trading NMS stocks, not just trading on the NMS Stock ATS. As revised, we urge the SEC to adopt these provisions.

### **Part III: Item 4**

Item 4 would require an NMS Stock ATS to describe relationships with unaffiliated trading centers “regarding access to the NMS Stock ATS”, including preferential routing arrangements.<sup>75</sup> These arrangements are of particular interest to market participants. For example, investors might be particularly concerned to learn that an NMS Stock ATS had an arrangement wherein it agreed to first route all orders coming to it back out to an unaffiliated non-ATS trading center (e.g., a wholesale market maker) in return for compensation.<sup>76</sup> This type of arrangement may give rise to information leakage and lead to lower quality executions for subscribers--either in the ATS or in other venues. We agree with all elements of this item and urge the Commission to adopt them.

### **Part III: Item 5**

Item 5 would require disclosure of details regarding trading by the NMS Stock ATS operator or affiliates in the NMS Stock ATS.<sup>77</sup> These disclosures are essential to ensure that subscribers have a reasonable understanding of the conflicts of interest posed by the ATS operator’s or its affiliates’ trading.

Again, we note the direct tie of these disclosures to recent enforcement actions. In that vein, we found one scenario highlighted by Proposal particularly troubling. The Proposal acknowledges that “an NMS Stock ATS may permit orders or other trading interest of all of its affiliates that trade on the NMS Stock ATS to enter through a means that can be used only by the broker-dealer operator or its affiliates and not by non-affiliated subscribers to the NMS Stock ATS (e.g., bypassing the broker-dealer operator’s SOR).”<sup>78</sup> Unquestionably, market participants would want to know the specific advantages afforded to the ATS operator or its affiliates, and so we urge the SEC to adopt these provisions.

### **Part III: Item 6**

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<sup>73</sup> Proposal at 81048.

<sup>74</sup> Proposal at 81048.

<sup>75</sup> Proposal at 81049.

<sup>76</sup> Proposal at 81049.

<sup>77</sup> Proposal at 81050.

<sup>78</sup> Proposal at 81051.



Item 6 would require detailed disclosures regarding smart order routers and algorithms offered by NMS Stock ATS operator or its affiliates, including how they may interact with the NMS Stock ATS.<sup>79</sup> As the Proposal acknowledges, ATS operators may use smart order routers and algorithms in a number of ways, including to route orders to or from the ATS or even as the exclusive means to access the ATS.<sup>80</sup> Further, the typically close relationship between the ATS operator and the ATS may result in the smart order router having access to confidential customer information from the ATS. In fact, this concern has undergirded recent enforcement cases. Understanding these relationships is essential for customers, and so we support the adoption of the Proposal.

### **Part III: Items 7 & 8**

Item 7 would require the disclosure of people who have responsibilities for the NMS Stock ATS but also provide non-ATS-related services to the ATS operator or an affiliate (i.e., shared employees). By focusing on shared employees, this disclosure obligation is “designed to provide information to market participants and the Commission about circumstances that might give rise to a potential conflict of interest and potential information leakage” As with other portions of Part III, its requirements appear to be in direct response to recent enforcement actions.<sup>81</sup> While we believe accountability for the safeguarding of customer information is essential, we are uncertain as to why this disclosure needs to be public, particularly in light of the Proposal’s other reforms regarding the safeguarding of customers’ confidential information.

Similarly, Item 8 “would require an NMS Stock ATS to disclose whether any operation, service, or function of the NMS Stock ATS is performed by any person(s) other than the broker-dealer operator,” and if so, to make detailed disclosures regarding (1) who it is, (2) what they’re doing, and (3) whether they can trade on the ATS.<sup>82</sup> As with the disclosure regarding the operator’s employees, this disclosure is intended to help market participants identify and assess the risk of information leakage. However, there may be some significant distinctions between a shared employee and a third-party service provider. A shared employee is likely subject to significantly greater oversight by the ATS operator, including through ongoing training and compliance (including through reviews of emails and trading records). In most instances, the oversight of third parties is significantly less formidable, and may thus result in greater risk of information leakage. Collectively, these disclosures should be adopted.

### **Part III: Items 9 & 10**

Item 9 would require disclosure of differences in functionality between the ATS operator or affiliates and other subscribers.<sup>83</sup> Again, rather than prohibit an ATS operator from giving itself or an affiliate preferential treatment, the Proposal would have the ATS operator simply disclose it. Assuming the SEC continues to decline to prohibit the deeply troubling conflicts of interest

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<sup>79</sup> Proposal at 81052.

