

May 26, 2023

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

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

Re: Release No. 34-97406; File No. SR-CboeEDGX-2023-016 and Release No. 34-97437; File No. SR-CboeBZX-2023-020

Dear Ms. Countryman:

The Healthy Markets Association<sup>1</sup> appreciates the opportunity to comment on the two above-referenced filings by the Cboe family of exchanges, which were suspended by the Commission.<sup>2</sup>

The Cboe Tier Filings do not provide sufficient information to support a finding by the Commission that the proposed changes:

- provide for an equitable allocation of reasonable dues, fees, and other charges;
- do not unfairly discriminate between different exchange participants;
- do not impose burdens on competition that are not necessary or appropriate; and

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<sup>1</sup> 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>.

<sup>2</sup> Suspension of and Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Change to Amend the EDGX Equities Fee Schedule to Eliminate and Modify Certain Growth Tiers and NonDisplayed Step-Up Volume Tiers, Modify a Retail Growth Tier, Introduce New Fee Code DX and Modify Fee Code DQ, SEC, April 28, 2023, available at <https://www.sec.gov/rules/sro/cboeedgx/2023/34-97406.pdf> and Suspension of and Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Change to Amend the BZX Equities Fee Schedule to Add and Modify Certain Step-Up Tiers, Add a Non-Displayed Step-Up Tier and Modify Certain Fee Codes, SEC, May 4, 2023 available at <https://www.sec.gov/rules/sro/cboebzx/2023/34-97437.pdf>

- do not impose impediments to the free and open market system.

As a result, the filing is insufficient to establish that the exchanges have met its obligations under the Exchange Act and Commission rules. Accordingly, we request that the Commission disapprove them.

## About Healthy Markets and Our Interest in Exchange Pricing Fairness

The conflicts of interest and costs associated with exchange pricing have been a longstanding concern for Healthy Markets and we along with our members have written extensively to the Commission regarding exchange pricing practices that are unfair, discriminatory, and burdens upon competition.

## Background on SEC Review of Exchange Rule Proposals

The Commission is obligated to review SRO filings and determine that those filings are consistent with the Exchange Act,<sup>3</sup> including that an exchange's rules:

- "provide for the equitable allocation of reasonable dues, fees, and other charges;"<sup>4</sup>
- not be "designed to permit unfair discrimination";<sup>5</sup>
- "not impose any burden on competition not necessary or appropriate in furtherance of the purposes of" the Act;<sup>6</sup> and

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<sup>3</sup> See *Susquehanna Int'l Grp., LLP v. SEC*, 866 F.3d 442 (D.C. Cir. 2017) ("The SEC "shall approve" a self regulatory organization's proposed rule change only "if it finds that such proposed rule change is consistent with" provisions of the Exchange Act."). *Accord*, Remarks of Brett Redfearn, SEC, before the SEC Roundtable and Market Access and Market Data, Oct. 26, 2018, *available at* <https://www.sec.gov/news/public-statement/statement-redfearn-102518> (declaring that in order for the Commission to "meet our obligations under the Exchange Act, we also need to ensure that the fees that are being charged for such important market services are fair and reasonable, not unreasonably discriminatory, and do not impose an undue or inappropriate burden on competition.").

<sup>4</sup> 15 U.S.C. § 78f(b)(4).

<sup>5</sup> 15 U.S.C. § 78f(b)(5).

<sup>6</sup> 15 U.S.C. § 78f(b)(8).

- be designed “to protect investors and the public interest.”<sup>7</sup>

While there are often over 100 filings per month, the difficulty in wading through the massive volume does not relieve the Commission of its legal obligation.<sup>8</sup> The Commission must review all exchange filings, including those related to market data,<sup>9</sup> connectivity costs,<sup>10</sup> and trading fees (such as the Cboe Tier Filing).<sup>11</sup>

## Background on Pricing Tiers

Transaction pricing tiers are common across exchanges, where they serve as powerful incentives for brokers and market makers to route orders to particular venues. Pricing tiers have also become a powerful tool for exchanges to compete for order flow.<sup>12</sup> This

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<sup>7</sup> 15 U.S.C. § 78f(b)(5).

