HMA HEALTHY MARKETS ASSOCIATION
A MEMBER ORGANIZATION

ASA american securities association

January 5, 2023

Via Electronic Mail

Hon. Gary Gensler, Chair
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Volume-Based Exchange Transaction Pricing for NMS Stocks, (File No. S7–18–23)[1] and Proposed Rule Change Relating to Alternative Display Facility New Entrant (File No. SR-FINRA-2022-032)[2]

Dear Chair Gensler:

The Healthy Markets Association[3] and American Securities Association[4] welcome the agency's Proposal to address discriminatory exchange pricing practices, which we urge you to significantly revise and adopt.

Tiered pricing schedules that allow for registered securities exchanges to implement pricing practices that favor specific customers are facially discriminatory and anti-competitive, inequitable, and harmful to investors.[5]

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[1] Volume-Based Exchange Transaction Pricing for NMS Stocks, SEC, 88 Fed. Reg. 76282 (Nov. 6, 2023), available at https://www.govinfo.gov/content/pkg/FR-2023-11-06/pdf/2023-23398.pdf ("Pricing Tier Proposal" or the "Proposal").

[2] *Notice of Filing of a Proposed Rule Change Relating to Alternative Display Facility New Entrant,* SEC, Exch. Act Rel. No. 96550, (Dec. 20, 2022), *available at* https://www.sec.gov/files/rules/sro/finra/2022/34-96550.pdf.

[3] The Healthy Markets Association ("HMA") 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.

[4] ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. ASA has a geographically diverse membership base that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

[5] HMA has repeatedly expressed concerns with preferential pricing practices that discriminate against smaller volume trading firms, and distort brokers' order routing decisions in ways that often harm investors, for years. *See, e.g.,* Letter from Tyler Gellasch, HMA, to Brent J. Fields, SEC, Oct. 12, 2018,

We appreciate that your agency has proposed to "prohibit exchanges from offering volume-based transaction fees, rebates, or other incentives in connection with the execution of agency or riskless principal orders in NMS stocks."[6]

Unfortunately, while the Proposal recognizes some of the problems with aggregate volume-weighted pricing tiers, the Commission has proposed an inadequate half-solution that would not fully address the identified market ailments and investor harms, and may create or exacerbate market inequalities and distortions.

We urge the Commission to revise the Proposal to:

- ensure that all pricing tiers (i.e., incentive payments or fee levels) are based upon the characteristics of the orders themselves (i.e., whether taking liquidity or not, whether a limit order, etc.), as opposed to the characteristics of the parties sending the orders;
- abandon its deeply flawed, unjustified distinction between agency and principal trading;
- provide that details of all pricing tiers, including numbers of transactions, firms who qualified, and dollars paid for each tier are publicly disclosed on a monthly basis; and
- ensure that the proposed reforms apply to any trading venues that enjoy protected quotations.

Further, while not part of the instant Proposal, we urge the Commission to take action to:

- ensure that all transaction pricing is known prior to and assessed at the time of the routing decision, and disclosed (including to investors) with the trade confirmation;[7] and

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available at https://www.sec.gov/comments/sr-nyse-2018-40/srnyse201840-4510950-175996.pdf; Letter from Tyler Gellasch, HMA, to Brent J. Fields, SEC, Nov. 13, 2018, *available at* https://www.sec.gov/comments/sr-nyse-2018-49/srnyse201849-4640899-176435.pdf; Letter from Tyler Gellasch, HMA, to Hon. Gary Gensler, SEC, Nov. 16, 2022, *available at* https://healthymarkets.org/wp-content/uploads/2022/12/HMA-Ltr-re-Volume-Based-Pricing-11-16-22-1.pdf; Letter from Tyler Gellasch, HMA, to Vanessa Countryman, SEC, at 10, Mar. 31, 2023, *available at* https://healthymarkets.org/wp-content/uploads/2023/03/Market-Structure-Comment-Ltr-to-SEC-3-31-23-Final.pdf; Letter from Tyler Gellasch, HMA to Hon. Gary Gensler, SEC, Aug. 1, 2023, *available at* https://healthymarkets.org/wp-content/uploads/2023/08/Ltr-to-SEC-re-Pricing-Tiers-August-1-2023-1.pdf.

[6] Proposal, at 76285.

[7] This would appear to be consistent with the Commission's outstanding proposed reforms to Regulation NMS. See, *Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders*, SEC, 87 Fed. Reg. 80266, 80293 (Dec. 29, 2022), *available at* https://www.govinfo.gov/content/pkg/FR-2022-12-29/pdf/2022-27616.pdf.

