August 9, 2017

Hon. Steven T. Mnuchin, Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Recommendations to the Treasury Department regarding the Report to the President from the Treasury Secretary called for by Executive Order 13772

Dear Secretary Mnuchin:

Thank you for conducting this important review of our capital markets, and for seeking input from the Healthy Markets Association. We understand that as part of your review, you plan to evaluate the current financial regulatory system and its effects across capital markets, including:

- Capital formation by businesses large and small;
- Market structure and liquidity, including the effects of technology and regulation on equity, fixed income, repo, and securitization markets;
- Derivatives markets and Title VII of Dodd Frank;
- Central clearing and risk management;
- The current regulatory structure, including the SEC, CFTC, and self-regulatory organizations; and
- International processes and standard setting bodies.

While many members of Healthy Markets may have distinct views on each of the six bullets above, we will confine our remarks to three distinct areas:

1. Existing concerns and opportunities for improvement in US equities trading;
2. Initial offerings and investors' needs in a healthy capital formation process; and
3. Existing concerns and opportunities for improvement in fixed income trading.

As you begin your work, we want to impress upon you our view that the US capital markets generally work well for most investors, and we urge you to be cautious in any proposals that may jeopardize the our standing as the premier market center for the world. However, over the past several years, high profile market disruptions and events, as well as troubling enforcement cases and press reports, have exposed cracks in the foundation of our capital formation processes and our market structure for all of our capital markets.

A handful of updates and enhancements -- many of which are already under consideration by the regulators -- could significantly improve market transparency, while also reducing risks and costs for investors. Importantly, many of these enhancements are market-based solutions that simply empower market participants with the information they need to make better, more informed decisions.

About Healthy Markets

The Healthy Markets Association is an investor-focused, not-for-profit coalition working to educate market participants and promote data-driven reforms to market structure challenges.[1] 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.

Since our launch in September 2015, we have become a leading voice for investors in the capital markets. We have:

- Drafted dozens of unique reports and analyses regarding market structure and regulatory developments, including our industry-leading monthly publication, "Market Structure Insights";
- Created two industry-leading "due diligence" questionnaires to assist investors and brokers in evaluating order routing practices and ATS risks; and
- Offered significant input to Congress, the Securities and Exchange Commission, and the SEC's Equity Market Structure Advisory Committee through dozens of meetings, hearing statements, and comment letters.

We appreciate your focus on ensuring that the US capital markets remain the most robust, vibrant, and efficient in the world.

Equity Market Structure

The US equity markets are more fragmented and complex than ever before. In many ways, they are also more efficient. However, dozens of high profile market disruptions and troubling enforcement cases over the past decade have made it clear that regulators and policymakers must be diligent in their efforts to promote the stability and integrity of the markets.

[1] Launched in 2015 by five leading buyside firms, Healthy Markets has since expanded to include eighteen buyside and working group members and partners. For more information about our membership, please see our website, healthymarkets.org. Prior to joining Healthy Markets as its first Executive Director, I served as Senior Counsel in the United States Senate, as well as Counsel to SEC Commissioner Kara M. Stein. Prior to my government service, I practiced law in the field of securities regulation at leading law firms in New York City and Washington, DC.

Most market participants recognize the needs for some basic reforms. There is even significant consensus amongst many diverse market participants regarding the substance of most of the needed improvements. We urge you to capitalize on those areas, and press Congress and regulators to implement several critical enhancements.

In particular, we believe that improving the equity markets must restore focus on enhancing transparency and reducing conflicts of interests facing market participants. These efforts should include:

1. Finalizing enhancements to disclosures of order routing by brokers;
2. Significantly reducing or eliminating incentives that distort order routing behavior and pose conflicts of interest, including rebates and access fees;
3. Finalizing enhancements to disclosures by execution venues, and particularly Alternative Trading Systems (ATSs);
4. Reducing the use of, and significantly reforming, NMS Plan structures; and
5. Offering clarity on reconciling disparate provisions between the US and Europe's MiFID II regime.

We also note that Congress and the SEC are currently being urged by some market participants and their advocates to eliminate certain provisions from Regulation NMS or reducing the number of securities covered by Reg NMS. In this regard, we urge caution. While we agree that some provisions within Reg NMS (such as the Order Protection Rule) may lead to perverse and sub-optimal outcomes (particularly for orders of significant size, without a tailored block exemption), we also note that these protections serve an important purpose for both "retail" and institutional investors. The Order Protection Rule is one of the only explicit protections that investors have to force their brokers to demonstrate best execution. Put simply, it is the best execution backstop.

If the protections of Reg NMS are reduced or eliminated, investors first need to have adequate safeguards in place to ensure that: (1) brokers are still fulfilling their duties of best execution, (2) investors have the ability to verify that their brokers have fulfilled their legal obligation, and (3) investors have the ability to change their behavior in response to what they learn. Eliminating the Order Protection Rule and the prohibition on locked and crossed markets prior to adopting reforms to Rules 605, 606, and 610 would likely result in significant harm to investors. And even with enhanced disclosures, elimination of the Order Protection Rule without other reforms will likely shift significant burdens (and costs) onto buyside firms to ensure that they are receiving even reasonable quality executions.

Adopt Reforms to Order Routing Disclosures

Order routing disclosure obligations are well overdue. It's been 17 years since the SEC's order routing rules were first adopted, and nearly every element of them is no longer relevant. Trading isn't measured in seconds or minutes anymore; it's measured in microseconds.