<sup>8</sup> *Susquehanna Int'l Grp., LLP v. SEC*, 866 F.3d 442 (D.C. Cir. 2017) (“We do not reach them because, as Petitioners also argue, the SEC’s Order approving the Plan fails in a more basic respect: the Commission did not itself “find[]” or “determin[e],” that the Plan met any of those requirements. Instead, the SEC effectively abdicated that responsibility...”)(citations omitted).

<sup>9</sup> See, e.g., *Order of Summary Abrogation of the Twenty-Third Charges Amendment to the Second Restatement of the CTA Plan and the Fourteenth Charges Amendment to the Restated CQ Plan*, SEC, Rel. No. 34-83148, May 1, 2018, available at <https://www.sec.gov/rules/sro/nms/2018/34-83148.pdf>; see also *Order of Summary Abrogation of the Forty-Second Amendment to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis*, SEC, Rel. No. 34-83149, May 1, 2018, available at <https://www.sec.gov/rules/sro/nms/2018/34-83149.pdf>.

<sup>10</sup> See, e.g., *Suspension of and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend the Fee Schedule on the BOX Market LLC Options Facility to Establish BOX Connectivity Fees for Participants and Non-Participants Who Connect to the BOX Network*, SEC, Rel. No. 34-84168, Sept. 17, 2018, available at <https://www.sec.gov/rules/sro/box/2018/34-84168.pdf>; see also *Suspension of and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend the Fee Schedule Regarding Connectivity Fees for Members and Non-Members*, SEC, Rel. No. 34-84175, Sept. 17, 2018, available at <https://www.sec.gov/rules/sro/miax/2018/34-84175.pdf>.

<sup>11</sup> We previously objected to a similarly unsupported pricing tier filing. Letter from Tyler Gellasch, Healthy Markets Association, to Brent J. Fields, SEC, Oct. 12, 2018, available at <https://www.sec.gov/comments/sr-nyse-2018-40/srnyse201840-4510950-175996.pdf>. In response to that comment, NYSE offered a response. Letter from Elizabeth King, NYSE, to Brent J. Fields, SEC, Oct. 22, 2018, available at <https://www.sec.gov/comments/sr-nyse-2018-40/srnyse201840-4549661-176172.pdf> (“NYSE Tier Response Letter”).

<sup>12</sup> We do not believe that the Commission is generally well-equipped to act as a “price controller.” However, in adopting the 30 cents per 100 shares cap on fees to access a protected quote, the Commission appropriately recognized that it would be detrimental to the markets to, on the one hand, compel market participants to interact with the protected quote, and then not restrict the fees at the venue where that quote is offered. The government mandate to access that quote necessitates the further

differential in prices creates a conflict of interest for brokers, as they're interests in maximizing a rebate or minimizing a fee (which often accrues to them) may conflict with their clients' interests in getting the best possible prices. In fact, investors' longstanding concerns with conflict of interest harming their execution quality was a major factor in the Commission's adoption of the since-scuttled Transaction Fee Pilot in 2018.<sup>13</sup>

As we explained to the Commission five years ago, "a broker is incentivized to route an order to the venue that pays it the most (or costs the least), instead of the venue that has the highest likelihood of offering the best execution for its customers, such as the one that offers a higher probability of execution or meaningful price improvement."<sup>14</sup>

As part of the Transaction Fee Pilot, the Commission included an Exchange Transaction Fee Summary, which was intended to facilitate comparison of exchanges' basic fee structures and identify changes.<sup>15</sup> That information would have been important for regulators, market participants, researchers, and others to know which firms are subject to which fees. For example, it may be that one or more market makers or large brokers may enjoy remarkably different cost structures than other market participants.

The Transaction Fee Pilot recognized that these disclosures -- while necessary to understanding order routing incentives -- nevertheless "ignore[] significant variation in exchange fee schedules."<sup>16</sup> And while the Commission stopped short of proposing more comprehensive disclosures,<sup>17</sup> it clearly recognized the relative impacts of these pricing tiers on order routing behavior.