- prohibit brokers acting as agents from considering rebate payments received or fees charged to them by exchanges (*i.e.*, that are not passed through to their customers) when making routing decisions.[8]

Commission Action is Needed

More than five years ago, HMA wrote to the Commission explaining that "each [trading] firm is subject to whatever rate it can convince an exchange (presumably for business reasons) to grant."[9] In recent years, these negotiations have led to the largest aggregate volume traders obtaining much higher rebate and lower fee levels per share traded than other traders.[10]

The current aggregate volume-weighted exchange transaction pricing practices effectively guarantee that high-volume trading firms, whether acting as principal or agent, retain a persistent competitive advantage over their lower-volume competitors.[11] Further, these different incentives embed conflicts of interest in order routing and create market distortions that harm investors.

The Proposal correctly identifies several problems with the current exchange pricing regime, including that:

- "[t]he large number of available tiers, and possible combinations of some tiers, greatly complicate exchange pricing schedules and that complexity can make it more difficult for the public to understand and meaningfully comment on exchange pricing proposals;"[12]

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[8] FINRA's rule on best execution and related guidance and enforcement actions make it clear that brokers cannot seek greater rebates at the expense of their customers' execution prices. *See, e.g.*, *In the Matter of Robinhood Financial, LLC*, Exchange Act Rel. No. 90694 (Dec. 17, 2020) (repeating that "[a] broker-dealer must not allow payment for order flow to interfere with its efforts to obtain best execution" and stating that the firm "did not take appropriate steps . . . to assess whether its higher payment for order flow rates were adversely affecting customer execution prices"). We note that this more explicit prohibition that we propose – which would apply to both rebate seeking and fee avoidance practices – may be best addressed as part of separately-adopted rules and guidance regarding brokers' best execution obligations. *See, e.g.*, Letter from Tyler Gellasch, HMA, to Vanessa Countryman, SEC, at Mar. 31, 2023, *available at* https://healthymarkets.org/wp-content/uploads/2023/03/Market-Structure-Comment-Ltr-to-SEC-3-31-23-Final.pdf.

[9] Letter from Tyler Gellasch, HMA, to Brent J. Fields, SEC, at 4, Nov. 13, 2018, *available at* https://www.sec.gov/comments/sr-nyse-2018-49/srnyse201849-4640899-176435.pdf.

[10] We note that while the current aggregate monthly trading volumes metric has become a common mechanism to provide pricing tiers, as discussed below, exchanges could also potentially adopt other mechanisms for offering differential incentives to specifically targeted firms, including those that may have other financial relationships with the exchanges.

[11] See, Proposal, at 76284.

[12] Proposal, at 76284.

- "lower-volume [brokers] may find it difficult to compete for customer order flow because they are unable to pass through to customers the favorable exchange transaction pricing or lower commissions that are available to higher-volume members;"[13]
- lower-volume brokers may be unable to effectively compete with larger-volume brokers for customer orders because larger-volume brokers may be able to charge lower commissions and fees (because those lost revenues are subsidized by more favorable transaction pricing);[14]
- lower-volume principal traders may be unable to effectively compete with larger-volume principal traders because they are unable to access the favorable exchange transaction pricing;[15]
- lower-volume traders (principals or agents) may route to their larger-volume competitors in order to split the more advantageous pricing available to their larger-volume competitors, concentrating market order flow volumes at larger volume firms, and "reducing the number of exchange members capable of offering them competitive exchange transaction pricing;"[16]
- "lower-volume exchange members [are compelled to] provide a subsidy for the high-volume members when exchanges use the higher fees and lower rebates of the lower-volume members to fund the lower fees and higher rebates the exchange offers to high-volume members;"[17] and
- brokers may "route orders to one particular exchange in order to qualify for that exchange's tiers and achieve lower fees and higher rebates as a result," even if that exchange may not provide the best execution for those orders.[18]

Each of those observations is consistent with our and our members' experience in the current marketplace, and they all point to an urgent need for Commission action. In addition to providing more factual support to the Commission's findings above, we also highlight below additional reasons why reforms are essential.

Proposal

The Proposal would arguably seek to partially address these concerns by:

- "prohibit[ing] equities exchanges from offering volume-based exchange transaction pricing in connection with the execution of agency or riskless principal orders in NMS stocks (''agency-related volume'');[19] and

[13] Proposal, at 76284.
[14] Proposal, at 76318.
[15] Proposal, at 76284.
[16] Proposal, at 76284.
[17] Proposal, at 76284.
[18] Proposal, at 76284-5.
[19] Proposal, at 76288.

- requir[ing] equities exchanges to disclose to the Commission "data tables of their volume-based transaction pricing tiers and the number of members that qualify for each tier in an Interactive Data File," which would be accessible through the EDGAR system.[20]

In part, because the Proposal would prohibit volume-based pricing tiers for agency orders, the Commission would also require exchanges to "establish, maintain, and enforce written policies and procedures that are reasonably designed to detect and deter members from receiving volume-based exchange transaction pricing in connection with the execution of agency or riskless principal orders in NMS stocks."[21]

Analysis

A prohibition on aggregate-volume based exchange pricing is both well within the Commission's authority to supervise the National Market System, and long overdue. However, applying the prohibition on aggregate volume-based pricing tiers to agency orders only, as proposed, will be insufficient to achieve the Commission's stated objectives. To the contrary, prohibiting aggregate volume-based pricing tiers for only agency trading would essentially countenance unfair discrimination by exchanges in pricing practices for proprietary trading, exacerbate anti-competitive practices, and lead to new (albeit different) investor harms. Put simply, the Commission has identified the correct set of problems, but failed to properly address them.