At the same time, numerous regulatory enforcement actions and press reports have made it clear that some brokers' order routing practices have been disadvantaging their customers. Although specifics may differ between so-called "retail" and institutional investors, the overarching concern is the same:[2] investors' orders are often routed in ways that may be worse for investors, but better for their brokers. In most cases, the investors will never know that their brokers' self-interested desire to avoid a fee, collect a payment, or hit a pricing tier at a venue resulted in a worse execution.[3] This lack of transparency results in increased risks and costs for investors, while also undermining the trust investors have in their service providers and the markets overall.

Many institutional investors have invested years of effort and millions of dollars engaging in "self help." They have created or used significant "due diligence" questionnaires. In fact, our Members have directed us to help them identify and address concerns with brokers' order routing practices. The Healthy Markets Order Routing Transparency Initiative is a multi-pronged effort to do just that. These efforts have included:

- Development and publication of the Healthy Markets Order Routing Questionnaire to help investors make more informed broker selection decisions;
- Development of Order Routing Disclosure best practices and working with individual firms to improve disclosure practices;
- Development and publication of unique reports related to key issues impacting broker order routing practices; and
- Offering suggestions to regulators and the public, including through regulatory comment letters.

[2] Healthy Markets generally objects to the characterization of "retail" investors as those who trade primarily through individual, often online brokers. As numerous studies have demonstrated, these individuals often have significantly greater wealth and financial resources than those who invest predominantly through institutional investment advisers. Thus, if policymakers and regulators are truly seeking to protect "mom and pop retail," it will ensure that its regulatory regime appropriately informs and empowers institutional investment advisers, like those who are members of Healthy Markets, who manage the bulk of savings and retirement assets.

[3] Often, the data that would be required to accurately measure the quality of the execution is simply unavailable to the investors. Further, even in the rare instances that reasonable information may be available, investors (particularly those trading through online, discount brokers) may be unable to bring the comprehensive financial and personnel resources to bear that would be necessary to make sense of it. Worse, even if those two conditions are met, there is often limited recourse for an investor.

The Healthy Markets Order Routing Questionnaire, which was released in January 2017, is particularly informative.[4] This Questionnaire is a comprehensive list of more than 200 questions that can help investors better understand the practices and operations of their brokers. Again, none of this information is currently specifically required to be disclosed, yet much of it may be covered by reforms to Rule 606.

In addition to increasingly using questionnaires, institutional investors have developed extremely sophisticated trading strategies and analytical tools. Unfortunately, the efficacy of their efforts is nearly entirely dependent upon the voluntary cooperation of their service providers. As you might imagine, larger investors (with more order flow to leverage) are often able to enjoy more cooperation from their service providers. Even then, information provided is often incomplete and difficult to compare across different firms.

Last year, the Commission proposed reforming order handling disclosures, which would level the playing field for investors and shed significant light on many current practices.[5] This is an important effort, and Healthy Markets has offered extensive commentary on both the need for these reforms and potential further enhancements.[6]

Reduce Distortive Incentives, or at a Minimum, Adopt an Access Fee Pilot

As execution venues have proliferated, so have the various avenues for competition amongst them. Most notably, many execution venues have sought to compete on price, such as by offering rebates and different pricing tiers for customers. With different combinations, each venue may have dozens of different prices that could apply to different customers--none of which is readily apparent. At the same time, these incentives for trading typically accrue to the brokers--not the underlying investors on whose behalf the order is being placed.

As we have said before, this creates a

> fundamental conflict of interest for brokers looking to route their
> customers' orders. At its worst, a broker is incentivized to route an

[4] The Healthy Markets Order Routing questionnaire is freely available to the public at: https://healthymarkets.org/order-routing-questionnaire.

[5] *Disclosure of Order Handling Information*, Securities and Exchange Commission, 81 Fed. Reg. 49432 (July 27, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-07-27/pdf/2016-16967.pdf.

[6] See, e.g., Statement of Healthy Markets Association Director Chris Nagy before the SEC Equity Market Structure Advisory Committee, Aug. 2, 2016, *available at* https://www.sec.gov/comments/265-29/26529-80.pdf; Letter from Healthy Markets Association to SEC, Sept. 26, 2016, *available at* https://www.sec.gov/comments/s7-14-16/s71416-19.pdf; and Letter from Healthy Markets Association to SEC, Jan. 6, 2017, *available at* https://www.sec.gov/comments/s7-14-16/s71416-1464340-130322.pdf.

> order to the venue that pays it the most (or costs the least), instead of the venue that that has the highest likelihood of execution fostering best execution for its customers.[7]

We are pleased at the growing consensus of market participants that have joined our longstanding calls for the elimination or significant reduction of rebates and other distortive incentives.[8] In large part because we believed the SEC was unlikely to aggressively limit these conflicts of interest, we and others have, for years, argued for the SEC to implement a pilot program to study the impact of this conflict of interest on investors.