Even more disturbingly, the conflict of interest created by different pricing tiers may also impact how brokers treat their own customers. For example, a broker with a less-sophisticated customer may send orders to a venue so that the firm would reach a certain tier threshold, despite the broker's awareness that executions on that venue may result in inferior execution outcomes to investors. However, the same broker, if faced

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protections to ensure the reasonability of the fee to access it. Notably, there is no cap on the rebates that venues may pay--even though those rebates facially create conflicts of interest for routing brokers. Further, we do not urge the Commission to simply mandate one pricing tier for each exchange.

<sup>13</sup> *Transaction Fee Pilot for NMS Stocks*, SEC, 84 Fed. Reg. 5202, 5204 (Feb. 20, 2019), *available at* <https://www.govinfo.gov/content/pkg/FR-2019-02-20/pdf/2018-27982.pdf>.

<sup>14</sup> Letter from Tyler Gellasch, HMA, to Brent Fields, SEC, at 5, May 24, 2018, *available at* <https://healthymarkets.wpengine.com/wp-content/uploads/2018/06/05-24-18-HM-letter-Transaction-Fee-Pilot.pdf>.

<sup>15</sup> Transaction Fee Pilot Proposal, at 13029.

<sup>16</sup> Transaction Fee Pilot Proposal.

<sup>17</sup> Id.

with the same order from a more-sophisticated customer, may not. Put simply, the broker may be tempted to engage in more conflicted routing practices based on the perceived likelihood of discovery by its customer.

But there is another important side effect of this competition for order flow beyond the direct impact on investors. It also impacts the competition between brokers. To the extent that different broker-dealers fall into different pricing tiers, it will directly impact the competitive balance between those firms.<sup>18</sup> As a result, pricing tiers not only impact the competition between venues for execution, but also the competition between brokers and other market participants. Despite the Exchange Act's mandate that exchange fees be reasonable, equitably allocated, not unfairly discriminatory, and not an undue burden on competition, each firm is subject to whatever rate it can convince an exchange (presumably for business reasons) to grant. This is left to the whims of the exchange and the market participants.

Those without market power (e.g., smaller firms or those with less order volume) are likely to obtain the worst deals. Further, over time, as order flow has aggregated to the largest firms, this has increased their ability to negotiate even better rates; further expanding the gap between themselves and the smaller firms.<sup>19</sup>

In practice, pricing tiers serve as a one-two punch against fair competition between firms who route orders to the exchange--and a powerful force for order flow and industry consolidation. First, pricing tiers -- by design -- typically offer cheaper trading for larger firms with greater order volumes. They may even subsidize the trading of the largest firms. This puts smaller firms at a competitive disadvantage on order and execution prices. A smaller firm's trading costs for any given trade on an exchange may be 30% or more of the costs of a larger competitor -- for the exact same trade.

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<sup>18</sup> Remarks of Joe Wald, Clearpool Group, before the SEC Roundtable on Market Access and Market Data, Oct. 25, 2018, Transcript at 198, *available at* <https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102518-transcript.pdf>. *Accord*, Remarks of Tyler Gellasch, Healthy Markets Association, before the SEC Roundtable and Market Access and Market Data, Oct. 26, 2018, Transcript at 280-281, *available at* <https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102618-transcript.pdf>.

<sup>19</sup> As an illustration of the highly skewed nature of rebate tier payouts, IEX calculated that attaining the top published adding tier on all of the major maker-taker exchanges would require a firm to be executing a volume of more than 9% of the total volume on all exchanges. Letter from John Ramsay, IEX, to Vanessa Countryman, SEC, Mar. 20, 2023, at 24-25.

