HMA | HEALTHY MARKETS ASSOCIATION
A MEMBER ORGANIZATION

March 31, 2023

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

Ms. Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Regulation Best Execution, File No. S7-32-22;[1]
Disclosure of Order Execution Information, File No. S7-29-22;[2]
Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, File No. S7-30-22;[3] and
Order Competition Rule, File No. S7-31-22[4]

Dear Ms. Countryman:

The Healthy Markets Association[5] appreciates the opportunity to comment on the Commission's four above-referenced proposals related to US securities trading infrastructure, including brokers' obligations when handling customer orders.

While HMA shares the general objectives and intentions of the four Proposals, many of which relate to issues we have been urging the Commission to address for years, we have specific concerns with each. Importantly, while we are commenting on all four proposals in one comment letter, we note that each proposal is reasonably designed to address a specific issue, and could be adopted, revised, or abandoned independently of any of the other proposals.

Broadly speaking, we recommend:

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[1] *Regulation Best Execution*, SEC, 88 Fed. Reg. 5440 (Jan. 27, 2023), *available at* https://www.govinfo.gov/content/pkg/FR-2023-01-27/pdf/2022-27644.pdf ("Best Execution Proposal").
[2] *Disclosure of Order Execution Information*, SEC, 88 Fed. Reg. 3786 (Jan. 20, 2023), *available at* https://www.govinfo.gov/content/pkg/FR-2023-01-20/pdf/2022-27614.pdf ("Rule 605 Proposal").
[3] *Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders*, SEC, 87 Fed. Reg. 80266 (Dec. 29, 2022), *available at* https://www.govinfo.gov/content/pkg/FR-2022-12-29/pdf/2022-27616.pdf ("Tick, Fees, and Odd Lots Proposal").
[4] *Order Competition Rule*, SEC, 88 Fed. Reg. 128 (Jan. 3, 2023), *available at* https://www.govinfo.gov/content/pkg/FR-2023-01-03/pdf/2022-27617.pdf ("Retail Order Competition Proposal").
[5] The Healthy Markets Association is a not-for-profit member organization focused on improving the transparency, efficiency, and fairness of the capital markets. Healthy Markets promotes these goals through education and advocacy to reduce conflicts of interest, improve timely access to market information, modernize the regulation of trading venues and funding markets, and promote robust public markets. Its members include public pension funds, investment advisers, broker-dealers, exchanges, and data firms. To learn about HMA or our members, please see our website at http://healthymarkets.org.

- Revising the Best Execution Proposal to eliminate the "institutional customer" exemption (described below), restore order-by-order analysis, adopt "order-by-order" routing decision-making, and revise any remaining exemptions to be structured as conditional "safe harbors," subject to certain conditions being met;
- Revising the Rule 605 Proposal modestly to adopt time increment buckets and eliminate the proposed, misleading "size improvement" statistic;
- Revising significantly the Tick, Fees, and Odd Lots Proposal to reduce the complexity and implementation risks, such as by reducing the number of tick and fee buckets; and
- Revising the Commission's analysis for the Retail Order Competition Proposal.

Lastly, if the Commission does not materially improve the Best Execution Proposal as described above, we urge the Commission to abandon it. Doing nothing is better than supplanting an already deficient system with a worse one.

BEST EXECUTION PROPOSAL

The Commission currently does not have a rule to govern best execution for either brokers or investment advisers, and HMA has long advocated for the Commission to rectify that error. The Best Execution Proposal, while ostensibly intended to bring such a rule "in house" to the Commission, would remove existing investor protections while also failing to update to address and mitigate known weaknesses.

The Commission should revise the proposal to, at a minimum, meet the existing quality of care for all investors as per the existing FINRA rules and guidance. Alternatively, the Commission could abandon the proposal and simply urge FINRA and the MSRB to improve their existing rules.

Proposed Standard

At the heart of the Best Execution Proposal is new Rule 1100, which would appear to largely codify the existing FINRA rule for best execution.

For example, Rule 1100 would state that:

> In any transaction for or with a customer, or a customer of another broker-dealer, a broker-dealer, or a natural person who is an associated person of a broker-dealer, must use reasonable diligence to ascertain the best market for the security, and buy or sell in such market so that the resultant

> price to the customer is as favorable as possible under prevailing market conditions.[6]

Meanwhile FINRA Rule 5310 currently states that:

> [i]n any transaction for or with a customer or a customer of another broker-dealer, a member and persons associated with a member shall use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.[7]

Proposed Rule 1100 would facially apply to trading in a broad swath of securities, including equities, options, corporate bonds, and government securities. We agree with that scope. If the Commission decides to move forward with this proposal, then the Commission should ensure that the best execution standard formally prohibits brokers from using fees and rebates offered by wholesalers, broker-dealers, exchanges, or ATSs into their order routing decisions.

Notably, "the proposed best execution standard would apply to broker-dealers that internalize their customers' orders, as well as to wholesalers or clearing firms that trade as principal with the customer orders routed to them from other broker-dealers."[8] We agree with that scope of application.

We also note that while the Best Execution Proposal suggested that the Commission would not eliminate FINRA's Best Execution Rule,[9] FINRA's CEO has subsequently commented that the self-regulatory organization would seek to revise FINRA's Best Execution Rule to match whatever the Commission ultimately adopts. This means that the Commission would be affirmatively lowering the best execution protections for investors in a number of respects.

Proposed Rule 1100 Exemptions Are Deeply Problematic

While proposed Rule 1100 was ostensibly intended to mimic existing FINRA rules for the Commission, it would include exemptions that would substantively materially weaken best execution obligations for brokers, particularly with respect to transactions with institutional customers.

Specifically, proposed Rule 1100 would exempt a broker-dealer when:

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[6] Best Execution Proposal, at 5451.

[7] FINRA, *Rule 5310: Best Execution and Interpositioning*, *available at* https://www.finra.org/rules-guidance/rulebooks/finra-rules/5310.

[8] Best Execution Proposal, at 5451-52.

[9] Best Execution Proposal, at 5473 n.219.

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- the broker is "quoting a price for a security where another broker-dealer routes a customer order for execution against that quote;"[10]
- "an institutional customer, exercising independent judgment, executes its order against the broker-dealer's quotation;"[11]or
- the broker "receives an unsolicited instruction from a customer to route that customer's order to a particular market for execution and the broker-dealer processes that customer's order promptly and in accordance with the terms of the order."[12]

The first exemption is similar to current FINRA Rule 5310.04 and MSRB Rule G-18.05, and the third exemption is similar to FINRA Rule 5310.08 and MSRB Rule G-18.07. However, the second exemption has never existed before. While all three exemptions are deeply troubling, as drafted, we wish to draw attention to the new exemption for a broker executing a trade on behalf of "an institutional customer, exercising independent judgment, executes its order against the broker-dealer's quotation" (aka, the "Institutional Customer Exemption").

As the Proposal explains:

> In the corporate and municipal bond and government securities markets, for example, institutional customers often handle and execute their own orders. Institutional customers in these markets commonly request prices from broker-dealers for particular securities (prices for any given security are often not quoted and made widely available) and exercise their own discretion concerning the execution of a particular transaction. In these instances, a broker-dealer is simply responding to the institutional customer's request (e.g., through widely known request for quote ("RFQ") mechanisms) and the institutional customer is exercising independent discretion over the handling and execution of its orders. Accordingly, the Commission believes that the broker-dealer in these circumstances should be exempted from the best execution standard under proposed Rule 1100.[13]

This Institutional Customer Exemption, as drafted, would be a disaster for many institutional investors, and should be abandoned.

[10] Best Execution Proposal, at 5452.
[11] Best Execution Proposal, at 5452.
[12] Best Execution Proposal, at 5452.
[13] Best Execution Proposal, at 5452.

If, for example, a registered investment adviser or small pension plan calls an institutional broker looking for a price on some bonds, and the broker provides some prices, it wouldn't matter if those prices are significantly away from the best available prices in the market. Nor would it matter if the broker was secretly aware of perhaps much better prices then available in the markets.

The proposed Institutional Customer Exemption would not distinguish between different types of securities. The proposal, for example, includes no significant discussion of how the exemption would or should apply to equity securities or equity derivatives, nor was there any discussion or analysis of its potential impact on these markets.