Exchanges Currently Use Aggregate Volume-Based Pricing Tiers to Target and Trap Order Flow of Specific Trading Firms

Aggregate volume-based pricing schedules used by many exchanges today effectively serve three purposes for the exchanges.

First, the form and levels of the tier criteria have been designed to identify specific firms. Exchanges need to know who may qualify and how much trading qualifies for the specific beneficial pricing tiers. This is extremely important, in part, because many of the top tiers offered by exchanges cause them to lose money on trading. While the exchanges can make up a portion of these losses through the sale of market data and other ancillary data services, they simply can't offer benefit pricing to everyone. That is why the mechanisms for identifying the beneficiaries of preferential access often involve compound, complex criteria. Not surprisingly, the largest, most connected trading firms often custom-negotiate their pricing schedules with the major exchanges (although the details of those often oral negotiations are nearly never disclosed publicly). The Commission should focus on these areas to make certain that all aspects of the

[20] Proposal, at 76289.
[21] Proposal, at 76288-289.

exchange trading environment remain open, fair, and competitive for all market participants.

Second, aggregate volume-based pricing arrangements are intended to entice the largest, most-connected traders to send orders to the exchange offering the benefits. Order flow begets order flow, and if an exchange can buy order flow from certain preferred traders, that network effect effectively compels other traders to come to the venue to interact, even when they don't enjoy the beneficial pricing of the preferred class.[22] In fact, brokers may be commercially or regulatorily compelled to trade at that exchange, even if they are forced to pay materially higher fees or obtain materially lower rebates.[23]

Third, by their nature, aggregate volume-based pricing tiers seek to "lock up" trading volumes for specific exchanges. If a trader needs to trade on a particular exchange in order to hit a pre-set preferential pricing tier, it has a financial incentive to choose that venue over others - irrespective of the potentially negative impacts on investors.

Aggregate Volume-Based Pricing Tiers Materially Impede Competition in Agency and Principal Trading

The Proposal explains that the proposed "prohibition is designed to remove a competitive impediment between higher-volume and lower-volume members when they compete for customer business, and also to mitigate the conflict of interest between members and customers presented by volume-based exchange transaction pricing tiers when members are routing customer orders to an exchange for execution."[24]

That objective is far more narrow than what the Exchange Act requires. The Exchange Act doesn't say that the Commission should promote competition between only agency brokers. Rather, it says that exchange rules, including transaction pricing:

- "provide for the equitable allocation of reasonable dues, fees, and other charges;"[25]

[22] As discussed in greater detail below, this is yet another reason why the proposed reforms should apply to any venues offering protected quotations.
[23] While Regulation NMS caps the fee that may be assessed for taking liquidity for a protected quotation, exchanges may – and often do – offer discounts from those fees to some traders. Further, the Order Protection Rule may lead to a broker's order being executed on an exchange with a protected quotation that charges it a higher fee than another exchange. The result may be that an exchange may have a strong financial incentive to offer aggressive rebates to proprietary trading firms, so as to capture more agency-based order flow at potentially higher fees for those agency brokers.
[24] Proposal, at 76285.
[25] 15 U.S.C.§ 78f(b)(4).

- not be “designed to permit unfair discrimination”;[26] and
- “not impose any burden on competition not necessary or appropriate in furtherance of the purposes of” the Act.[27]

As the Proposal notes, smaller broker-dealers may elect to route orders to their larger competitors so as to take advantage of their competitors’ beneficial pricing with the exchanges.[28] We note that this is true for both agency and principal trading.

In practice, this process often begins with the larger-volume trading firm sharing with smaller volume trading firms its “pricing” for different types of orders on different exchanges, typically segregated by Tape (A, B, and C), and by whether the order is taking or providing liquidity. Below is an actual copy of such a sheet, which was submitted to a regional broker by a bulge bracket bank over five years ago, as a way to solicit orders from that smaller-volume broker.

	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)

However, since HMA first shared the above pictured pricing sheet with the Commission, we have learned (from the exchanges’ filings, which we review each month) that the preferential pricing for larger-volume traders has diverged even further from the prices available to lower-volume traders.