Healthy Markets and the SEC's Equity Market Structure Advisory Committee have detailed proposals to implement such a study. While we might prefer Congress to direct the Commission to take more aggressive action, the SEC should, at a minimum, adopt a comprehensive pilot study without delay.[9] In addition to the thoughtful recommendations of the EMSAC, we would also urge you to consider recommending that the SEC (1) directly propose the pilot program, and not use the NMS Plan process; (2) simplify the study as much as possible, while also including all relevant exchanges and off-exchange venues; and (3) offer the Canadian regulators an opportunity to coordinate a similar effort.[10]

Reducing the myriad conflicts of interest facing brokers should be a key objective towards promoting more fair and efficient capital markets.

Adopt Reforms to Regulation ATS

Amidst a slew of regulatory enforcement actions against ATS operators, in November 2015, the SEC proposed significantly expanding and improving the disclosures required of ATSs that trade NMS stocks (NMS Stock ATSs).[11]

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[7] Letter from Healthy Markets Association to SEC, Dec. 23, 2016, *available at* https://www.sec.gov/comments/265-29/26529-1441899-130023.pdf (citing, *inter alia*, *Conflicts of Interest, Investor Loss of Confidence, and High Speed Trading in U.S. Stock Markets*, Hearing before the Permanent Subcommittee on Investigations, Committee on Homeland Security and Government Affairs, June 17, 2014, *video available at:* http://www.hsgac.senate.gov/subcommittees/investigations/hearings/conflicts-of-interest-investor-loss-of-confidence-and-high-speed-trading-in-us-stock-markets).

[8] See, e.g., Letter from SIFMA to SEC, Mar. 29, 2017.

[9] A simpler approach might be to run a pilot eliminating rebates.

[10] See Letter from Healthy Markets Association to SEC, Dec. 23, 2016, *available at* https://www.sec.gov/comments/265-29/26529-1441899-130023.pdf.

[11] Regulation of NMS Stock Alternative Trading Systems, 80 Fed. Reg. 80998 (Dec. 28, 2015) (the "Proposal").

Investors and brokers now know that many of the oldest, largest, and most well-respected execution venues have broken the law.[12] Some of these infractions have been relatively minor, while others have consisted of the ATS operator deceptively acting as the very type of predatory trader that it was publicly arguing it was protecting its customers against.

Unfortunately, as the SEC recognized in its proposed reforms to Reg ATS, the current regulatory regime is woefully inadequate to empower investors and brokers with the information they need to reasonably protect themselves.

In fact, to help fill this void, the Healthy Markets Association's members have directed us to engage in our ATS Transparency Initiative, which is a multi-pronged effort to enhance ATS disclosure practices. Our work on this initiative has included:

- Development and publication of the 2017 Healthy Markets ATS Questionnaire to help investors and routing brokers make more informed venue selection decisions;
- Creation and distribution of the ATS Transparency Index™, which provides a unique system to help inform market participants of ATSs' transparency and disclosure practices;
- Creation and distribution of the 2016 ATS Risk Assessment, which provides comprehensive comparisons and analyses of 18 leading ATSs, on issues ranging from conflicts of interest to technology risks (which we are in the process of repeating in 2017);
- Development of ATS disclosure best practices and working with individual ATSs to improve disclosure practices;
- Development and publication of unique reports related to key issues impacting ATSs, including the Dark Side of the Pools: What Investors Should Learn from Regulators' Actions; and
- Offering suggestions to regulators and the public regarding the regulation of ATSs, including through regulatory comment letters.

The Healthy Markets ATS Questionnaire, which we first publicly released in September 2015 and have revised and re-released in July 2017, is particularly noteworthy.[13] That ATS Questionnaire arms investors and brokers with dozens of questions to ask their ATSs on issues ranging from technology to conflicts of interest to quantitative measurements of executions. Importantly, almost none of this information is currently explicitly required by Regulation ATS. Equally important, much of this information has been included in the Commission's proposed reforms to Regulation ATS.

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[12] To date, regulators have settled cases against the operators of many of the leading equity ATSs, including Barclays, Convergex, Credit Suisse, Deutsche Bank, eBX (LeveL ATS), Goldman Sachs, ITG, Liquidnet, Pipeline, and UBS.

[13] The 2017 Healthy Markets ATS Questionnaire is freely available to the public at: https://www.healthymarkets.org/ats-questionnaire.

Nevertheless, as we articulated in our February 2016 comment letter,[14] we encourage you to recommend that the SEC:

- Consider expanding and enhancing disclosures by ATSs beyond those that trade just NMS stocks, as well as other venues (or firms) that consistently demonstrate significant execution volumes on FINRA's OTC reports;
- 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.

We hope you will urge the SEC to adopt revised ATS reporting obligations on a bipartisan basis without delay.

Significantly Reduce the Use of NMS Plan Process and Reform NMS Plan Governance

We agree with the growing chorus of market participants and experts arguing that NMS Plan usage and governance deserves significant reforms, including through the direct inclusion of other market participants.

However, we believe that the NMS Plan process is deeply conflicted and outdated. Since it was first adopted, the self-regulatory organizations (SROs) have both proliferated in number and become for-profit entities. Conceptually, we are concerned any time the regulatory apparatus is outsourced to market participants whose financial interests may be in conflict with their regulatory responsibilities.

This concern is not just theoretical. The recent history with NMS Plans, particularly regarding the design and implementation of the Consolidated Audit Trail and the Tick Size Pilot, have been disappointing at best. Administratively, these plans are burdened with an incredible amount of process and frequent delays. Substantively, these plans also have tended to show a distinct bias towards the market participants involved in their creation and adoption (the SROs). For example, we find it puzzling how little of the costs of the CAT will be borne by the actual exchanges, and how much will be borne by the broker-dealer community.