Rather, we understand that the exemption was included in the proposal at the urging of officials from the US Treasury Department, in order to address some perceived concerns in trading of US Treasury Securities. We are unaware of the specifics of any of those concerns, as they are not included in the Best Execution Proposal.

Nevertheless, the Best Execution Proposal does not explain how a wholesale exemption from best execution (including any related recordkeeping and analysis required by the potential Regulation Best Execution) would be essential to protecting investors or promoting more fair, orderly, and efficient markets – even with respect to US Treasury Securities markets.

That said, assuming that such a showing was made, it is unclear why such an "institutional customer" exemption would also be necessary for corporate bond trading or equities trading, for example. Why shouldn't, for example, a block trade in Apple stock between an asset manager and a bank be subject to best execution recordkeeping and analysis? Why shouldn't a state pension buying an index of corporate bonds from a bank be protected by best execution?

The Institutional Customer Exemption Would Ignore Execution Quality and Market Integrity

The proposed Institutional Customer Exemption would not regulate the quality of the quote taken by the "institutional customer." It doesn't say the "broker-dealer's quotation" has to be "reasonable," near the market, or even close to a fair value. It doesn't prohibit a broker from providing a quote at prices that it knows are far inferior to the market.

Put simply, if a bank can get an "institutional customer" to "exercise" its own "judgment" to *knowingly or unknowingly* trade through the market by accepting its quote, then the whole trade would appear to fall outside of the entire framework for best execution.

The Institutional Customer Exemption Would Exacerbate Inequality Across Different Institutional Investors

The proposed Institutional Customer Exemption also doesn't address the disparity in market power, expertise, and resources of different "institutional customers." While a trillion dollar asset manager may have the market power, systems, expertise, and

incentives to effectively police its brokers to ensure high execution quality, many other "institutional customers" will not.

We see this today in the massive variability across different investment advisers and other institutional investors in their efforts to police best execution quality. Put simply, the institutional investors that have the resources, market power, and expertise to effectively command better pricing are more likely to receive materially better execution quality than those that don't have those advantages. Thus, if adopted as proposed, the "Institutional Customer" exemption would create and exacerbate differences in execution quality received by different institutional investors.

The Institutional Customer Exemption Would Promote Opaque, RFQ Trading – With Potentially Sweeping Ramifications Across a Swath of Securities Asset Classes

While much of the Commission's regulatory agenda for 'equity market structure and treasuries market structure proposals generally seem designed to promote more on-exchange, transparent, competitive trading, the Institutional Customer Exemption would go in precisely the opposite direction.

If a broker can convince an "institutional customer" to exercise its "judgment" to accept a quote (regardless of what it is for or whether it's any good), then the broker would be completely outside of its duty of best execution. There would appear to be no substantive protections (including legal liability for potential violations of its fiduciary duty) nor procedural protections (e.g., recordkeeping or analysis) that would appear to apply.

Ultimately, as the Commission has heard many times throughout the years during its consideration of reforms to US equity market structure, institutional investors like public pension funds or mutual funds are nothing more than the pooled resources of millions of "retail" investors – often with lesser account balances and resources than so-called "retail" traders. So these millions of Americans practical abilities to enjoy regulatory protections of best execution would become solely dependent upon – not the decades-old fiduciary obligations of brokers, the prices in the markets, the documentation and analysis of their brokers, or the supervision of regulators – but instead the "judgment" of what is likely to be a single person at their entrusted firm.

As a result, brokers would be strongly incentivized to push as much of their customers' trading into request-for-quotes or negotiated trading models as possible, as it could both lower their compliance burdens and expand revenue opportunities. This could result in brokers providing less robust depth of quotations in the displayed markets, and essentially more "indications of interest" to serve as a "call me" signal to begin negotiations with customers.

This could create a negative feedback loop in different assets for inventors, where banks may materially reduce the publicly available liquidity in more transparent

exchanges, thus making request-for-quote or bilateral, negotiated trading the only practical way to execute trades of significant size in a swath of different securities.

The Institutional Customer Exemption Could Discriminate Against Non-Bank Liquidity Providers

To the extent that brokers engaged in request-for-quote trading with "institutional customers" could be exempted from their best execution obligations, the Proposal would appear to strongly favor banks and other brokers who may be able to "commit capital" against their customers' trades over less capital-intensive market intermediaries.

Further, to the extent that banks may reduce their displayed liquidity across different asset classes to essentially ask more customers to "call them," this could lead to both less competitive, displayed liquidity volume overall. This could likely make for wider spreads, and more materially volatile markets (as the public markets digest the risks of less transparent, request-for-quote trades hitting and moving the markets).

The proposed Institutional Customer Exemption also doesn't seem to reconcile with the existing rules for fixed income trading. For example, we find it extremely odd that the Best Execution Proposal doesn't even attempt to contrast (or reconcile) its lax approach against the "markup and markdown" disclosure rules from FINRA and MSRB.

Lastly, as discussed above, by framing the three exemptions as strict "exemptions" from the requirements of the proposed Regulation Best Execution, the Commission would inexplicably be foreclosing both itself and investors from policing brokers' use of the exemption.

We urge the Commission to revise any exemptions from its new best execution obligations to be safe harbors that would be conditioned upon detailed specific recordkeeping requirements and disclosures. Again, while we believe the Commission should abandon the proposed Institutional Customer Exemption, if such an exemption is retained, it should be conditioned upon the broker keeping details documenting the trade, and disclosure to the customer of any better prices known by the bank at the time of the trade.

Proposed Best Execution Policies and Procedures Don't Include Order-By-Order Decision Making

Under Proposed Rule 1101(a), "a broker-dealer that effects any transaction for or with a customer or a customer of another broker-dealer to establish, maintain, and enforce written policies and procedures reasonably designed to comply with the best execution standard."[14] Further, "all customer orders must be covered by a broker-dealer's best

[14] Best Execution Proposal, at 5454.

execution policies and procedures, and the broker-dealer would be required to enforce such policies and procedures,"[15]

As a result of the direct tie between the policies and procedures and the new best execution standard, the exemptions to the standard would enable materially looser (or non-existent) policies and procedures for certain institutional customers' orders.

Interestingly, while brokers could adopt policies that are tailored for different types of assets (e.g., different types of equities or fixed income securities), brokers can also treat different types of customers differently. We fear that this customer-level variability could dramatically exacerbate the already disparate treatment and execution quality received by different investors.

Worse, the proposal would not require those policies and procedures to include brokers analyzing and making routing decisions on an order-by-order basis. Today, brokers' "smart order routers" are routinely expected to make routing decisions in real time based on then-available market information. Further, at the retail level, we understand that OTC market makers routinely decide whether to accept for execution or route away orders based on real-time order-specific circumstances. Put simply, in today's markets, routing and execution decisions are made in real time on an order-by-order basis.

The Commission should acknowledge that reality and require brokers to, as part of their duties of best execution, engage in order-by-order decision making for where and how to route orders.

Identifying and Integrating Liquidity and Liquidity Sources

Rule 1101(a)(1) would require brokers' policies and procedures to provide that brokers "(i) obtain[] and assess[] reasonably accessible information, including information about price, volume, and execution quality, concerning the markets trading the relevant securities; (ii) identify[] markets that may be reasonably likely to provide material potential liquidity sources (as defined above); and (iii) incorporat[e] material potential liquidity sources into its order handling practices and ensuring that it can efficiently access each such material potential liquidity source."[16]

Interestingly, while "Proposed Rule 1101(a)(1)(ii) would require a broker-dealer's policies and procedures to address how it will identify material potential liquidity sources," "it would not require a broker-dealer to include in its policies and procedures a minimum number of markets that it would need to identify as material potential liquidity sources."[17]

For the NMS stock market, the Best Ex Proposal notes that "material potential liquidity sources could include exchanges, ATSs, and broker-dealers, including market makers

[15] Best Execution Proposal, at 5455.
[16] Best Execution Proposal, at 5455.
[17] Best Execution Proposal, at 5457.

and wholesalers."[18] The proposal similarly notes that the liquidity source "could also include trading protocols and auction mechanisms operated by these entities, including those that may provide price improvement opportunities, such as exchange limit order books, retail liquidity programs, midpoint liquidity, and wholesaler price improvement guarantees."[19]

This should be obvious.