Discrimination, market distortions, and conflicts of interest have grown over the past several years. As HMA wrote to the Commission in August 2023,

> [O]n NYSE ARCA, at least one broker has negotiated a rebate of a whopping 32 cents per 100 shares traded for adding liquidity in a Tape B name, guaranteeing that the exchange is losing money on that trade (because the fee is capped at 30 cents). However, the “standard” rebate given to the vast majority of brokers for the exact same orders is just 20 cents.
>
> Put another way, if a regional broker-dealer sent a 100 share order in a Tape B security to the exchange it would make 20

[26] 15 U.S.C.§ 78f(b)(5).
[27] 15 U.S.C.§ 78f(b)(8).
[28] Proposal, at 76284.

cents, whereas this particular unnamed broker would be paid 60% more for the exact same trade.

This phenomenon isn't unique to NYSE ARCA. BATS has recently negotiated to pay at least one broker a rebate of 32 cents per 100 shares traded for adding liquidity in Tape A securities, but its "standard" rebate given to the vast majority of brokers for the exact same orders is just 16 cents. ***So, the unidentified broker is twice as profitable on the exact same trade as a regional broker-dealer would be.***[29]

Worse, as the Proposal acknowledges, "[w]hile the highest volume traders are either trading at heavily discounted rates or making a profit from exchange transaction rebates, the revenue to supply such discounts may come, in part, from lower-volume broker-dealers who do not qualify for volume discounts."[30] We remind the Commission that more than five years ago, the President of Cboe stood on the stage in the auditorium at the Commission's Washington, DC headquarters, and acknowledged that the firm was net writing checks to half of its ten largest volume trading customers.[31]

The Commission doesn't seem to have considered why the exchange family was choosing to lose money on those high-volume traders, even though it seems to acknowledge that those traders were being subsidized by lower-volume trading firms. Even more oddly, the Commission appears to have undertaken no meaningful analysis of the competitive impacts of subsidization on principal trading firms, agency trading firms, or investors – even though that is essentially the entire point of the Proposal.

Notably, we have also learned that some of the larger-volume order flow aggregators (aka large banks and high-volume trading firms) have essentially held their smaller competitors who seek better pricing through them hostage – including by requesting that their smaller competitors help their cause in opposing this instant rulemaking.

The Proposed Aggregate Volume-Based Pricing Tier Prohibition For Agency-Only Trading Would Lead to Market Distortions and be Easily Evaded.

[29] Letter from Tyler Gellasch, HMA to Hon. Gary Gensler, SEC, Aug. 1, 2023, *available at* https://healthymarkets.org/wp-content/uploads/2023/08/Ltr-to-SEC-re-Pricing-Tiers-August-1-2023-1.pdf (emphasis added).
[30] Proposal, at 76313.
[31] 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.

Prohibiting volume-based pricing tiers for agency trading, but not principal trading, will lead to market distortions, and simply won't work as intended.

The Proposal's distinction of agency versus principal trading would block existing practices used today by smaller-volume traders to mitigate the discriminatory, anti-competitive impacts of exchange pricing tiers.

Today, many smaller-volume traders route their orders through their larger-volume competitors so as to take advantage of some portion of their larger-volume competitor's preferential pricing. For example, a simple review of the filings shows that at least one trading firm enjoys a rebate of 34.5 cents per 100 shares of adding liquidity on Nasdaq for Tape B securities, while the "standard" rate for nearly every other market participant is 18 cents per 100 shares for the same securities. In that instance, a smaller-volume broker might route orders to that larger-volume broker. In addition to seeing the additional order flow, the larger-volume broker will typically charge a fee of 1-2 cents to the smaller-volume broker in exchange for "access" to the better exchange pricing. The lower-volume broker, in turn, will typically be charged less of a fee or receive a much greater rebate than it would have on its own. So the smaller-volume broker would receive a rebate of perhaps 32 cents per 100 shares from engaging in the arrangement, versus just 18 cents, were it to send the orders directly to the exchange.

However, the Proposal would effectively end this practice, as lower-volume traders would not be able to benefit from their competitors' preferential pricing, as the brokers accessing the exchanges would be acting in an "agency" capacity. While the Proposal explicitly acknowledges that this practice occurs, it doesn't qualitatively or quantitatively address how its Proposal would impact those smaller-volume brokers (although it does for larger-volume brokers). If the Commission adopts a distinction between agency and principal order flow, it would have to analyze how this distinction would impact these different market participants.

The Proposal's distinction between principal and agency trading would incentivize larger banks to shift their customers' trading from cash equities to equity derivatives.

The Proposal's distinction between principal and agency trading would encourage traders that can afford to do so (such as banks with significant capital) to shift their customers' trading to derivatives trades, so that they may then "hedge" those trades in the cash equities markets (where the banks can continue to obtain the preferential pricing, because they would be "principal" trades).

In fact, investors with “pass through” pricing would be highly incentivized to shift their trading to swaps-based strategies so as to take advantage of that potential pricing differential.[32]

For example, already a hedge fund that has implemented a “pass through” pricing model with its brokers has repeatedly shared with the Commission that it actively discriminates against all but the handful of largest brokers because those brokers do not have the most beneficial pricing rates from exchanges. If a bank could still take advantage of preferential pricing by engaging in a swap transaction and cash equities hedge, but a smaller-volume trading firm could not, then this Proposal would have the effect of perversely consolidating more agency trading at banks who could engage in this strategy.[33]

The Proposal’s distinction between principal and agency trading would incentivize proprietary trading and would likely lead to greater disintermediation and greater risks for investors.