[14] Letter from Healthy Markets Association to SEC, Feb. 26, 2016, *available at* https://www.sec.gov/comments/s7-23-15/s72315-18.pdf.

Simply broadening participation to include more for-profit market participants (such as broker-dealers and investment advisers) may reduce concerns with the balance of the substantive results of NMS Plans, but may also lead to regulatory stagnation and generate even more conflicts of interest. It will almost assuredly not speed up or ease the administration of these plans, and will likely have the opposite effect.

We urge you to recommend that Congress revisit the law creating this deeply flawed process. At the same time, we recommend that you urge the SEC to reduce its outsourcing of its governmental responsibilities, and use the NMS Plan process infrequently. This would allow the SEC to avoid issues created merely by the conflicts of interest that plague the NMS Plans. In that vein, we were encouraged by then-Acting Chairman Piwowar's recent remarks that an Access Fee Pilot would be done as an SEC rule, and not as an NMS Plan.

Further, to the extent that the NMS Plan process is still utilized, we encourage you to recommend that the SEC: (1) significantly modify the governance to include significant voting representation of other non SRO market participants, (2) increase transparency of market data costs, and (3) adopt measures to prevent deadlocks and undue delays. Without these measures, we fear that NMS Plans will continue to be examples of self-regulation at its worst: self-interested, conflicted, and slow.

Offer Clarity on Reconciliation of US and EU Obligations for Best Execution and Research Payments

In the US, investment advisers are statutorily permitted to pay for research using commission dollars, if certain criteria are met. For many asset managers, particularly small and mid-sized, active managers, this is a critical element to their ongoing business. At the same time, several very large US firms have sought—for more than a decade—to unbundle research and execution costs, and have been largely unsuccessful.

Some brokers who provide research have refused to accept cash payments for their research, while others have accepted cash payments or commission dollars.

Now, MiFID II in Europe, which becomes effective in January 2018, is pushing firms to use Research Payment Accounts or pay directly in hard dollars. This move is driving many firms to develop costly compliance regimes for research provision and payment, but also appears to be inconsistent with Section 28(e). Further, many investment advisers with US and European customers are being pressured to develop consistent policies and practices.

There are a number of thorny issues that could use regulatory input. For broker-dealers, just an acknowledgement that a cash payment may be permissible in some circumstances (i.e., broadening the no-action relief currently provided to some brokers) would resolve significant regulatory uncertainty. For investment advisers, guidance on trade and research allocations could be appropriate. For example, if a portfolio manager generates an order for one million shares of stock, and that order is to be allocated to two different funds, one subject to US rules while the other is subject to EU unbundling rules, how should the adviser allocate the trades, commission costs, and research costs? While splitting the clients into two groups may seem an easy and logical solution, in practicality this may present some challenges, as more often than not client orders are combined into blocks for purposes of seeking best execution and operational efficiency.

We urge you to recommend the SEC issue new guidance for investment advisers that may re-affirm the principles of Section 28(e), as well as provide clarity on compliance with the inconsistent regulatory regimes facing US firms (perhaps structured as a safe harbor).

Don't Leave Investors Without Order Protection

Regulation NMS is designed to protect investors through a combination of disclosures, obligations, and prohibitions. The collective ruleset is intended to ensure that investors receive best execution, and the rules are designed to work together. The Order Protection Rule is a critical element of that ruleset. For example, as we explained to the EMSAC in May 2015:

> Rule 611 sought to provide strong intermarket price protections and offer greater assurance on an order-by-order basis. Rules 605 and 606 were intended to supplement Rule 611 by providing transparency into execution quality and broker order routing, thereby empowering investors to make informed decisions based on quantitative metrics.[15]

The objective of Rule 611 is very clear: ensure investors get the best available prices. In fact, Rule 611 is one of the few protections that investors have in place which serves as a backstop on an order-by-order basis to ensure that they are receiving the best price in the market.[16]

Some market participants and their advocates are now asserting that Rule 611 should be eliminated. However, to support this argument, they have offered no specific evidence that Rule 611 has proven harmful on any grand scale, nor have we seen any specific evidence to support the assertion that it is the root cause of increased fragmentation and complexity in US markets. That said, we recognize that Rule 611, as it currently exists within the rest of Reg NMS, has several flaws and detractors.

Some have argued that Rule 611 may:

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[15] Statement of Healthy Markets Association Chairman Dave Lauer before the SEC Equity Market Structure Advisory Committee, May 11, 2015, *available at* https://www.sec.gov/comments/265-29/26529-15.pdf.

[16] Id.

- Subsidize non-viable exchanges;
- Increase connectivity costs to the industry;[17]
- Create unnecessary complexity and intermediation, including the promotion of complex order types; and
- Maintain a one-size-fits-all market that has not served small- and mid-cap companies well.

We urge you to consider several refinements to Regulation NMS in addition to those identified above, including:

- Modernizing brokers' best execution obligations, including more quantitative analysis and more rigorous review of executions;
- Re-examining order handling and routing by exchanges generally, including a reexamination of complex order types; and
- Boldly exploring ideas to reduce distortive incentives, including rebates, access fees and the consolidation of multiple exchange subsidiaries.