Frankly, we were flabbergasted that the Best Execution Proposal didn't offer concrete substantive mandates, but instead suggested that "a broker-dealer generally *should consider* whether consolidated trade information, exchange proprietary data feeds, odd lot market data, and execution quality and order routing information contained in reports made pursuant to Rules 605 and 606 of Regulation NMS are readily accessible and needed in order for the broker-dealer to identify material potential liquidity sources for its customers' orders."[20]

How is this not a "must be considered" obligation? What's the counterargument?

Even FINRA's 2015 Best Execution Guidance declared that if a broker is already subscribing to proprietary data feeds "for its proprietary trading, [the broker] *would be expected* to also use these data feeds to determine the best market under prevailing market conditions when handling customer orders."[21]

Once again, the Best Execution Proposal is affirmatively less protective for investors than existing FINRA rules and guidance. This should be remedied.

Connecting to Liquidity Sources Directly Versus Indirectly

Interestingly, neither the Commission nor FINRA have ever explicitly mandated that brokers connect to all the relevant market centers. And the Proposal "would not necessarily require that a broker-dealer directly connect to a market, as it may be efficient in some circumstances for a broker-dealer to use another broker-dealer to access a particular market for a customer order."[22]

Yet, at the same time, the Best Execution Proposal asserts that "interposing a third-party between the broker-dealer and the market reasonably likely to provide the most favorable price for its customer would not be consistent with the concept of 'efficient access,' if the broker-dealer could access the market directly but chose instead to access the market indirectly resulting in a worse execution for the customer."[23]

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[18] Best Execution Proposal, at 5457.
[19] Best Execution Proposal, at 5457.
[20] Best Execution Proposal, at 5457.
[21] FINRA, *Guidance on Best Execution Obligations in Equity, Options and Fixed Income Markets*, Reg. Notice 15-46, Nov. 20, 2015, *available at* https://www.finra.org/rules-guidance/notices/15-46.
[22] Best Execution Proposal, at 5458.
[23] Best Execution Proposal, at 5458.

This determination, while making intuitive sense, also puts many smaller brokers in an effectively impossible situation. On the one hand, many smaller brokers are unlikely to have negotiated the lowest fees or highest rebates with different trading venues on their own, and so they may likely be compelled for business reasons to connect to different exchanges and market centers through other (often larger) competitors.

On the other hand, doing so likely introduces latencies and other considerations that may modestly impair their services to their customers.

This is, in our minds, almost impossible to reconcile with the Commission's determination to not prohibit discriminatory pricing tiers by market centers that provide materially lower fees and higher rebates to larger volume traders. A smaller broker could access a venue at materially different pricing than a larger competitor. It may route customer orders through that larger competitor so as to obtain some portion of the competitors' more favorable pricing. However, doing so would introduce latencies and risks that, if the broker was directly connected to the venue, might not occur. At times, these latencies and risks introduced by the routing through the larger broker may likely negatively impact customers' executions.

At root, the proposal seems to expand the set of market data that is needed to participate in the U.S. equity markets, and yet continues to generally fail to meaningfully address how it will ensure that the associated fees to access and participate in the market are fair, reasonable, and not unreasonably discriminatory, as required under the Exchange Act.

Put simply, the Commission permitting differential (and discriminatory) exchange pricing based on customer (as opposed to order) characteristics and permitting the imposition of enormous connectivity and data costs on the one hand, while also frowning upon the potential negative impacts of not connecting directly, creates a material internal conflict – and compliance challenge – for smaller brokers.

Policies and Procedures for Conflicted Transactions Would be Facially Inadequate

The Proposal would adopt a new "conflicted transaction" definition that would be "any "transaction for or with a retail customer" where a broker-dealer: (i) executes an order as principal, including riskless principal; (ii) routes an order to, or receives an order from, an affiliate for execution; or (iii) provides or receives payment for order flow as defined in Rule 10b-10(d)(8) under the Exchange Act."[24]

For the purposes of the rule, the "retail customer" would be an "account of a natural person or held in legal form on behalf of a natural person or group of related family members."[25]

As the Proposal explains, it

[24] Best Execution Proposal, at 5464.
[25] Best Execution Proposal, at 5464.

> is not designed to eliminate order handling conflicts of interest, and does not ban conflicted transactions. However, because a broker-dealer engaging in conflicted transactions for or with retail customers has an incentive to handle those orders in a manner that prioritizes its own interests over its customers' interests, the Commission preliminarily believes that, correspondingly, such transactions should be subject to more robust policies and procedures in order to help mitigate the potential for these incentives to negatively affect the broker-dealer's best execution determinations.[26]

The Best Execution Proposal would "require a broker-dealer to document its compliance with the best execution standard for conflicted transactions, including all efforts taken to enforce its policies and procedures for conflicted transactions and the basis and information relied on for its determination that such conflicted transactions would comply with the best execution standard."[27] However, it "would not [be required] to document its compliance with the best execution standard with respect to its conflicted transactions in any specific way."[28]

The Commission should require some specific details of what would satisfy the documentation requirements, and just as importantly, what wouldn't. Investors simply don't have the ability to pierce their brokers' policies, procedures, and practices, and make meaningful sense of them – much less meaningfully compare them. But perhaps more importantly, the Commission's examinations and enforcement staff will be unable to establish meaningful baselines and comparisons without basic minimum standards. Further, these documentation requirements, which should be tailored to different markets and types of securities, should be clearly laid out in Commission guidance, so that they may evolve over time with industry capabilities and practices. Compliance with best execution should not be left to speculation or sporadic enforcement.

Interestingly, the Proposal suggests that "in connection with documenting its compliance with the proposed best execution standard and its best execution determinations for conflicted transactions, the broker-dealer could document the prices received from those markets that it checked pursuant to its policies and procedures," and that "such information could serve as a basis for demonstrating a broker-dealer's best execution efforts and determinations."[29] We struggle to understand how this is only a suggestion, and not a requirement.

Again the Proposal explains that "in connection with a determination of whether to route customer orders to the wholesaler that pays for order flow, the retail broker-dealer could evaluate other exchanges, ATSs, or order exposure opportunities that may not have

[26] Best Execution Proposal, at 5467.
[27] Best Execution Proposal, at 5468.
[28] Best Execution Proposal, at 5468.
[29] Best Execution Proposal, at 5468.

been determined by the retail broker-dealer to be material potential liquidity sources for non-conflicted transactions under proposed Rule 1101(a)(1)."[30]

Again, we struggle to understand how a broker could be satisfying its existing best execution obligation if it wasn't doing this already.

Similarly, the Proposal explains that

> For retail nonmarketable orders routed to markets (e.g., exchanges) that pay rebates for those orders, a retail broker-dealer would need to document its basis for determining that routing orders to such markets would comply with the best execution standard, as well as the information relied on for such determination. It could do so by, for example, documenting its assessment of fill rates and the likelihood of execution for nonmarketable orders at such markets as compared to other markets that do not provide such rebates.[31]

Documenting fill rates and "likelihood of execution" are less than the bare minimums of existing industry practices.

All that said, these requirements are almost exclusively about retail payment for order flow, and are not really relevant for anything else. However, even in that narrow context, it's strikingly disappointing that the discussion doesn't directly address fee avoidance, which appears to have a very strong connection to existing routing practices.

We don't understand the principle behind addressing payments, but not fees, especially when one considers that the fee avoidance considerations are such significant portions of the overall incentive structures for the retail order handling practices. Put another way, while some leading brokers don't currently take payment for order flow for their customers' equity trades, they still route to the same market makers as those that do take payments from those market makers. Why? The answer is simple: the brokers can avoid the complexity and fees associated with developing and operating its own routing systems and still meet the current regulatory expectations.

If the Commission intends to meaningfully improve execution quality for investors by addressing their brokers' conflicted routing incentives, the Commission should:

- Revised the standard to directly address all routing incentives – including disincentives, which may cause brokers to avoid what may be the best venues for their customers' orders;

[30] Best Execution Proposal, at 5469.
[31] Best Execution Proposal, at 5470.