<sup>80</sup> Proposal at 81052.

<sup>81</sup> See, e.g., *In the Matter of ITG, Inc. and AlterNet Securities, Inc.*, Exch. Act Rel. 34-75672 (Aug. 12, 2015).

<sup>82</sup> Proposal at 81055.

<sup>83</sup> Proposal at 81056.

attendant with allowing an ATS operator or affiliate to trade in the ATS, then we urge the SEC to affirmatively restrict how the operator or its affiliates interact with the ATS so that its functionality is not objectively better than, nor substantively different from, its top unaffiliated, third-party subscribers. If the SEC declines to implement even this basic protection, then the Proposal's requirements from Item 9 are reasonable.

Item 10 would require an ATS to “describe the written safeguards and written procedures to protect the confidential trading information.”<sup>84</sup> Further, Item 10 calls for the broker-dealer operator to provide specific details on how customers may agree or opt-out of having their information shared, details regarding who has access to what and why, as well as a prohibition against misuse of this information.<sup>85</sup> Given the risk of misuse of confidential information, these reforms seem appropriate. They also appear to fit well within the framework of the new requirement that all ATSs maintain written safeguards and procedures to protect customer confidential information.

#### **Part IV: ATS Operational Basics**

Part IV of Form ATS-N would provide market participants with certain basic information about how the NMS Stock ATS operates. For example, Part IV would require filing of a new Exhibit 4 to provide details regarding:

- hours of operations;
- order types;
- connectivity and order entry;
- segmentation of order flow;
- display of orders and trading interest;
- trading services;
- procedures governing suspension of trading and trading during system disruptions and malfunctions;
- opening, reopening, closing and after-hours trading procedures;
- outbound routing from the NMS Stock ATS;
- use of market data by the NMS Stock ATS;
- fees;
- trade reporting, clearance and settlement procedures;
- order display and execution access; and
- fair access standards.<sup>86</sup>

All of these disclosures are essential for investors or routing brokers seeking to understand how the ATS works. For example, a time-sensitive trader would likely find it very important that an ATS does not use direct feeds to construct the NBBO, but instead uses the SIP.

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<sup>84</sup> Proposal at 81058.

<sup>85</sup> Proposal at 81058-59.

<sup>86</sup> Proposal at 81060.

However, these operational disclosures are facially inadequate to inform market participants about the stability and integrity of an ATS. Participants make decisions on venue interaction based on many different considerations. We believe that the following supplemental operational disclosures (in addition to the previously mentioned ones above) would allow participants to make more informed decisions. We urge the SEC to revise the Proposal to require annual disclosure of:

- the number of unique disruptions in previous 3 calendar years, where a unique disruption is categorized as multiple ATS trading participants experiencing technical difficulties with the ATS;
- whether the ATS has ever had a full or partial system failure, and if so, descriptions of each failure (including length of downtime);
- whether the ATS has ever been deliberately taken down rather than allow for a previously unanticipated fail over (a “take down”), and if so, descriptions of each take down;
- the ATS’s policies, procedures and expectations for addressing any future failure or take down;
- the number of trading days in which ATS operated from its disaster recovery location in the previous 3 calendar years.
- details regarding the ATS’s efforts in clock synchronization, including technology and protocols used;
- a listing of the feeds used to construct the NBBO for order routing and matching purposes;
- the approximate latency (in microseconds) to receive market data feeds (from the point of network ingestion of the data), assemble the NBBO and deliver the updated NBBO to the matching engine, as well as the:
  - Mean
  - Median
  - Standard Deviation
  - 90th and 99th percentiles
- If the ATS offers collocation or a cross-connect in the same data center that houses the matching engine, or any other type of speed-segmented access options:
  - the number and class types of firms that are collocated / cross-connected / speed segmented (Note: Assumes detailed description of subscriber class type determinations in the ATS-N);
  - the percentage of orders entered and partially or completely filled by participants that are collocated / cross-connected / speed segmented.