As one smaller broker-dealer told the Commission five years ago, the interactions between market data costs and pricing tiers combine to create significant barriers to entry and disadvantages for smaller firms:

First, is there a disproportionate impact of the current market data and market access regime on smaller broker-dealers and does this act as a barrier of entry to innovation? From what we have experienced, through the high costs for market data and the complex and opaque tiering structure established by the exchanges for transactional fees, smaller broker-dealers end up subsidizing many of the costs for larger firms.<sup>20</sup>

In fact, this disproportionate impact of pricing tiers on different market participants was expressly highlighted to the Commission by the President and COO of Cboe Global Markets, who explained that:

This is just our top 10 firms across our four exchanges by market share. So presumably, they're making a lot of money, given the size of their market share. There are four investment banks and six HFTs. Five out of the top 10 get a check from us after the costs of their connectivity and market data. So we are cutting them a check monthly after their costs.

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[At the same time, the] top 10 firms on our exchange eat up 50 percent of the capacity on our exchanges.<sup>21</sup>

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<sup>20</sup> Remarks of Joe Wald, Clearpool Group, before the SEC Roundtable on Market Access and Market Data, Oct. 25, 2018, Transcript at 198, available at <https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102518-transcript.pdf>.

<sup>21</sup> Remarks of Chris Concannon, Cboe Global Markets, before the SEC Roundtable on Market Access and Market Data, Oct. 25, 2018, Transcript at 74-75, available at <https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102518-transcript.pdf>.

If the top 10 firms that comprise more than half the volume, and half of them are getting checks at the end of the month, who’s actually paying for the exchange operations (and the checks to the largest volume traders)?

In many instances, we know of exchange pricing tiers, where the rebates paid may exceed the fees taken in on the other side of the trade. To whom are those rebates being paid? None of those details are known. Who is subsidizing their trading (and paying the exchanges’ operating costs)? Again, those details are unknown. In fact, even the number of pricing tiers is unknown, much less who qualifies for them. However, given the public statements of exchange executives, we suspect that it is not smaller volume traders.<sup>22</sup> Put simply, some of the largest volume traders may be trading at dramatically reduced costs--or even for a profit--while smaller customers may be paying significant sums for the exact same security amount. This seems to be the opposite of an equitable allocation of reasonable fees, dues and charges.

Several larger trading firms commonly use their lower fees and higher rebates to attract greater order flow--consolidating order flow from smaller, less-connector or powerful competitors. For example, below as Figure 1 is an excerpt from a pricing sheet from one large bank broker-dealer that is a few years old.

**FIGURE 1: Broker A Exchange Pricing**

	Tape A (NYSE)		Tape B (AMEX & Other)		Tape C (NASDAQ)	
	Taking	Providing	Taking	Providing	Taking	Providing
ARCA	0.00300	(0.00300)	0.00280	(0.00230)	0.00300	(0.00300)
BATS	0.00300	(0.00310)	0.00300	(0.00310)	0.00300	(0.00310)
NYSE	0.00250	(0.00180)	0.00250	(0.00180)	0.00250	(0.00180)
NASDAQ	0.00300	(0.00295)	0.00300	(0.00295)	0.00300	(0.00295)

Similarly, Figure 2 is another “price sheet” from another broker-dealer from around the same time period. Interestingly, the email enclosing Figure 2 noted the “tier improvement” to reflect Broker B had negotiated better rates.

**Figure 2: Broker B Exchange Pricing**

<sup>22</sup> Concannon, at 74-75.

Description	Current Rate	New Rate
NASDAQ Make non-NBBO	-0.00295	-0.00305
NASDAQ Make NBBO	-0.0031	-0.00315
NASDAQ MidPoint	-0.0014	-0.0017
EDGA Make	0.0005	0.0003
Arca Make Tape A	-0.0029	-0.0032
Arca Make Tape B	-0.0022	-0.0025
Arca Make Tape C	-0.0029	-0.0032

These private advertising sheets, and many others like them, are often used by those who negotiate customized beneficial tiers to solicit greater order flow from other, likely smaller, brokers who are unable to negotiate the better rates.