- revise the "conflicted transactions" definition to include such transactions for all brokers' customers, including institutional customers, as appropriate for each class of covered securities; and

- Establish standardized minimum documentation requirements by markets and asset class (e.g., varying to reflect differences between a junk bond and a heavily traded NMS stock).

The Commission adopted a Transaction Fee Pilot program in 2018 following years of complaints from investors – including HMA members – who expressed to the Commission fears that their brokers were routing their orders to market centers to maximize the brokers' profits, not get their customers the best prices.

Since that rule was ultimately struck down by the DC Circuit, we would have hoped the Commission would have used this opportunity to address these concerns directly through updating existing best execution requirements. Unfortunately, the Best Execution Proposal didn't do that. The Commission should remedy the error and expand the scope of transactions covered to include institutional customers.

SEC Lowers the Bar With So-Called Regular and Rigorous Reviews

The Proposal would eliminate order-by-order assessments for execution quality, including those currently required by FINRA's Best Execution Rule.[32]

A broker doesn't have an amorphous duty to its customer for best execution. Rather, the fiduciary duty of best execution attaches when the customer sends its broker an order. The duty applies to that specific order for that specific customer.

A "regular and rigorous" review is meaningless to a customer with a bad fill. Just as a broker's duty of best execution should entail making order-by-order routing and execution decisions, a review of performance should similarly be conducted on an order-by-order basis.

We are disappointed that the Commission has decided to ignore current industry market practices wherein market participants are taking in real time data, making routine routing decisions on an order-by-order basis, and reviewing them on an order-by-order basis. While this has long been true for years for institutional customers' orders, for retail customers, OTC market makers are also deciding how to handle those orders in real time on an order-by-order basis as well.

Rather than acknowledge these realities, the Best Execution Proposal would require brokers to simply meet a standard that was arguably adequate for best practices two decades ago. Broker would have to, at least quarterly,

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[32] Best Execution Proposal, at 5473 n.219.

> review the execution quality of its transactions for or with its customers or customers of another broker-dealer, and how such execution quality compares with the execution quality the broker-dealer might have obtained from other markets, and to revise its best execution policies and procedures, including its order handling and routing practices, accordingly. Proposed Rule 1101(c) would also require a broker-dealer to document the results of this review.[33]

The Commission should revise the proposal to, at a minimum, meet the existing quality of care for all investors as the existing FINRA rules. It should establish standardized minimum analysis and expected documentation.

Rule 1101(d): Introducing Brokers

Current FINRA Rule 5310.09(c) allows introducing brokers to rely on executing brokers for compliance with best execution, provided that the executing broker conducts a "regular and rigorous review", and the results are fully disclosed to the introducing broker and the introducing broker periodically kicks the tires on those reviews.

The Best Execution Proposal would adopt a similar approach. That said, the definition of "introducing broker" is slightly narrower than FINRA provides, and the details required are slightly more onerous. Specifically,

> Rule 1101(d) would require the introducing broker's policies and procedures to provide for comparisons between the execution quality obtained from its executing broker and the execution quality it might have obtained from other executing brokers, which would be a more specific policies and procedures obligation for introducing brokers than required under the current FINRA and MSRB rules. Finally, a broker-dealer that qualifies as an introducing broker under proposed Rule 1101(d) would be exempt from the requirement to separately comply with proposed Rules 1101(a), (b), and (c). (pg. 144-145)

In general, we agree with the approach taken in the Best Execution Proposal for inclusion of "introducing brokers."

Rule 1102: Annual Reports

The Best Ex Proposal would require brokers to

> no less frequently than annually, review and assess the design and overall effectiveness of its best execution policies

[33] Best Execution Proposal, at 5471.

> and procedures, including its order handling practices. Such review and assessment would be required to be conducted in accordance with written procedures and would be required to be documented. The broker-dealer also would be required to prepare a written report detailing the results of such review and assessment, including a description of all deficiencies found and any plan to address such deficiencies. The report would be required to be presented to the board of directors (or equivalent governing body) of the broker-dealer.[34]

Interestingly, while an "introducing broker … would need to conduct a review and prepare a written report pursuant to proposed Rule 1102, an introducing broker's review should appropriately reflect its obligations under proposed Rule 1101(d), rather than the aspects of proposed Rules 1101(a), (b), and (c) that would be considered as part of the executing broker's annual review.[35]

While FINRA's Best Execution Rule doesn't, by itself, mandate that the broker review its best execution policies and procedures annually, the FINRA Rule 3130(c) generally requires brokers to review their policies and procedures for compliance and periodically update them. Notably, for many brokers, we know that best execution policies and procedures are reviewed annually as part of that process. As a result, it's not entirely clear how much the new "Annual Report" would change existing practices. That said, we support it.

Scope and Documentation Generally

Lastly, we note that the Best Execution Proposal appears intended to cover a broad swath of securities, which may have very different market and trading characteristics. While the standard itself should apply broadly across products, the policies, procedures, and practices used to effectuate that standard (including documentation standards) should be tailored by the Commission to the characteristics of the particular markets.

RULE 605 PROPOSAL

Timely, reliable, and useful statistics about order execution information from trading venues is essential to empowering investors and their brokers with the information they need to make sound order routing decisions.

HMA has advocated for modernizing Rule 605[36] for the organization's entire existence, including in recommendations to the Commission itself and the Commission's now-defunct Equity Market Structure Advisory Committee.

[34] Best Execution Proposal, at 5479.
[35] Best Execution Proposal, at 5479-80 n.246.
[36] 17 CFR § 242.605.

The metrics – which are decades-old – are wildly outdated. Updating these metrics to reflect modern trading practices and time horizons would greatly enhance competition for order flow and investors' abilities to achieve best execution.

In general, HMA agrees with the viewpoints, suggestions, recommendations outlined in the Rule 605 Proposal, and believes that the proposal should be implemented without delay. Below, we make a number of comments and recommended technical enhancements:

1. Header data should be included within the reports and reporting buckets should be labeled in a straight-forward manner rather than a numerical sequence. Today any person that would like to view Rule 605 reports would need to find header information which is literally hidden in the backwaters of an SEC's FAQ. Without this crucial piece of information, it is impossible to understand the reports.

2. The Rule 605 reports should be centralized for easy access and comparability across firms. Ideally, this should be done within a public database maintained by the Financial Industry Regulatory Authority (FINRA). Any firm that will be reporting to Rule 605 is a FINRA member, and FINRA has long had reporting systems for many such metrics.[37] The SEC's EDGAR system is inadequate for the task. Further we recommend that as part of its access to CAT data to create 605 reports as part of their regulatory oversight/surveillance, FINRA should make its report cards publicly available.

3. Rule 605 reports should continue to be made available in the machine readable format.

4. Covered orders should be expanded to include any security whose quote is disseminated via the Securities Information Processor, which includes any fund security (ETF) listed on an SEC registered exchange or Alternative Trading System (ATS) or Single Dealer Platform (SDP).

5. Rule 605 reports should cover large brokers that route orders on behalf of investors, regardless of size.[38]

6. Additionally, brokers that are also market centers (including as OTC market makers) should be required to separately report their market center functions for all covered orders (e.g. ATS or SDP operations).

7. Brokers should be required to calculate time of order receipt based on when that broker-dealer received the order which can show if there are order-delays and

[37] See https://www.finra.org/finra-data

[38] We agree with the Commission's determination of the "customer account threshold," as defined in proposed Rule 605(a)(7).

provide a useful metric for anyone examining order-routing latency across brokers.[39]

8. The rule should be expanded to include OTC securities. Notably, FINRA has recently attempted to expand order routing disclosure requirements to include OTC securities.[40]

9. Rule 605 should run from primary market open to primary market close (e.g. 9:30 to 4:00 p.m. eastern standard time).[41]

10. Overall we agree with all of the proposed changes to the definition of "categorized by order size.[42] We reiterate our longstanding concerns that the lack of odd lot orders within 605 has created perverse reporting issues.[43] HMA has commented extensively to the commission to include odd lot information both within Rule 605 and the Securities Information Processor.[44]

11. We recommend that the Commission modify the required time-to-execution buckets for all order types to time buckets that can be adjusted over time. Currently, we recommend the following buckets: less than 500 microseconds; 500 microseconds - 1 millisecond; 1 - 10 milliseconds; 10 - 100 milliseconds; 100 milliseconds - 1 second;[45] 1-10 seconds, and greater than 10 seconds. By creating buckets for timestamp, rather than average time to execution, the reports would provide much greater granularity while still allowing a user of the data to recreate average time to execution.[46] That said, given that time horizons are likely to shorten over time (as they have since Rule 605 was first adopted), we recommend that these buckets be adopted pursuant to an attachment that can be easily updated over time.