If the Commission elects to adopt changes to Rule 611, we might consider shifting the responsibility of order protection on an order-by-order basis in Rule 611 from the exchanges back to the brokers and expanding its scope to provide protection to the displayed "depth-of-book."[18]

Rule 611 serves as an imperfect backstop to a broker's best execution obligation, by ensuring that an investor should not generally receive an execution outside the prevailing market. If the backstop is removed or weakened without the implementation of new protections, investors will be more at risk to their brokers' conflicts of interest. Brokers will remain incentivized to route orders for reasons other than best execution, but will have even less of a standard against which to measure their own obligations. Investors will remain largely unable to identify and police abuses. Put simply, removing Rule 611 now will harm investors.

This is not a theoretical concern; as data suggests, brokers are already making order routing decisions based on their own bottom lines, and not necessarily the execution quality received for their customers.[19] Currently, these practices are bound by Rule 611 to result in executions that

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[17] We note that these costs may also be up because of market venues' decisions to repeatedly increase their various data fees, which are rarely scrutinized or rejected, and the proliferation of venues.
[18] In its 2010 concept release, the Commission sought input on various provisions to promote displayed liquidity, such as expanding depth-of-book protections under Rule 611.
[19] For example, IEX currently occupies about 2% market share, despite consistently showing the lowest effective spread in the most symbols, as measured to the millisecond. For information on execution quality, please see "Execution Quality", BATS, *available at* http://www.bats.com/us/equities/market_statistics/execution_quality/ (last viewed Aug. 2, 2017). Similarly, TD Ameritrade has stated that it has consistently routed orders to the venues that pay it the most. Scott Patterson, *TD Ameritrade Executive Says Orders Go to Venues That Pay Highest Fees*, Wall St. Journal, June 17, 2014, *available at*

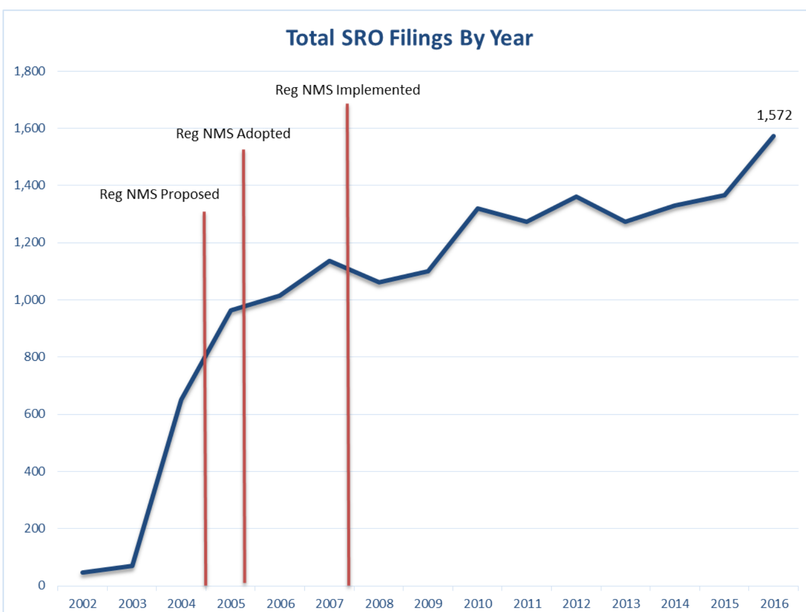
are within the market prices. This acts as a practical limit to the number of trade-throughs which is what the Commission originally sought to reduce through the adoption of the rule. It caps the amount of losses an investor could suffer from a conflicted broker. If Rule 611 is removed or weakened, then those losses would not be easily identified and limited.

We urge Congress and the SEC to consider all of these issues and rules collectively, as modifications to one rule (such as the Order Protection Rule) could have significant ramifications on other key trading rules (such as best execution). In general, we support reducing conflicts of interest and distortionary incentives, while increasing transparency.

Stop the Insanity with Exchange Filings, Fees, and Market Data Costs

The process used by exchanges to set fees is also in need of reform to increase transparency and reduce conflicts of interest. Exchanges looking to change their rules or take other actions need to file their changes with the SEC. Unfortunately, this reasonable approach to increase transparency has led to an ever-rising flood of SRO rule filings.

The explosion of SRO filings over the last decade is best demonstrated in the following chart. Following the adoption of Regulation NMS, filings have increased at a steady pace each year, setting up 2017 to outpace 2016's number.



https://www.wsj.com/articles/td-ameritrade-executive-says-orders-go-to-venues-that-pay-highest-fees-1403043559 (quoting TD Ameritrade testifying before Congress).

Market participants simply cannot keep up with them. Unfortunately, given the incredible volume, we also suspect that the SEC staff can't either. While some of these filings are relatively straightforward, with easy-to-see implications, many are not. Many filings, such as filings related to order types and fees, may appear simple on their face, but may have extremely complex implications and impacts on not just the filing venues but on other market participants as well. Unfortunately, given the sheer volume and the abridged time horizon within which the SEC is expected to respond, we suspect that many of these complexities are never explored.

By default, nearly all filings are approved. Most receive no comments.[20] Market participants (and, we suspect, the SEC staff) are simply overwhelmed.