As the economic analysis in the Proposal acknowledges, by expressly blessing significant pricing discrimination for principal traders, but not agency trading firms, the Proposal would make it more likely that all traders would interact with principal traders on exchanges, and less likely to interact with “naturals,” who would not be able to benefit as much from passive trading strategies.

This would likely skew the current market structure towards more disintermediation by principal trading firms, with potentially significant associated costs to other market participants – including greater risks for information leakage and higher execution costs. While the Commission’s analysis recognizes that there would be likely some shift in the mix of trading on exchanges as a result of its changes to incentives of principal versus

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[32] We applaud the Commission for separately proposing to improve exchange pricing practices so that more investors may be able to implement “pass through” pricing models with their brokers. See, *Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders*, SEC, 87 Fed. Reg. 80266, 80292-293 (Dec. 29, 2022), *available at* https://www.govinfo.gov/content/pkg/FR-2022-12-29/pdf/2022-27616.pdf. As HMA has shared with the Commission before, “pass-through” pricing may reduce brokers’ conflicts of interest in order routing. However, it is currently impossible for many investors to adopt because of many peculiarities of exchange pricing models. The Commission’s proposal to ensure that brokers know the fee or rebate at the time of the execution for a particular trade would make “pass through” relationships more possible, and should be implemented without delay.

[33] The Commission has separately proposed to implement transaction pricing transparency that may lead to more investors adopting so-called “pass-through” pricing. While we strongly support that proposed reform, we note that if that reform is combined with this proposal, the net impact could be to exacerbate the existing competitive advantages of large volume trading firms that could engage in mirrored equity derivative trading strategies.

agency trading, the Proposal does not adequately analyze what that shift would mean for investors.

The Proposal's distinction between principal and agency trading would exacerbate pricing disparities for agency and principal order flow, and would likely also exacerbate the disparities in pricing between larger-volume and lower-volume principal traders.

If equities exchanges are able to conserve costs on agency trades by applying lower, consistent rebates or higher fees for most or all agency trades, they would likely reallocate those saved costs into continuing to compete more aggressively for order flow in other areas – such as providing even more discriminatory, preferential pricing to the largest, most connected principal traders. This could mean that the variance in pricing for the same order sent to an exchange could perversely grow.

The Proposal's anti-evasion requirements for identifying principal versus agency trading would be difficult to effectively implement.

As a practical matter, banks are already supposed to clearly market principal vs. agent trades. For example, as the Commission notes in its analysis, reporting entities to the Consolidated Audit Trail are expected to report whether they are acting as agency, principal, or riskless principal capacity.[34]

Sadly, this distinction isn't particularly well-policed. At the same time, the consequences for mis-reporting are also generally minimal. However, allowing exchanges to differentiate pricing based on agency and principal would likely lead to much greater incentives for principal trading activity vis-a-vis the agency activity. This difference would strongly incentivize banks to shift as much trading to quasi- "riskless principal" or "principal" trading (including through shifting their customers to derivatives trading, which they may then hedge in the cash equities market).

Lastly, as we have previously shared with the Commission, in addition to the concerns outlined above, including shifting the nature of orders in the marketplace towards more principal trading, and increasing the likelihood of mismarking of trades, the Proposal's principal versus agency distinction would unquestionably exacerbate the complexity and burdens of the price reconciliation process used to determine and assess fees and rebates due from or to each trading firm.

The Proposal's Distinction Between Principal and Agency Trading is Logically and Legally Inconsistent.

[34] Proposal, at 76302.

The Proposal states that "[s]imilar competitive concerns also may be present for members as a result of volume-based exchange transaction pricing when they trade proprietarily using principal orders where no customers are involved."[35] "May" is the wrong word. The massive competitive disparity between higher-volume and lower-volume traders certainly exists irrespective of whether the trading is done by a trading firm as a principal, or in an agency capacity.

By seeking to impose a prohibition on aggregate volume-based pricing tiers in one capacity, but not another, the Proposal would appear to be facially inconsistent. Why is a facially discriminatory burden on competition that imposes greater fees on some firms worthy of prohibition in one context (when firms are ostensibly acting as agents), but permissible in another (when the firms are principal trading)? The Commission doesn't engage in robust analysis to justify this distinction. It should.

The Proposal's Aggregate Volume-Based Pricing Tier Prohibition Would Not End Discriminatory Pricing Practices

We agree with the Commission's determination that aggregate volume-based pricing tiers discriminate against lower volume traders. However, the Proposal somewhat inexplicably ignores that equities exchanges could easily achieve the same effect as aggregate volume-based pricing tiers through other mechanisms.