12. To best identify adverse selection and as we have commented on numerous occasions, realized spread should be calculated on short timeframes to include 50ms, 100ms. As the Commission notes, a one minute measurement only captures about 50% of the variation in realized spreads for the smallest cap stocks. 15 seconds, let alone one minute is an eternity in today's markets and would not sufficiently capture adverse selection.

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[39] See, Rule 605 Proposal questions 1-14.

[40] https://www.sec.gov/rules/sro/finra/2022/34-96415.pdf

[41] See, Rule 605 Proposal questions 15-19.

[42] See, Rule 605 Proposal questions 20-23.

[43] See, e.g.,Letter from Tyler Gellasch, HMA, to Brent J. Fields, SEC, Mar. 5, 2019, *available at* https://www.sec.gov/comments/4-729/4729-5020185-182987.pdf.

[44] See, Letter from Chris Nagy, HMA, to SIP Operating Committee, July 18, 2019, *available at* https://healthymarkets.org/wp-content/uploads/2022/07/7-18-22-Odd-Lot-Proposal-Letter-to-CTA_UTP-1.pdf.

[45] If the Commission separately adopts the Retail Order Competition Proposal, we would recommend segmenting orders subject to this system out from all other orders, as they are likely to significantly skew the statistics.

[46] Rule 605 Proposal questions 27-31.

13. The Commission should eliminate the proposed easy-to-manipulate and misleading statistics related to so-called "size improvement." To accurately identify size improvement not only would proprietary depth of book feeds be required, the statistic would be misleading as it would not reflect, top of book across public quotes, nor would it reflect hidden or mid-point priced orders which are extremely prevalent in today's market if sole reliance was on the SIP. We therefore recommend that this statistic not be included within Rule 605 until such a time when the public data feed contains more information regarding the depth of quotations.[47]

Again, we commend the Commission on this modernization proposal and again recommend that it is adopted without delay.

TICK, FEES, AND ODD-LOTS PROPOSAL

Quotation and Trading Increments

We agree with the Commission that (1) quotation increments should be narrower on the majority of NMS stocks, and (2) trading increments should be standardized across all trading venues, including ATSs and OTC market makers.

Under Rule 612(a) of Reg NMS,

> [n]o national securities exchange, national securities association, alternative trading system, vendor, or broker or dealer shall display, rank, or accept from any person a bid or offer, an order, or an indication of interest in any NMS stock priced in an increment smaller than $0.01 if that bid or offer, order, or indication of interest is priced equal to, or greater than, $1.00 per share.[48]

For stocks under $1.00 per share, the minimum quotation increment is $0.0001.[49]

At the time Reg NMS was adopted, the Commission declared that the penny quotation limit "was designed to limit the ability of a market participant to gain execution priority over a competing limit order by stepping ahead by an economically insignificant amount."[50] Further, at that time, the Commission found that "market participants frequently [had] used their ability to quote in sub-pennies [off exchange] to step ahead of competing limit orders by the smallest possible amount."[51]

[47] Rule 605 Proposal questions 32-39.
[48] 17 CFR § 242.612.
[49] 17 CFR § 242.612.
[50] Regulation NMS, SEC, 70 Fed. Reg. 37496, 37551 (June 29, 2005), *available at* https://www.sec.gov/rules/final/34-51808fr.pdf ("NMS Adopting Release").
[51] NMS Adopting Release, at 37553 n.505.

The Tick, Fees, and Odd Lots Proposal, consistent with analyses of many market participants, finds that a significant number of stocks "could be priced more aggressively within the spread than is possible with the current minimum pricing increment of $0.01."[52] Today, however, "a significant percentage of executions occur in sub-penny increments as a result of midpoint executions and sub-penny price improvement provided by OTC market makers who internalize retail orders or RLPs on exchanges."[53]

Put another way, sub-pennies are often significant today.

On the other end of the spectrum, as demonstrated by the ill-advised "Tick Size Pilot," artificially wide ticks may materially harm investors.[54] In general, narrowing them could help investors. Each of the dominant US equity exchange operators (NYSE,[55] Cboe,[56] and Nasdaq[57]) has supported narrower quotation increments under different circumstances.

Each exchange has its own methodology for determining which stocks are "tick constrained," and what the new quotation increments should be. The Commission has proposed to define "tick constrained" stocks as those "that have a time weighted average quoted spread of 1.1 cents or less,"[58] which are the majority of stocks. In fact, as defined, there would be 1337 tick-constrained NMS stocks, accounting for 56.1% of estimated share volume and 23.2% of estimated dollar volume.[59]

To address this perceived severe tick constraint, the Tick, Fees, and Odd Lots Proposal would implement four different minimum quotation pricing increments:

- $0.001, if the Time Weighted Average Quoted Spread for the NMS stock during the Evaluation Period was equal to, or less than, $0.008;
- $0.002, if the Time Weighted Average Quoted Spread for the NMS stock during the Evaluation Period was greater than $0.008 but less than, or equal to, $0.016;

[52] Tick, Fees, and Odd Lots Proposal, at 80268.
[53] Tick, Fees, and Odd Lots Proposal, at 80278.
[54] Traders Magazine, *SEC Tick-Size Pilot Cost Investors Over US$300 Million: Report*, Sept. 11, 2018, *available at* https://www.tradersmagazine.com/news/sec-tick-size-pilot-cost-investors-over-us300-million-report/.
[55] Letter from Hope Jarkowski, NYSE, to Vanessa Countryman, SEC, Mar. 13, 2023, *available at* https://www.sec.gov/comments/s7-31-22/s73122-20159561-327567.pdf.
[56] Cboe, *Cboe Proposes Tick-Reduction Framework to Ensure Market Structure Benefits All Investors*, Sept. 22, 2022, *available at* https://www.cboe.com/insights/posts/cboe-proposes-tick-reduction-framework-to-ensure-market-structure-benefits-all-investors/.
[57] Nasdaq, *Getting Ticks Right Improves Valuations*, July 14, 2022, *available at* https://www.nasdaq.com/articles/getting-ticks-right-improves-valuations.
[58] Tick, Fees, and Odd Lots Proposal, at 80268.
[59] Tick, Fees, and Odd Lots Proposal, at 80274.

- $0.005, if the Time Weighted Average Quoted Spread for the NMS stock during the Evaluation Period was greater than $0.016 but less than, or equal to, $0.04; and
- $0.01, if the Time Weighted Average Quoted Spread for the NMS stock during the Evaluation Period was greater than $0.04.

The Proposal estimates that this formulation would reduce the minimum quotation and trading increment to $0.005 or less for 81.9% of the share volume, which represents approximately 60.2% of dollar volume that trades with a spread of approximately $0.04 or less.[60]

To implement the changing quotation and trading increment sizes, the primary listing exchanges would measure and calculate the Time Weighted Average Quoted Spread of each NMS stock in order to determine the applicable minimum pricing increment for such NMS stock during the months of March, June, September, and December of a particular calendar year (i.e., "Evaluation Period") for the three months to follow.

Notably, the Tick, Fees, and Odd Lots Proposal would require quotation and trading increments to be the same, and then it would apply the new "minimum pricing increments to the quoting and trading of NMS stocks in order to promote fair competition and equal regulation between trading in the OTC market and trading on exchanges and ATSs."[61]

As the proposal notes, "[t]rading on national securities exchanges and ATSs … largely occurs in penny increments because national securities exchanges and ATSs generally execute trades at the prices that orders and quotes must be displayed, accepted or ranked under rule 612."[62]

Of course, exchanges and ATSs may execute orders in sub-penny increments for (1) midpoint orders, (2) orders that are benchmarked (such as volume-weighted average price ("VWAP") and time-weighted average price ("TWAP") orders), and (3) retail liquidity programs ("RLP") that operates pursuant to exemptions granted by the Commission. Nevertheless, the Rule 612 restriction puts exchanges at a significant competitive disadvantage to their OTC market making competitors.