## Market Quality Statistics Reporting

The Commission has an excellent opportunity to enhance ATS disclosure requirements to address the problem that the Commission identifies in the Proposal:

Given the dispersal of trading volume in NMS stocks among an increasing number of trading centers, the decision of where to route orders to obtain best execution for market participants is critically important. ... market participants have limited information about how these markets operate. The Commission is concerned that this lack of operational transparency impedes market participants from adequately discerning how orders interact, match, and execute on NMS Stock ATSs, and may hinder market participants' ability to obtain, or monitor for, best execution for their orders.<sup>87</sup>

While operational disclosures are critically important, they tell a small piece of a much larger story. As the Commission notes, the above concern about market participants' ability to obtain best execution being hindered is primarily based on "increasing operational complexity of NMS Stock ATSs."<sup>88</sup> It is due to this very complexity that simple operational disclosures are inadequate. First, more detailed operational disclosures are required, and are suggested above. However, more importantly, participants must be given the ability to understand how these disclosures manifest in terms of order flow and participant interaction. As such, further detail on order flow and trade dynamics is warranted, and detailed suggestions are made in **Exhibit 2**.

The Commission says that the "proposed Form ATS-N would be generally similar to the information disclosed by national securities exchanges about their operations."<sup>89</sup> However, there is a fundamental difference in this analogy - **participants have public market data to assess trading dynamics on a public exchange. They do not have the same data for an ATS.** We therefore believe it is incumbent upon the Commission to mandate a set of disclosures to supplement Rule 605 that provides a far more detailed and quantitative view of the trading dynamics on an ATS.

Nearly all of our suggested quantitative disclosures address the fundamental issue that the Commission is trying to confront: ensuring that market participants can assess ATS performance, including in comparison to registered exchanges. This is the fundamental conundrum of participants who are trying to make venue interaction decisions while upholding their best execution responsibilities.

Currently mandated public disclosures are facially inadequate to compare and evaluate ATSs with each other, and with registered exchanges. Item 16 of Part IV of Form ATS-N would

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<sup>87</sup> Proposal at 81060.

<sup>88</sup> Proposal at 81060.

<sup>89</sup> Proposal at 81060.

require an ATS to “explain and provide certain aggregate platform-wide market quality statistics that it publishes or provides to one or more subscribers.”<sup>90</sup> This information is intended to supplement information reported pursuant to Rule 605. However without mandating a minimum level of disclosure, the Commission runs the risk of participants receiving inadequate information with which to make venue interaction decisions.

Instead, the Commission should utilize a combination of disclosures to ensure that participants have all of the information that they need to make venue interaction decisions and satisfy their best execution requirements. This combination would consist of:

1. Monthly disclosures as part of Rule 605;
2. Periodic disclosures that are included under Part IV of ATS-N; and
3. Monthly disclosures included under enhanced FINRA ATS data collection.

Leveraging Rule 605 makes sense inasmuch as it already provides a mechanism for monthly quantitative disclosures. The periodic disclosures under Part IV would already be mandated, and therefore add little additional burden on ATSs. Finally, the FINRA ATS data collection is now occurring with minimal effort on the part of ATSs. We believe that our quantitative disclosure regime would represent little additional effort on the part of ATSs to implement, other than the initial development of metrics that many are already tracking.

### **Rule 605**

Rule 605 is a lynchpin of the current disclosure regime. However, it suffers from fundamental flaws in having not been updated as technology has revolutionized equity market trading. The primary deficiencies are:

1. Low coverage of trading activity due to proliferation of new order types, especially Pegged order types, which are most commonly used on ATSs.
2. No coverage of order sizes over 10,000 shares, which again are most commonly used on ATSs.
3. Metrics that provide little useful information, such as execution time (where the majority of venues show 0-9 seconds for most executions).
4. Data that may not reflect the reality of execution dynamics on the ATS - if an ATS uses direct feeds, there is still a Rule 605 requirement to base execution quality disclosures on the SIP.
5. Specifically regarding ATSs, many ATSs include their Rule 605 disclosures in their broker/dealer parent filing, which muddles the information of the routing broker and ATS.

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<sup>90</sup> Proposal at 81084.

As such, Healthy Markets has in the past proposed updates that address all of these issues. We have reviewed our past proposals and updated them, and are including these proposals as **Exhibit 2**. The primary benefits of these enhancements to Rule 605 would be to ensure:

1. Complete coverage of all order types.
2. Complete coverage of all order sizes, including odd-lot and block orders.
3. Utilization of modern metrics, including execution time, realized spread, quoted spread and new metrics for limit orders.
4. A clearer picture of an ATS's trading as distinct from the trading of its affiliated broker-dealer.