Sadly, many forms of prohibited discrimination across society have been masked over the years through means that are intended to appear to be non-discriminatory, objective criteria. The imposition of an ostensibly objective criteria doesn't mean that the discrimination is any less persistent or pernicious.

What if, for example, instead of using aggregate volume-based pricing tiers, an exchange simply declared that it would offer a particular pricing schedule to a particular firm, and it named the firm? What if an exchange chose to offer preferential pricing to any firm whose headquarters is at a particular address? What if, instead of those means of identifying a firm, it chose to offer the pricing to any firm that serves as an underwriter for a large number of listings on the exchange per year? Or the exchange offers a preferential price to only trading firms that buy other specified services? Or what if an exchange determines to offer beneficial pricing to a trading firm simply because it has an executive that is longtime personal friends with an executive at the trading firm?
Could an exchange claim that its pricing was consistent with the Exchange Act if it simply offered a pricing tier to a large bank, and named the firm? Why would that be any different if the exchange identified a bank through some other mechanism, albeit not by name?

[35] Proposal, at 76284.

Unfortunately, by simply focusing on prohibiting aggregate volume-based pricing tiers, the Commission is effectively inviting exchanges and their largest or otherwise most-favored customers to find other mechanisms to effectuate discriminatory outcomes.

If the Commission is finally looking to end transaction pricing discrimination that is inconsistent with the plain language of the Exchange Act, it should not simply prohibit one form of the practice, while permitting others. The Commission must clearly articulate the principle that it is trying to implement, and ensure that the rule and related guidance reasonably effectuate that principle. Focusing on the aggregate volume-based pricing tiers, while not addressing other mechanisms to effectuate discriminatory pricing tiers that benefits large, or favored firms, would not only be ineffective, but may also be viewed as “arbitrary and capricious.”

Prohibitions on Some Forms of Incentives are Not Prohibitions on All Incentives

While the Commission should prohibit exchanges (and any ATSs with protected quotations) from adopting variable incentives based upon who is sending the orders, we do not object to variable order routing incentives. For example, we believe that the Commission could – consistent with the Exchange Act – permit venues with protected quotations to allow for orders in less liquid names, or of a larger size, to receive preferential pricing. However, those incentives should apply regardless of the firm sending the order or capacity in which the order is sent. Put simply, the Commission could still permit incentivizing market participants to submit orders, but those incentives should comply with the Exchange Act’s requirements. Aggregate volume-based pricing tiers do not, just like naming a single firm for preferential pricing would not. But allowing *any firm* sending a 200 share or greater order to a venue in an illiquid name likely could.

The Commission Should Further Refine Its Economic Analysis

While the Proposal recognizes that the largest volume traders often enjoy preferential access to the exchanges, neither the exchanges nor the Commission have ever undertaken a public legal or quantitative analysis of the extent of the preferences or the impacts on different market participants or the markets overall. Indeed, even the Proposal itself heavily relies upon estimates based on publicly available summary information from exchange’s 10-Q filings[36] and anecdotal summary information based on its staff’s “conversations with industry members.”[37]

[36] Proposal, at 76302.
[37] *See, e.g.*, Proposal, at 76302 (explaining that exchanges’ “net capture for non-auction trading in stocks is likely close to $0.0002 per share”).

We urge the Commission to qualitatively and quantitatively evaluate the extent to which custom-tailored exchange pricing targeted at preferred (often, largest-volume trading) firms is inconsistent with the Exchange Act. This analysis should include:

- the extent to which the preferred trading firms benefit from exchange's preferential pricing practices; and
- The extent to which other market participants (including regional broker-dealers) suffer from existing preferential pricing awarded by the exchanges to the preferred firms.

Put another way, the Commission should identify the different costs, risks, latencies, impacts on different market participants, and impacts on market quality created by having some trading firms with extremely preferential access (lower fees and higher rebates) to exchanges.[38]

The Commission should use exchange filings and Consolidated Audit Trail data to examine the top pricing tiers offered by each of the major exchanges and identify to the public how many firms qualify for that pricing. In particular, the Commission could use the CAT data to extrapolate – in hard numbers – the differences between what a "normal" firm versus a "favored" firm pays or is paid by an exchange, on a per share basis, compared to other traders. This should be performed for each of the largest, most connected firms across each of the major exchanges.[39]

For example, it's easy to see that at least one trading firm enjoys a rebate of 34.5 cents per 100 shares of adding liquidity on Nasdaq for Tape B securities, while the "standard" rate for nearly every other market participant is 18 cents per 100 shares for the same securities. In this example, the first trading firm would not give the exchange a net capture rate of 2 mils. Rather, we know that the exchange *would absolutely lose money on all of those qualifying trades*. On the other hand, an exchange might make 12 mils in net capture if another trading firm sends such an order. The Commission should seek to quantify this impact.