However, "the ability of OTC market makers to trade more readily in finer increments (i.e., offering sub-penny price improvement over the displayed quote) compared to the trading on exchanges and ATS has contributed to the increased percentage of executions that occur off-exchange."[63]

[60] Tick, Fees, and Odd Lots Proposal, at 80278.
[61] Tick, Fees, and Odd Lots Proposal, at 80269.
[62] Tick, Fees, and Odd Lots Proposal, at 80268.
[63] Tick, Fees, and Odd Lots Proposal, at 80268.

By leveling the playing field between these different trading venues, the proposal would have significant implications for on- and off-exchange execution prices and volumes.

The Commission suggested another alternative, including that it could apply its new tick increments "only to accepting, ranking, and quoting but not to trading – reflecting the current baseline application of rule 612."[64] According to the Proposal, an "advantage" of this approach would be that "broker-dealers, including wholesalers, could still offer price improvement relative to exchanges in whatever increments they choose—leaving unchanged a wholesaler's ability to offer price improvement relative to the baseline. This alternative would eliminate the uncertainty in the proposal regarding how applying the tick increment to trading could affect retail price improvement."[65]

We vigorously disagree with this being an "advantage" to investors or more competitive markets.

That "advantage" would be to simply preserve existing market distortions that segment order flow away from transparent trading centers, provide investors with immaterial "price improvement," and often leave investors with inferior-priced executions.

While reducing the quotation increment is important, perhaps moreso is standardizing the trading increments for both on- and off-exchange trading. If the Commission revises the Tick, Fees, and Odd Lots Proposal, it should preserve standardized trade increments across all trading venues.

Lastly, we note that there would be a lengthy phase-in period for these new ticks and for the implementation of the new trading increment restriction. The Tick, Fees, and Odd Lots Proposal would delay the requirement that orders in NMS stock be executed in the minimum pricing increments until the fifth quarter of effectiveness so as "to facilitate an orderly transition by allowing market participants additional time to adjust and comply with the requirement to quote and trade" at the new, fixed increments.[66]

Transaction Fees

The current access fee cap imposed by Rule 610(c) for NMS stocks with prices over $1 is 30 cents per 100 shares, and 0.3% of the quotation price per share for stocks less than $1 per share.[67]

Unfortunately, the current fee levels foster and enable significant market distortions in today's marketplace. Specifically, the fees charged by exchanges often serve as powerful disincentives for market participants to access that liquidity. Brokers' avoidance of these fees is a significant contributor for brokers often choosing to internalize or first route to ATSs or OTC market makers, rather than to exchanges with their customers'

[64] Tick, Fees, and Odd Lots Proposal, at 80339.
[65] Tick, Fees, and Odd Lots Proposal, at 80339.
[66] Tick, Fees, and Odd Lots Proposal, at 80285.
[67] 17 C.F.R. 242.610(c).

orders – even if they are not accepting any payment from those venues for the orders. Notably, while existing FINRA rules and guidance purportedly prohibit brokers from being unduly influenced by receipt of payments for order flow in their routing decisions, there is inexplicably no explicit prohibition on brokers' consideration of fees (and avoidance) in their agency routing decisions. The Commission's Regulation Best Execution should remedy this error.

Nevertheless, as a result of the significant fee disparities between exchanges and off-exchange trading venues, many brokers' financial incentives often push them towards routing to off-exchange venues, or exchanges with which they may have customized, discounted transaction fees.

Further, the fees charged by exchanges are often far in excess of those necessary to maintain the operations of the exchange. Rather, significant portions of the transaction fees collected – and at times all of the fees – are often used to subsidize exchanges' rebates to brokers. These rebates often explicitly favor the largest volume customers of the exchanges, despite the Exchange Act's express prohibition on exchanges having rules that would provide for inequitable fees, create undue burdens on competition, or be discriminatory. Further still, these rebates often result in brokers preferencing routing to exchanges or other trading centers that pay them the highest rebates.

HMA has repeatedly urged the Commission to adopt rules to prohibit brokers from factoring exchange fees and rebates into their routing decisions. Put simply, agents should be focused on the best executions for their customers, and not their own economics. This could be adopted as part of the Commission's Regulation Best Execution Proposal, but wasn't. As we discussed above, we urge the Commission to revise that proposal to implement this basic rule.

Further, given the Proposed changes in the tick sizes, the Commission declared that, "absent an adjustment to the current fee caps, access fees would make up a larger proportion of the per share quotation price than they do today because of the proposed decreases in the minimum pricing increments, which could lead to unintended market distortions and undermine price transparency."[68]

We agree.

In part to address this concern, and in part to address the direct, known concerns with fees and rebates, the Proposal would impose a $0.0005 access fee cap on NMS stocks that have a minimum pricing increment of $0.001 (aka 5 cents per 100 shares), and a $0.001 access fee cap for NMS stocks that would have a minimum pricing increment greater than $0.001 (aka 10 cents per 100 shares).[69]

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[68] Tick, Fees, and Odd Lots Proposal, at 80289.

[69] We agree with commenters who worry about the complexities that may be introduced with locked and crossed markets if the Commission is not careful with the application of the fees to sub-penny ticks.

While the Proposal acknowledges that the transaction fee caps apply to only incoming orders that execute against resting protected quotes, and don't directly limit rebates, it nevertheless asserts that "rule 610(c) access fee caps typically indirectly limit the average amount of the rebates that an exchange offers to less than $0.0030 per share in order to maintain net positive transaction revenues."[70]

We certainly understand this thinking, if the argument had been made a decade ago, when the rebates were consistently materially lower than the fees collected on the same transactions. That is no longer consistently the case. Today, it is clear that a cap on access fees is not a cap on rebates, as is plainly demonstrated by numerous exchange filings that the Commission staff has permitted to go into effect over the past several years.

Over the past decade, as exchanges' fees for connectivity and market data fees products have skyrocketed, exchanges have been adopting rebates to some customers that already materially exceed the fee caps. Put simply, exchanges are already subsidizing trading by some of their largest volume trading customers with not just the transaction fees of other customers, but also other customers' market data and connectivity payments.

For example, MEMX has adopted transaction pricing that would pay rebates in excess of the fee caps on protected quotations. Those rebates (and the exchange's operating costs) are being subsidized by more than the capped transaction fees. The rebates may be coming from the fees, but must also be coming from other revenues, such as its recently adopted connectivity and market data-related charges.

The Proposal states that a material reduction in transaction fees would lead to a significant overall decrease in net rebates paid by exchanges. Reducing the fees charged would – in absolute dollar terms – likely significantly reduce the conflicts of interest facing brokers for both fee avoidance and rebate seeking when acting as agents for their customers.

However, reducing fees alone would be insufficient to eliminate the brokers' conflicts of interest, and would not address the significant and material competition issues among broker members that the current pricing system imposes.

At face value, even if the rebates go down in dollar terms, while the overall conflicts of interest facing all brokers and traders may decline, the relative competitive disparities between different market participants is being ignored and may even grow.

Put simply, if the Commission does nothing to restrict preferential and tiered pricing, and only lowers the fee caps, a larger volume broker or principal trader will still have a very significant competitive advantage over its smaller competitors.[71]

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[70] Tick, Fees, and Odd Lots Proposal, at 80288.

[71] The Commission is unfortunately inappropriately ignoring the law today by permitting exchanges to adopt different pricing schedules based not upon the characteristics of the order for which the fee or

For example, suppose a large bank has negotiated a 32 cents per 100 shares rebate on an exchange that currently pays a smaller broker 24 cents for the same 100 share order. The exchange would lose 2 cents for trading by the bank (because it is 2 cents more than the current 30 cents per 100 shares fee cap). However, the exchange would be turning a profit on the trade with the smaller broker, because it would be collecting 30 cents, while only paying 24 cents per 100 shares. As said before, this inequitable price discrimination is, in our view, facially inconsistent with the law, and should be prohibited – but is currently permitted by the Commision.