As a result, two areas that have come to be key points of competition between the exchanges have led to a proliferation of complexities and expenses for market participants: order types and fees. The discussions regarding the proliferation of order types at market venues have gone on for years, spurred in part by SEC investigations and high-profile enforcement actions against market venues for creating predatory order types. Importantly, while the operators of many execution venues have professed a desire to eliminate some of this complexity, the order type complexity still abounds. This is further complicated by the interactions between different market venues. Unfortunately, this complexity makes it both likely for nefarious order types to exist, and also difficult for market participants or regulators to identify and stop manipulative or disruptive behavior.

Perhaps one of the greatest concerns for many market participants these days is the proliferation of market data and other fees. It's no secret that execution venues compete on price. As part of that ongoing competition, exchanges have developed complex tiered pricing regimes and market data fee structures. Collectively, these fee structures dramatically impact where orders are routed, and how much market participants pay.

On the other hand, one area that is not necessarily prone to competition is market data. And here's why: each exchange is a mini-monopoly. We believe the record on this point has been well-established by SIFMA and the NetCoalition in their ongoing dispute with the Commission.

Every routing broker and market maker, to be competitive, must have timely access to the broad spectrum of available information, including depth-of-book information from every major execution venue. In other words, no matter what the cost is, an institutional broker cannot simply "opt out" of paying the "voluntary" fee for more information faster, or his business will simply evaporate. He would be unable to provide adequate service to his customers, and would likely consistently provide lower-quality executions. He may even be violating his duty for best execution.

[20] Less than 2% of the 1572 filings we reviewed in 2016 received comments.

Exchanges are unquestionably aware of their unilateral monopoly pricing power over data fees. For example, NYSE has expanded its assertion of data control and fees in several different ways in recent years.[21] There are almost never any details explaining or justifying any fee increases.[22]

At the same time, the SEC is tasked with ensuring the fees are "reasonable." While individual increases may not appear to be so egregious as to be facially unreasonable, collectively, the exchanges seem to have clearly crossed the blurry line. The Commission has allowed the exchanges to raise fees significantly and repeatedly, and other market participants, including both brokers and investors, are being pressed by regulations to pay them.

Market data fees are little more than government mandated and government sanctioned monopolies for the now "for profit" exchanges. Market data fees are taxes on all market participants that the government has obligated market participants to pay and have remained unchanged since the adoption of the Securities Act Amendments of 1975. Meanwhile, exchanges have morphed from mutual entities to for-profit publicly traded companies. We urge Congress and the SEC to step in. The SEC must accept its role in approving the amount of these taxes and the frequency with which the rates change.

We urge the SEC to rapidly adopt a clear, public framework for evaluating any fee change proposals, particularly the "reasonableness" mandate of any fee increase, and if it fails to do so, for Congress to step in. Congress and the SEC should directly address the role regulations have played in creating the opportunity for exchanges to extract these significant monopolistic rents from market participants.

Initial Offerings and Investors' Needs in a Healthy Capital Formation Process

We strongly support efforts to grow and improve the US public markets.

For decades, corporate issuers, lawmakers, regulators, market participants, and others have struggled with finding the appropriate regulatory balance to ensure that (1) companies are able to raise the capital they need to survive and grow, and (2) investors are able to have a fair understanding of the reasonable risks and returns of the securities they buy.

For most of this period, the concerns have largely focused on the burdens facing corporate issuers of securities, particularly in the public markets. These arguments were well-articulated long before the Enron and Worldcom accounting scandals gave rise to the adoption of Sarbanes-Oxley

[21] In April of 2017, NYSE introduced a revised Master User Agreement that implies that NYSE owns the data that brokers submit to it when they buy and sell stocks.

[22] For example, in May 2017 Nasdaq filed (Release No. 34-80808; File No. SR-GEMX-2017-20)to begin charging $1,250 per month, per computer port, for a specialized quote feed. In its filing, Nasdaq merely cites that it is in accordance with Section 6(b)(8) of the Exchange Act.

Act. In fact, both before and after the passage of SOX, these arguments gave rise to an array of largely disconnected, discrete exemptions from the registration and trading restrictions of the federal securities laws, including the creation of Rule 506 and Rule 144A. In recent years, these same issues have given rise to new proposals, such as those adopted by the JOBS Act of 2012. They have also led to the dramatic curtailment of securities litigation, embodied by the Private Securities Litigation Reform Act.

Nevertheless, despite all of these efforts, the relative number and overall quality of public offerings has deteriorated. Predictably, the number, volume, and quality of private offerings has exploded, from once just a fraction of the overall markets to now more than 60%.

Today, the public markets are no longer the primary way for companies to get the capital they need to survive and grow. Instead, companies and their executives are increasingly turning to the private markets for equity and debt offerings. Thus, the shouldn't necessarily be about whether it's "easy" for companies to raise capital, but rather why most of the new capital being raised isn't done in the public markets. There's good reason to focus on restoring the dominance of the public markets.

When compared to private securities, public securities typically offer a number of significant advantages, including:

- Public securities often are accompanied by more robust accounting and business disclosure practices.
- Information about public companies, including third party research, are much more readily available and fairly distributed (as required by SEC rules).
- Public securities are far more easily and reliably valued.
- Liquidity risks and trading costs for public securities are often significantly lower than for similarly-situated private securities.
- Public securities are much more easily benchmarked, such as against the S&P 500.