Similarly, we know that larger-volume traders often make their negotiated, preferential pricing available to smaller-volume traders for a fee. The Commission should identify the fees charged (often 1-2 cents per 100 shares) and use the Consolidated Audit Trail data to quantify the explicit economic rent extracted by those firms from other market participants.

Unfortunately, the secondary impact on agency-based routing decisions is much harder to identify and assess (as the Commission discussed in the Transaction Fee Pilot) than

[38] Notably, none of these concerns or analysis are dependent upon whether the traders are acting as principals or agents.
[39] We recommend that the Commission do that for January 2023, as that month was used for other parts of its analysis.

the direct impacts of the pricing tiers on brokers and principal traders of different sizes and types.

If the Commission proposes implementing a principal versus agent distinction for pricing discrimination, we question how it would justify stopping the discrimination for agents, since the same issues above would apply equally with principals. Further, any language or analysis from the Commission used to make a principal versus agency distinction would appear to fundamentally weaken any legal or economic analysis underpinning the adoption of the prohibition of agents only. Put simply, when comparing two similar situations for which the Commission has proposed adopting disparate regulatory treatment, the Commission should fully explain the facts and legally justify the analysis underpinning the distinction.[40]

The Proposed Mandatory Pricing Tier Disclosures Should be Expanded Materially, Revised, and Adopted.

The Proposal includes a very useful summary table of the variable prices for the different registered exchanges.[41]

[40] Notably, the Commission's failure to adequately explain its regulatory distinction between two similar Bitcoin-related financial products led to the Court of Appeals for the District of Columbia Circuit to hold that the Commission's denial of one product was "arbitrary and capricious." *Grayscale Inv. LLC v. SEC*, No. 22-1142 (DC Cir. 2023), *available at* https://www.cadc.uscourts.gov/internet/opinions.nsf/32C91E3A96E9442285258A1A004FD576/$file/22-1142-2014527.pdf.
[41] Proposal, at 76286.

TABLE 1—SUMMARY OF TRANSACTION-BASED PRICING SCHEDULES FOR DISPLAYED/REGULAR ORDERS ON EQUITIES EXCHANGES DURING REGULAR TRADING HOURS AS OF MAR. 2023

Fees and rebates for transactions at or above $1.00 on Tapes A, B & C *			
Exchange	Pricing model	Fees (# of categories)	Rebates (# of categories)
Cboe BZX	Maker-Taker	$0.0030 (Tapes A, B & C—1 each)	($0.0016)–($0.0031) (Tapes A, B & C—7 each).
Cboe BYX	Taker-Maker	$0.0012–$0.0020 (Tapes A, B & C—6 each)	($0.0002)–($0.0015) (Tapes A, B & C—2 each).
Cboe EDGA	Taker-Maker	$0.0015–$0.0030 (Tapes A, B & C—4 each)	($0.0016)–($0.0022) (Tapes A, B & C—3 each).
Cboe EDGX	Maker-Taker	$0.00275–$0.0030 (Tapes A, B & C—2 each)	($0.0016)–($0.0029) (Tapes A, B & C—4 each).
BX	Taker-Maker/Flat	$0.0012–$0.0030 (Tapes A, B & C—5 each)	($0.0004)–($0.0018) ** (Tapes A, B & C—5 each).
Phlx (PSX)	Maker-Taker	$0.0030 (Tapes A, B & C—1 each)	($0.0020)–($0.0032) (Tapes A, B & C—2 each).
Nasdaq	Maker-Taker	$0.0030 (Tapes A, B & C—1 each)	($0.0013)–($0.00305) (Tapes A, B & C—11 each).
NYSE Arca	Maker-Taker	$0.0029–$0.0030 (Tape A—1, Tapes B & C—2 each).	($0.0016)–($0.0034) (Tape A—7, Tapes B & C—10 each).
NYSE American	Maker-Taker	$0.0026–$0.0030 (Tapes A, B & C—3 each)	($0.0020)–($0.0026) (Tapes A, B & C—3 each).
NYSE	Maker-Taker	$0.0026–$0.0030 (Tapes A & B—1 each, Tape C—3).	($0.0012)–($0.0031) (Tape A—2, Tape B—4 & Tape C—5).
NYSE National	Taker-Maker	$0.0020–$0.0029 (Tapes A, B & C—5 each)	$0.000–($0.0030) (Tapes A, B & C—5 each).
NYSE Chicago	Flat	$0.0010 (Tapes A, B & C—1 each)	$0.00 (0).
IEX	Flat	$0.0009 (Tapes A, B & C—1 each)	$0.000 (0).
MEMX	Maker-Taker	$0.0029–$0.0030 (Tapes A, B & C—3 each)	($0.0018)—($0.00335) (Tapes A, B & C—5 each).
MIAX Pearl	Maker-Taker	$0.00275–$0.00295 (Tapes A, B & C—3 each).	($0.0029)–($0.0036) (Tapes A, B & C—4 each).
LTSE	Free	$0.0000 (0)	$0.0000 (0).