We further support other efforts to improve Rule 605, and encourage the Commission to include changes to Rule 605 as part of their ATS transparency efforts.

### **Additional Part IV Disclosures and FINRA ATS Data Collection**

As previously stated, participants are able to make detailed liquidity and order flow profiles of public Exchanges due to the availability of public market data. The same is not true for ATSs. Further, despite the availability of Rule 605 data, participants (and the Commission) have been unable to recognize behavior that would later become the subject of enforcement proceedings. As such, while we commend the Commission on its attempts to modernize disclosure, we believe that **additional quantitative disclosures are required for participants to uphold their best execution responsibilities**.

We have attempted to identify a comprehensive list of important metrics that, in our experience, are often relied upon when making venue interaction decisions and to satisfying best execution responsibilities. We expect that many of these metrics could be calculated by FINRA given the data they are currently collecting. Others could be calculated by FINRA if they were to collect some additional information, or they could be disclosed on a regular basis via FINRA's current ATS disclosure site, or via periodic Part IV disclosures.

We have included a set of ATS-specific metrics in **Exhibit 3** below, which focuses on the following quantitative disclosure categories:

- **Order and Trading Descriptive Statistics:** These statistics would provide detailed information on incoming order sizes and the resulting trade sizes. Further disclosures would provide more detail on price improvement (a principle feature of ATSs) and principal trading (one of the areas of most concern for abuse). Nearly all of this data could be generated with current FINRA data collection.
- **Subscriber Characteristics:** Most ATSs segment their participants and allow them to opt-out of interacting with other segments or categories. Looking to industry best practices allows us to adopt current disclosure practices and mandate them across ATSs to provide a far more detailed look into the trading characteristics of subscriber segments, and would allow participants to uphold their best execution responsibilities

when making decisions over interacting with venues and specific participant segments on those venues.

- **ATS Relationships and Trading Statistics:** As the Commission has made clear throughout the Proposal, the conflict-of-interest when an ATS operator trades in its own pool, or has arrangements with other market centers and participants, is one of the most important aspects of the new disclosure regime. The SEC has an opportunity to not only ensure such relationships are disclosed, but to quantify the importance of those relationships and the associated trading activity.

These regular disclosures will provide participants a wealth of needed information as to the characteristics of order flow and trading activity, the nature of various subscribers on the ATS, and they will quantify the extent of the conflicts-of-interest faced by the ATS.

We urge the Commission to adopt these specific disclosures, and have worked with several ATSs to ensure that such a regime would not be overly burdensome. We are concerned that in the absence of specific disclosures, a fragmented regime will emerge in which it becomes difficult, if not impossible, to make reasoned comparisons across venues and across time. If this were to occur, participants will have more difficulty satisfying their best execution responsibilities, as the Commission indicates it is concerned about.

### **Protecting Confidential Information**

Lastly, the SEC appears to be closing a loophole that affects all ATSs. Rule 301(b)(10) currently requires “every ATS to have in place safeguards and procedures to protect subscribers’ confidential trading information and to separate ATS functions from other broker-dealer functions, including proprietary and customer trading.”<sup>91</sup> However, nothing requires those safeguards and procedures to be written.<sup>92</sup>

We agree with the proposed amendment to Rule 301(b)(10) to require all ATSs (not just NMS Stock ATSs) to have these safeguards and procedures in writing. As a matter of practice, while significant ATSs have largely reduced their practices to writings, those writings likely occur in multiple formats and in different forms (such as in the broker-dealer’s written supervisory procedures). The proposed reforms would aid investors, other market participants, and regulators by consolidating these safeguards and procedures in one place for easy review and evaluation. Further, the process of consolidating these safeguards and procedures may facilitate ATS operators’ identification of gaps or opportunities for improvement of these measures.

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<sup>91</sup> Proposal at 81086.

<sup>92</sup> Proposal at 81086.

## Conclusion

Healthy Markets thanks the Commission for considering our recommendations to bolster the effectiveness of this new rule proposal. Should you have any questions or wish to discuss our recommendations in further detail, please do not hesitate to contact us.

Respectfully Submitted,



Dave Lauer  
Chairman  
Healthy Markets Association

Cc: Hon. Mary Jo White, Chair  
Hon. Michael Piwowar, Commissioner  
Hon. Kara Stein, Commissioner  
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