We believe that just focusing on the absolute costs or burdens of public offerings isn't going to solve the puzzle. Rather, policymakers should evaluate the comparative cost of capital of public offerings versus various forms of private offerings, not just in the US, but also abroad. At the same time, policymakers also need to focus on the impacts of these various alternatives on investors--the providers of the essential capital.[23]

When viewed in this light, it's clear that simply removing information or rights for shareholders in US public equities will likely not meaningfully increase the number of public companies. To the contrast, it will likely have a modestly negative impact.

[23] For example, one recent study tied the rise of private offerings to the easing of rules designed to increase their usage. Elisabeth de Fontnay, The Deregulation of Private Capital and the Decline of the Public Company, 68 *Hastings Law Journal* 445-502 (2017), *available at* http://scholarship.law.duke.edu/faculty_scholarship/3741/.

Put simply, if a company can raise an unlimited sum from a practically unlimited number of investors using a Facebook advertisement or Super Bowl halftime commercial, all while not incurring basic accounting or corporate administrative costs, they will likely do so. This will be even more likely if traditional restrictions on trading of these "private" securities are loosened or repealed.

As a result, we're increasingly seeing a few trends in our capital markets:

(1) Our public markets are increasingly concentrated on a decreasing number of corporate issuers;
(2) Many high quality companies are staying private for very long into their corporate life-cycle, denying most mutual fund investors and pension funds the opportunities to invest without incurring significant (and often unprecedented) levels of risk and costs;
(3) Companies that utilize the markets are typically bifurcated between (1) blank check companies and operational companies of dubious financial prospects[24] and (2) very large, established, multinational companies that may choose to list in the US market for a number of unique reasons, including that US regulators allow for greater shareholder disenfranchisement than other major market centers; and
(4) A significant portion of IPOs are simply exits for early investors and executives, and not traditional "capital raises" for companies to survive and grow their businesses.

Each of these trends comes with significant costs and risks for investors. Unfortunately, some corporate issuers and their allies have offered suggestions to make things worse. These ideas include:

(1) restricting information provided to investors (e.g., by repealing disclosures);
(2) Increasing the riskiness of a company's financials (e.g., by repealing Section 404(b) of SOX);
(3) Increasing the valuation risks of a company (e.g., by eliminating accounting and risk disclosures);
(4) Increasing the costs of trading the securities (e.g., by eliminating the application of Reg NMS to smaller companies' stocks); and
(5) Decreasing corporate accountability to shareholders (e.g., by restricting the proxy access or shareholders' rights to litigation).

Importantly, not a single applicable study or any credible evidence exists to support how any of these changes individually or collectively would increase the number or dollars raised by IPOs. Nor would such a result reasonably follow. After all, the purported "beneficiary" of each of these proposals would be a potential corporate issuer. But none of these factors is likely to overcome the already extremely low cost of selling private corporate debt or equity.

[24] For example, a significant percentage of companies going public in recent years have been revenue negative or have disclosed notable accounting issues.

We are skeptical that expanding private offerings or decreasing investors' information or rights will be effective at spurring additional IPOs or public securities. However, these efforts may negatively impact shareholders--deteriorating the quality of public offerings and the rights afforded shareholders in those offerings. We urge you to go in the opposite direction. We urge you to promote higher quality public markets with greater accountability, reliability, and price transparency. We urge you to reduce investors' risks and costs--so that more of their investment dollars go to the great companies that need the money.

Fixed Income Market Structure

We welcome your interest in potential reforms to fixed income market structure, as well as the new focus of the SEC on these issues. The fixed income markets are, in many ways, decades behind the equities markets in terms of transparency and trading risks and costs. As with the equities markets, we urge you to recommend enhancements to promote integrity and stability of the secondary markets in these securities. In most cases, we believe that these efforts should involve improving disclosures about pricing and conflicts of interest.

Before you begin your efforts, we urge you to separately consider each different set of asset classes within the broad subset of "fixed income." The treasuries market is extremely different than the corporate debt markets, which, in turn, are fundamentally different than the various municipal bond markets. The risks and opportunities for improvement in each of the different asset classes are very different. Below, we individually address treasuries, corporate debt, and muni trading issues.

Following the Treasuries "flash crash" in October 2014, it was abundantly clear that many market regulators were simply unaware of how these securities were traded, or by whom. If the most liquid market in the world could experience an event like this, then stability issues certainly deserved renewed focus.

The Joint Staff Report,[25] as well as the subsequent actions by the SEC and FINRA to assert jurisdiction over treasuries trade reporting[26] and treasuries traders, were extremely welcome. However, we worry that the current reporting regime nevertheless leaves some notable gaps, which should be mitigated. We share the view of key market participants that, "for surveillance to

[25] U.S. Dep't of Treasury, et. al, *Joint Staff Report: The U.S. Treasury Market on October 15, 2014*, July 13, 2015, *available at* https://www.treasury.gov/press-center/press-releases/Documents/Joint_Staff_Report_Treasury_10-15-2015.pdf.

[26] Since just last month, July 10, 2017, FINRA members have been required to report U.S. treasury securities trades to FINRA using the TRACE system. Previously, these securities were exempted from TRACE reporting. *See, e.g.*, FINRA, *Reporting Transactions in US Treasury Securities*, Reg. Notice 16-39, Oct. 2016, *available at* http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-16-39.pdf.

be effective, the underlying data collection should be both comprehensive and immediate with very few exceptions, such as for trades in excess of a specified volume threshold or in less liquid securities."[27] We also worry about market dominance of a handful of trading platforms, without sufficient transparency in operations and operational risks. We also worry about the inability of investors to directly interact with significant sources of liquidity.