Sadly, the most important information in this chart is what is not specifically detailed. From this chart, for example, we can't see which firms, or how many orders are able to enjoy getting paid by the exchanges an amount in excess of what the exchange may charge the customer on the other side. We can't see in the chart above which firms are subsidizing that trading, or by how much.

However, just because we don't have the information with which that can be determined doesn't mean the Commission doesn't. To the contrary, the Commission could simply request the pricing records for the exchanges for the month of January 2023, and marry that to the data from the Consolidated Audit Trail to actually answer the basic questions highlighted above.

Given the rapid proliferation of differential pricing tiers, we believe the Commission should require the exchanges to provide details of pricing for all of its transactions on a monthly basis, along several different lines of analysis. For each applicable pricing level, each exchange should detail the number of customers who executed trades at that level during the month, and the volume executed per customer at that level. Further, the exchanges should be required to disclose the number of any customers that month who received net payments for trading on the exchange, and provide the total payment for each customer.

Any Adopted Changes Should be Applied to All Venues with Protected Quotations

As of today, all venues with protected quotations under Regulation NMS are registered securities exchanges. As HMA has written extensively,[42] the Commission should continue to ensure that it has direct, exchange-level oversight over all venues offering a protected quotation, and the Commission should not award the favored regulatory status of having a protected quotation to an ATS without significant not-yet-existing regulatory protections, if at all.

However, given that the Commission is in the process of considering awarding protected quotation status to an ATS, it is essential that the Commission ensure that any rules regarding exchange transaction pricing (including any potential prohibitions on pricing tiers) must apply to all venues offering protected quotations. Alternatively, a failure to adopt such a prohibition should constitute sufficient grounds so as to deny an ATS the privilege of having a protected quotation.

Put simply, if this rule is adopted as proposed, and the Commission were to award an ATS a protected quotation, the Commission would be creating an unlevel playing field for trading venues, while also creating significant market order routing distortions and investor harms.

Conclusion

The Proposal would seek to partially address non-transparent, discriminatory exchange transaction pricing practices that benefit the largest, most connected traders to the detriment of everyone else.

The Commission should adopt a rule to clearly end these pricing practices, which are facially inconsistent with the exchanges' obligations under the Exchange Act. That prohibition should include aggregate volume-based pricing tiers and any other methods that could be used to implement such discrimination. Further, the Commission must abandon its unsupported and unjustified distinction between principal and agency trading, which would render the Proposal not only ineffective, but worse, create new market distortions and complexities.

Ultimately, we suspect that the Commission concocted its half-solution of applying its prohibition on aggregate volume-based pricing tiers to only agency trading because the

[42] Letter from Tyler Gellasch, HMA, to Gary Gensler, SEC, et al, Oct. 27, 2023, *available at* https://healthymarkets.org/wp-content/uploads/2023/10/Ltr-to-SEC-re-FINRA-IC-ADF-Application-10-27-23.pdf; Letter from Tyler Gellasch, HMA, to Vanessa Countryman, SEC, Mar. 14, 2023, *available at* https://healthymarkets.org/wp-content/uploads/2023/03/Ltr-to-SEC-re-FINRA-IC-ADF-Application-3-14-23.pdf; Letter from Tyler Gellasch, HMA, to Vanessa Countryman, SEC, Jan. 13, 2023, *available at* https://healthymarkets.org/wp-content/uploads/2023/01/Ltr-to-SEC-re-FINRA-IC-ADF-Application-1-13-22.pdf.

Commission made a political calculation to avoid essentially picking a fight with the large proprietary trading firms, some of which have proven to be uniquely litigious. The Commission's fear of litigation isn't a substitute for robust economic analysis or sound public policy.

During the Open Meeting at which the Proposal voted to be released, Commissioner Crenshaw asked whether "a prohibition on tiered pricing that is limited to the execution of agency-related volume adequately address[es] the concerns we have identified about member competition?"[43] The answer is a resounding no.

Thank you for the opportunity to offer our support for ending discriminatory, anti-competitive, and unfair pricing practices by exchanges. We urge you to revise the Proposal with our suggestions and adopt it without delay.

Should you have any questions or seek further information please contact Tyler Gellasch at Healthy Markets Association or Jessica Giroux, General Counsel, of the American Securities Association.

Sincerely,

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Cc: Hon. Caroline Crenshaw
Hon. Hester Peirce
Hon. Mark Uyeda
Hon. Jaime Lizarraga
Haoxiang Zhu, Director, Division of Trading and Markets

[43] Remarks of Hon. Caroline Crenshaw, SEC, Statement on Volume-Based Exchange Transaction Pricing for NMS Stocks, Oct. 18, 2023, *available at* https://www.sec.gov/news/statement/crenshaw-statement-volume-based-rebates-and-fees-101823.