Nevertheless, if the Proposal were adopted and the exchange maintains its margins on the same in dollar terms, the competitive distortions among brokers due to preferential and tiered pricing still remains. For example, an exchange may continue to subsidize the bank's 2 cents per 100 shares, and so it could pay a rebate to the bank of 12 cents per 100 shares traded. At the same time, it could choose to continue to pay the smaller broker a rebate of 6 cents less than the fee cap, which would mean that its rebate collected would be just 4 cents per 100 shares traded.

A rebate differential between 24 and 32 is the same as the difference between 4 and 12 and the smaller broker member is still disadvantaged. In fact, one could argue that on a relative basis it is more disadvantaged given the relative disparity between its prices and the largest volume traders would increase. Again, without taking other actions (such as by eliminating aggregate volume-based rebate disparities), the Proposal does nothing to address the material pricing inequalities for different brokers and trading firms, even as it lowers overall explicit costs and conflicts of interest.

We urge the Commission to lower the transaction fee cap to 10 cents per 100 shares traded, regardless of the quotation and trading increments selected.[72] Further, to address heightened concerns about the potential impacts on market participants' relative transaction pricing, we urge the Commission to finally preclude exchanges from adopting pricing schedules for fees or rebates that distinguish between customers' aggregate trading volumes, as opposed to the characteristics of each order giving rise to the fee or rebate. If two different brokers send the exact same order to an exchange, they should get the same pricing for that order. Pricing should be based on the order being sent, not the other businesses or trading by the party sending it.

Lastly, we note that when the current access fee levels were established, they were justified as generally consistent with the then-common industry practices. The Commission is unlikely to withstand legal challenges to its access fee determinations unless it more fully addresses the relationships between access fees, other fees (including market data), and rebates in the final rule, including how the adjustments will

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rebate would be applied, but rather the volume and characteristics of the parties sending the orders. We simply do not understand how these arrangements – which are often custom-negotiated – are consistent with the Exchange Act.

[72] For this purpose, we assume the Commission will not move forward with a 1/10th penny quotation and trading increments.

impact different market participants (e.g., large volume customers versus smaller volume customers).

Adding Timely Fee and Rebate Transparency

For years, HMA has remained baffled at how brokers made routing decisions without fully knowing for certain what the applicable fees or rebates would be.

In 2018, Quantitative Investment Management, petitioned the Commission to revise its rules to ensure that brokers know their transaction fees or rebates at the time of the order routing decisions.[73] HMA has also recommended that the Commission ensure that exchange transaction pricing is known at the time of the routing decision and communicated back to the customer along with the trade confirmation.[74]

The Proposal would add a new Rule 610 subsection (d), "'Transparency of Fees,' which would prohibit a national securities exchange from imposing, or permitting to be imposed, any fee or fees, or providing, or permitting to be provided, any rebate or other remuneration (e.g., discounted fees, other credits, or forms of linked pricing) for the execution of an order in an NMS stock unless such fee, rebate or other remuneration can be determined at the time of execution."[75]

This oddly-worded requirement does not explicitly say that the fee or rebate has to be communicated to, much less known by, the broker at the time the broker can make use of it (i.e., when making its routing decision). "Can be determined at the time of execution" is very different from "is known by the broker prior to execution" and "communicated to the broker on the confirmation."

However, that does seem to be the Commission's intent. As the Proposal explains:

> Certainty about the cost of a transaction at the time of the trade may help broker-dealers make better order routing decisions. The proposal should reduce order routing incentives that are based on achieving a threshold in order to gain a specific fee or rebate. Today, lower fees or higher rebates based on volume achieved in a current trading month can lead to routing to exchanges solely for purposes of achieving a certain level of volume or attaining a possible tier level rather than routing to achieve best execution. In addition, the proposal would allow market participants to

[73] See, Letter from Jaffray Woodriff and Michael Ledwith, Quantitative Investment Management, to Brent J. Fields, SEC, Dec. 21, 2018, *available at* https://www.sec.gov/comments/sr-cboeedga-2018-017/srcboeedga2018017-4827803-177046.pdf.

[74] *See, e.g.*, Letter from Tyler Gellasch, HMA, to Hon. Gary Gensler, SEC, Oct. 29, 2021, *available at* https://www.sec.gov/rules/petitions/2021/petn4-778.pdf (requesting that the Commission require exchanges to "ensure that any fees or rebates are known at the time of trade, and are provided to the executing parties at the time of trade confirmation").

[75] Tick, Fees, and Odd Lots Proposal, at 80292.

> know with certainty the cost of their transactions at the time of the trade, which would facilitate a broker-dealer's ability to pass through the fee/rebate associated with a transaction because it would know at the time of the transaction the amount of the fee/rebate that is applicable to each execution. Further, the proposal would provide more transparency into whether a broker-dealer may be routing to certain venues based on the fee/rebate that venue assesses. Investors could more readily request details about fees and rebates related to their orders. If market participants pass through exchange fees/rebates, an ancillary benefit of the proposed amendment would be that the potential inducement to broker-dealers to route orders solely based on garnering the highest rebate/paying the lowest fee would be reduced since broker-dealers would no longer directly benefit from such remuneration, but instead would pass along such fees/rebates to their customers. Although a broker-dealer could still choose not to pass along fee/rebate, the proposal would facilitate a customer's ability to ask more direct questions of its broker-dealer about how the broker-dealer handles fees and rebates, which could increase accountability of the broker-dealer, which in turn could lead to better order execution and more transparency regarding fees/rebates.[76]

We agree with all of those arguments, which we have made to the Commission repeatedly.

However, the proposed rule language needs to be cleaned up to actually do all of that. Specifically, the language of the proposed rule should reflect that the routing party knows the pricing at the time of execution and the exchange communicates that to the routing party as part of the confirmation process. This would allow for customers of the brokers to negotiate for pass-through pricing with their brokers to limit their brokers' conflicts of interest, if they so choose. Without this clarity, the intent of this language will be unrealized.

Making Some Odd Lots Round and Putting Quotes on the Tape

The Proposal would accelerate the revisions to the round lot definition that was adopted as part of the Market Data Infrastructure.

[76] Tick, Fees, and Odd Lots Proposal, at 80293.

HMA has repeatedly urged regulators (including in March 2019,[77] October 2019,[78] and July 2022[79]) to add odd lot quotations to the data disseminated pursuant to the CTA/CQ and Nasdaq UTP Plans. In particular, HMA has raised concerns that the exclusions of better-priced odd lots from the SIPs may lead to significant market distortions, including materially misleading claims of "price improvement" or "size improvement." Unfortunately, the Commission has separately proposed exacerbating this problem by adopting a "size improvement" statistic that would inexplicably ignore odd lot shares and other known liquidity (as we separately describe in our assessment of the Rule 605 Proposal).

Rather than simply add odd lot quotations to the SIPs (which has been formally proposed twice by the Operating Committee for the Plans in the past few years), the Market Data Infrastructure Rule established a new "round lot" definition for NMS stocks that varies based on the stocks' price levels. Specifically, "for NMS stocks priced $250.00 or less per share, a round lot will be 100 shares; for NMS stocks priced $250.01 to $1,000.00 per share, a round lot will be 40 shares; for NMS stocks priced $1,000.01 to $10,000.00 per share, a round lot will be 10 shares; and for NMS stocks priced $10,000.01 or more per share, a round lot will be 1 share."[80]

Interestingly, as the Proposal acknowledges, since the Market Data Infrastructure Rule was adopted, "[o]dd-lot quotes in higher priced stocks continue to offer prices that are frequently better than the round lot NBBO for these stocks, and this better priced odd-lot liquidity is distributed across multiple price levels. In addition, odd-lot rates have increased among lower priced stocks."[81]

This is unsurprising, given current trends in trading, and it is also why all odd lot quotations should be included in the SIPs as soon as possible. The already-adopted Market Data Infrastructure Rule would require odd lot quotations to be disseminated on the SIPs by competing consolidators.