Two significant potential enhancements could be to (1) open up BrokerTec to appropriate buyside firms and (2) promote access to clearing on alternative trading venues. Put simply, we encourage you to explore efforts to ensure competition, transparency, and resiliency in trading platforms.

In corporate debt securities, it's important to keep in mind that the market has more than doubled in size in less than a decade. Fueled by an extremely low interest rate environment and relatively tepid counterparty credit risk premiums, corporate issuers have sold unprecedented amounts of new debt and the number of individual securities has exploded. This has created unique challenges for investors seeking to trade both the new and existing debt. Put simply, the secondary trading market has suffered somewhat as many investors have been able to meet their investment needs by acquiring new issues. While this may be good for the overall economy, it may also have a marginally negative impact on liquidity in existing issues.

That said, bid-ask spreads and other data points seem to reflect more liquidity than the macro-economic trends might suggest. In fact, while some have argued that primary dealers have withdrawn from the market as a result of the Dodd-Frank Act and new bank capital rules, those arguments appear to be erroneous, as the inventory levels are on par with those before the rules came into effect (albeit somewhat lower than the 2006 peak). Thus, while we are cognizant in some banks' decreasing inventories of some assets, it does not appear to be dramatically negatively impacting trading costs--yet. This may, of course, change if we exit the current period of extremely low interest rates and volatility.

As the trade sizes in the market have fallen, trading has also become increasingly concentrated amongst a handful of market participants. For example, according to one recent study by Greenwich Associates and the Bond Dealers of America, 90% of investment grade volumes and 92% of high yield volumes are executed by the 10 largest dealers.[28] This incredible degree of concentration increases risks in times of disruptions and potential for abuses. We encourage you to promote competition for non-banks in market making for these securities.

We would encourage you to consider recommending significant enhancements to pre-trade and post-trade price transparency, including more precise time increments for securities reported to TRACE. We also recommend efforts to encourage pooling of securities by issuer or some other method, so that buying and selling interests, currently set on different individual securities, might

[27] Letter from Virtu Financial Inc. to Securities and Exchange Commission, Aug. 15, 2016.
[28] Greenwich Associates and Bond Dealers of America, The Fixed Income Dealer Evolution, Q3 2017, at 3.

be more likely to interact. One promising avenue that may cause minimal negative consequences could be to improve tools for substitution. While some trading venues offer some versions of these services, greater advancements may be possible. This will be critical to effectively automating these markets and driving down trading costs, but they may also be critical to managing any shocks (such as may come with a hike in interest rates).

Importantly, we also note the strong reliance investors in corporate debt securities have on corporate disclosures and operational integrity. To the extent that corporate accounting and disclosure practices are deteriorated (as discussed above), we worry that these may increase valuation and liquidity risks for these securities.

In the so-called "muni markets," the proliferation of state, local, and other governmental authority debt securities leaves investors of all types with significant exposures. As with the other elements of fixed income, we urge you to consider expanding pre-trade (as well as post-trade) price transparency and timeliness of reporting. We also worry that investors and other market participants--particularly given some of the recent events in Detroit, Puerto Rico, and the unfolding events in Illinois and other places--may withdraw from the market based on concerns over valuation and liquidity risks. To address these concerns, we recommend that you urge Congress to empower the SEC with authority to ensure complete, accurate, and timely information about the securities and issuers.

Lastly, we note that the concept of "best execution" has evolved significantly for brokers and for buyside firms alike over recent years. For brokers, FINRA has recently taken great pains to clarify brokers' obligations in fixed income securities (as well as equities and options).[29] However, the processes, data points, and cost analyses for trading in these markets varies significantly. This makes it extremely challenging for brokers to develop consistent, effective frameworks for ensuring they are fulfilling their best execution obligations across asset classes. Worse, for investment advisers and other investment firms, there is no relevant guidance at all regarding what does, and what does not, constitute "best execution." Accordingly, as we have said with respect to equities, *supra* 9-10, regulatory guidance for investment advisers on the contours of their responsibilities for best execution would appreciated.

Conclusion

Amidst growing concerns about the integrity and stability of the U.S. capital markets, market participants, experts, and policymakers have been clamoring to modernize disclosures and the basic ground rules for equities trading for years. If the US capital markets are to remain the best in

[29] FINRA, *Best Execution: Guidance on Best Execution Obligations in Equity, Options and Fixed Income Markets*, Reg. Notice 15-46, Nov. 2015, *available at* https://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-46.pdf.

the world, we urge you to work with investors, other market participants, and regulators to implement some modest, but essential, reforms without delay.

We thank you again for undertaking this important effort and for the opportunity to have our views considered. If you or your staff have any questions or comments, please feel free to contact me at (202) 909-6138.

Sincerely,

Tyler Gellasch
Executive Director

Cc: Hon. W. Jay Clayton, Chairman, Securities and Exchange Commission
Hon. Michael S. Piwowar, Commissioner, Securities and Exchange Commission
Hon. Kara M. Stein, Commissioner, Securities and Exchange Commission