The ability to negotiate a better pricing tier with an exchange or set of exchanges has become a point of competition between brokers--leading to unfair and anti-competitive practices. As we have previously articulated to the Commission:

In recent years, the number of brokers has declined. These economics may have nothing to do with the quality of service the smaller brokers provide, but rather their abilities to qualify for what are essentially volume discounts--notwithstanding the facts that the discount providers (the exchanges) are obligated by the Exchange Act to not discriminate between customers.<sup>23</sup>

## The Cboe Tier Fee Filings Are Inconsistent with the Exchange Act

The Cboe Tier Filings – like many tier filings – facially discriminate against smaller aggregate volume customers, which we believe is facially inconsistent with the Exchange Act. Nevertheless, we also understand that the Commission has inexplicably

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<sup>23</sup> Letter from Tyler Gellasch, Healthy Markets Association, to Brent J. Fields, SEC, at 22, May 24, 2018, available at <https://www.sec.gov/comments/s7-05-18/s70518-3704495-162465.pdf> (“HMA Initial Fee Pilot Letter”).



allowed such violative pricing practices to persist and grow over the past several years. We urge the Commission to reverse course, and finally begin to enforce the law.

Further, however, the Cboe Tier Filings are unique from their predecessors in that they are more overtly discriminatory than others. Specifically, because the tiers are based on known, past volumes, the identities of the qualifying firms are explicitly known to the exchange, albeit undisclosed in the filing. Why is the exchange providing a specific pricing schedule to this set of one or more firms?

Again, these filings dispense with the fiction that “any firm” could qualify for a particular pricing tier. As we’ve said before, pricing tiers are often negotiated between a single broker or market maker and an exchange, and the “qualifications” for the particular fee schedules are typically structured so as to target only that firm, or perhaps a small handful of similar firms.

You might think of it as saying that only a person who spends a monthly average of between \$10 and \$12 per day on coffee and a Napa Almond Chicken Salad Sandwich and Wild Rice soup for not less than 20 days per month at the Mt. Lebanon, Pennsylvania Panera Bread may qualify for a 20% off coupon. Sure anyone could do it. But given the level of specificity, the number of qualifying individuals is likely to be quite low (in this case, it’s a set of one).

However, for the past several years, exchanges and seemingly the Commission, have clung to the fiction that such specificity still left open the possibility that multiple firms \*could\* qualify for the special pricing privileges. We have dismissed this logic in the past as still inconsistent with the law, but that seems to be the only fig leaf of a justification for allowing these discriminatory, anti-competitive prices to persist.

The instant filings, however, dispense with that fiction altogether. Instead, they are picking very specific, known firms without any potential change in who may qualify. We understand why the Commission must squash these filings, because they expose the failure of its current logic. The Cboe Tier Filings must be disapproved.

## Conclusion

In sum, the latest Cboe Tier Filings are yet another example of a conflicted process wherein an exchange has proposed non-transparent, discriminatory benefits to some

selected customers. As such, the Cboe Tier Filings are facially inconsistent with the exchange's obligations under the Exchange Act, and should be disapproved.

Further, the Cboe Tier Filings are but one of many fee filing changes--almost none of which provide sufficient details to permit the Commission to find that the proposals are consistent with the Exchange Act. Accordingly, we urge the Commission to, for this and all similar filings, take any appropriate actions to pause and carefully review the filings for their compliance with the law.

Lastly, because of the importance of pricing tiers on order routing incentives more broadly, we strongly urge the Commission to revise its rules to prohibit discrimination based upon the firm sending the order, and instead make any price distinctions based upon the characteristics of the orders being sent.

Put another way, everyone should pay the same price for the same cup of Panera coffee. The characteristics of the purchaser should be irrelevant. But, of course, the prices for a cup of coffee and a sandwich could be different.

Further, requiring basic disclosures of pricing tiers would greatly improve market participants' and regulators' understanding of how they work, and the impacts of pricing tiers have on market participant behavior and execution quality.<sup>24</sup>

Thank you for the opportunity to highlight our concerns contained within the Cboe Tier Filings. Should you have any questions or seek further information please contact me at (202) 909-6138.

Sincerely,



Tyler Gellasch  
President and CEO

Cc: Hon. Gary Gensler, Chair

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<sup>24</sup> See, e.g., HMA Initial Fee Pilot Letter, 19-23; see also, Chester S. Spatt, *Is Equity Market Structure Anti-Competitive?*, May 24, 2018 (working draft available upon request to the author).