However, since we appear to be nowhere close to having competing consolidators, the Proposal would "accelerate the compliance date for odd-lot information as defined in rule 600(b)(59)" by requiring the exchanges to "provide the data necessary to generate odd-lot information to the exclusive SIPs and to require the exclusive SIPs to collect, consolidate, and disseminate odd-lot information."[82] We agree.

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[77] Letter from Tyler Gellasch, HMA to Brent J. Fields, SEC, Mar. 5, 2019, *available at* https://www.sec.gov/comments/4-729/4729-5020185-182987.pdf.

[78] Letter from Tyler Gellasch, HMA, to SIP Operating Committee, Oct. 30, 2019, *available at* https://www.theice.com/publicdocs/Healthy_Markets_odd_lot_comment_letter_10.30.19.pdf.

[79] Letter from Chris Nagy, HMA, to SIP Operating Committee, July 18, 2022, *available at* https://healthymarkets.org/wp-content/uploads/2022/07/7-18-22-Odd-Lot-Proposal-Letter-to-CTA_UTP-1.pdf.

[80] Tick, Fees, and Odd Lots Proposal, at 80294.

[81] Tick, Fees, and Odd Lots Proposal, at 80296.

[82] Tick, Fees, and Odd Lots Proposal, at 80298.

We urge the Commission to revise and adopt the Tick, Fees, and Odd Lots Proposal without delay.

RETAIL ORDER COMPETITION PROPOSAL

HMA does not take any formal position regarding the Retail Order Competition Proposal, which would create a new Rule 615 that would establish an order-by-order competition requirement for some retail orders.

As we understand it, Rule 615 would prohibit a "restricted competition trading center" from executing a segmented order until after a broker-dealer has exposed the order to competition at a "specified limit price in a qualified auction operated by an open competition trading center."[83] Put another way, "Rule 615 would allow segmented orders to continue to be executed internally by a wholesaler or other restricted competition trading center, but not until after the execution price had been exposed to order-by-order competition in a fair and open qualified auction."[84]

Notably, the orders subject to the auctions would have to be from "natural persons" who do not trade very often. Further, We also note that there would be a number of exceptions, including:

- larger orders ($200,000 or more);
- orders that are executed at favorable prices for individual investors (orders executed at the NBBO midpoint or better);
- limit orders that have a limit price that is equal to or more favorable for the segmented order than the NBBO midpoint (i.e., non-marketable segmented orders with a limit price that is equal to or lower than the midpoint for buy orders and equal to or higher than the NBBO midpoint for sell orders); and
- orders sized less than one share and for the fractional component, if any, of a segmented order if no qualified auction is available to execute the fractional share or fractional component.

Again, while we take no formal position on the Retail Order Competition Proposal, we wish to make several observations.

First, if the Commission thinks that the best execution rule works and is enforceable, then this new, exceedingly complex apparatus for some subset of so-called "retail" orders should be unnecessary. Brokers should be required – as part of their distinct best execution obligations – to route their customers' orders to the venues with the best available pricing.

[83] Retail Order Competition Proposal, at 146.
[84] Retail Order Competition Proposal, at 148.

If the Commission believes that retail orders aren't getting routed correctly, then this raises questions with the adequacy of existing best execution policies, procedures, and practices. If the Commission shares our concerns that retail orders may not be getting routed to the trading venues offering the best prices, the Commission should require brokers to make "order-by-order" routing decisions as part of the Proposed Regulation Best Execution, as suggested above. In our view, this would likely be a far more readily enforceable, and less complex method to ensure better routing practices by brokers than implementing this elaborate system.

Second, the Order Competition Rule Proposal is also inconsistent with its own logic.[85] On the one hand, the Commission has asserted that

> Proposed Rule 615 is designed to benefit individual investors by promoting competition and transparency as means to enhance the opportunity for their orders to receive more favorable prices than they receive in the current market structure, as well as to benefit investors generally by giving them an opportunity to interact directly with a large volume of individual investor orders that are mostly inaccessible to them in the current market structure.[86]

On the other hand, the rule does not apply to a very material portion of orders that are executed through retail execution channels (such as smaller institutional investors or orders from individuals that trade frequently). If the Commission believes that the current retail execution channels (with orders segmented and routed predominantly to market makers) leads to inferior pricing for investors, why would the Commission then only confer the "protections" of the rule to only a subset of the investors who are subjected to that system? Many smaller registered investment advisers and small business entities trade through the same retail channels as natural persons, yet these investors sending an order to their broker for execution would not be subject to the rule while other customers of the same broker with the exact same order would be subjected to the rule. That discrepancy in treatment is not materially addressed. If the Commission proceeds with the proposal, it should better establish why it is making this distinction, or revise it.

Third, and perhaps most importantly, throughout the Retail Order Competition Proposal, the Commission suggests that "institutional investors" would likely participate in the auction mechanisms. The phrase "institutional investor" appears 115 times in the release, and release repeatedly notes that current retail channels do not generally allow institutional customers "to compete" to provide more favorable prices" for retail customer orders.[87]

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[85] We also note that the proposal shares many similarities with the highly controversial, so-called "Flash Orders" from a decade ago.
[86] Retail Order Competition Proposal, at 129.
[87] See, e.g., Retail Order Competition Proposal, at 130.

We question the extent to which traditional, long-only or other large "institutional" investors are likely to compete for order flow in the proposed auctions. Put simply, institutional investors are generally looking to buy or sell very significant volumes of securities, and are extremely sensitive to adverse selection and heightened execution costs that could arise from information leakage about their intentions prior to the completion of their trades.

We would expect the bidders in any auctions under the proposal to include the current market makers and high frequency traders that dominate the equity market making business and options auctions markets. Of course, we can imagine that order-by-order competition as contemplated by the Retail Order Competition Proposal, could lead to better ultimate execution prices for many covered orders. However, that would likely be a result of market makers and high frequency trading firms competing against each other on an order-by-order basis – not a material influx of new bidders.

Regardless, for most institutional investors we think the risks of leaking information about their large orders to market makers and high frequency traders by affirmatively bidding on very small, retail orders are likely to far outweigh any potential benefits of receiving the executions. While some institutional investors may be willing to take information leakage risk (which would be exacerbated if broker IDs are given up), we do not believe any meaningful percentage of institutional orders would receive meaningful fills. Frankly, it isn't likely that a billion or trillion dollar asset manager would start tipping its hand by bidding in these new retail auction mechanisms for orders that are, by definition, small.

DATA AND ANALYSIS GENERALLY

We appreciate the Commission's thorough data-driven analysis of each of the proposals, which has been enabled, in part, by the Commission's ability to overcome over a decade of industry opposition to adopt, implement, build, and use the Consolidated Audit Trail ("CAT").[88] The CAT has finally empowered the Commission to see what's actually happening in the largest capital markets in the world, and ensures that the government is generally no longer exclusively dependent upon the often-cherry-picked data and analysis of self-regulatory organizations and interested market participants and academics (who may have limitations and incentives that undermine their reliability). While the data and analysis relied upon by the Commission in the proposals is imperfect, it is far more reasonable than necessary at this stage of the rulemaking process, and provides a solid foundation for the Commission's ultimate rule adoptions.

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[88] *See generally*, *Hearing on Implementation and Cybersecurity Protocols on the Consolidated Audit Trail Before the House Financial Services Committee, Subcommittee on Capital Markets, Securities and Investment*, 115th Cong. 2017 (Testimony of Tyler Gellasch, HMA), *available at* https://financialservices.house.gov/uploadedfiles/hhrg-115-ba16-wstate-tgellasch-20171130.pdf (detailing the evolution of what would become the CAT since 2009).

CONCLUSION

The Commission has a once-in-a-generation opportunity to materially improve US equity market structure. Unfortunately, while we agree with the Commission's overall objectives of improving executions for investors, we believe the Commission's most important proposal, on best execution, is sorely lacking. We urge the Commission to (1) revise the proposal materially or (2) abandon it, and instead direct FINRA and the MSRB to improve their rules as outlined above. With respect to the Rule 605 Proposal and Tick, Fees, and Odd Lots Proposals, we urge you to revise them and adopt them without delay.

If you have any questions, please contact me at (202) 909-6138 or ty@healthymarkets.org. Thank you for your consideration.

Sincerely,

Tyler Gellasch
President & CEO
Healthy Markets Association