March 30, 2023

Via Electronic Mail: rule-comments@sec.gov

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

Re: (1) Disclosure of Order Execution Information, Release No. 34-96493; File No. S7-29-22; (2) Regulation Best Execution, Release No. 34-96496; File No. S7-32-22; (3) Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, Release No. 34-96494; File No. S7-30-22; (4) Order Competition Rule, Release No. 34-96495; File No. S7-31-22

Dear Ms. Countryman:

Managed Funds Association ("**MFA**")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission (the "**SEC**" or the "**Commission**") on the above-captioned proposed rules (the "**Proposed Rules**").[2] The Proposed Rules would, together, fundamentally alter U.S. equity securities trading and market structure regulation. As we discuss below, we support certain aspects of these changes, but we think that the Commission should take a more gradual and incremental approach overall.

MFA's members are some of the most significant and active participants in the U.S. equity securities markets, including on national securities exchanges ("**NSEs**"), as well as other

[1] MFA represents the global hedge fund and alternative asset management industry and its investors by advocating for regulatory, tax, and other public policies that foster efficient, transparent, and fair capital markets. MFA's more than 150 member firms collectively manage nearly $2.6 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, Brussels, London, and Asia. *See* www.managedfunds.org for more information.

[2] Disclosure of Order Execution Information, Release No. 34-96493 (Dec. 14, 2022), 88 Fed. Reg. 3786 (Jan. 20, 2023) ("**Rule 605 Proposal**"); Regulation Best Execution, Release No. 34-96496 (Dec. 14, 2022), 88 Fed. Reg. 5440 (Jan. 27, 2023) ("**Regulation Best Execution**"); Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, Release No. 34-96494 (Dec. 14, 2022), 87 Fed. Reg. 80266 (Dec. 29, 2022) ("**Reg NMS Proposal**"); Order Competition Rule, Release No. 34-96495 (Dec. 14, 2022), 88 Fed. Reg. 128 (Jan. 3, 2023) ("**Order Competition Rule**").

platforms, such as alternative trading systems ("**ATSs**"), and as customers of over-the-counter ("**OTC**") market makers and other broker-dealers. Any proposed changes to equity market structure are, therefore, of great interest to MFA and our members. In this regard, over the years, we have published various reports and white papers concerning equity market structure.[3]

Our members' experience is that U.S. equity market structure has been highly effective in promoting transparency and liquidity for market participants, even during periods of extreme market volatility such as March 2020. Accordingly, while we think targeted updates would be appropriate, more far-reaching changes could be disruptive and counterproductive. In addition, while we understand the Commission's desire to enhance execution quality for retail investors, we think it is also important to account for the potential impact on institutional investors, who together comprise a majority of trading activity.

These considerations inform our preference for the more gradual and incremental approach we lay out below, with a focus on increased transparency coupled with more limited changes to core market structure components such as tick sizes. This approach would lead to more predictable outcomes and better enable market participants to adapt to the changes. It also would allow the Commission to assess the incremental impact of individual market structure changes. If additional changes were warranted based on such assessment, the Commission would retain flexibility to make them.

EXECUTIVE SUMMARY

We appreciate the opportunity to share our views in connection with the Proposed Rules. The following is a summary of our recommendations, which we explain more fully below. MFA recommends that:

- With respect to the Rule 605 Proposal, the Commission should: (1) prioritize its adoption vis-à-vis the other Proposed Rules and (2) ensure that the proposal does not require order or execution management systems to provide Rule 605 reports.

- The Commission should not create undue overlap and uncertainty by adopting a Commission-level best execution standard that duplicates existing self-regulatory organization ("**SRO**") rules. To the extent the Commission believes that a Commission-level best execution standard is needed, the Commission should ensure that the proposed Regulation Best Execution: (1) allows broker-dealers to consider appropriate factors when making best execution determinations and (2) provides institutional customers with appropriate protection by (i) defining the term as other than a "retail investor";
(ii) refining the definition of "retail customer" to be more consistent with Regulation Best

[3] *See, e.g.*, MFA, *2022 Market Structure Recommendations: Promoting Fair, Efficient, and Transparent Markets* (April 2022), *available at* https://www.managedfunds.org/wp-content/uploads/2022/04/MFA-Market-Structure-Recommendations.pdf ("**2022 Market Structure Recommendations**"), and MFA, *Equity Market Structure Policy Recommendations* (Sept. 28, 2015), *available at* https://www.managedfunds.org/wp-content/uploads/2015/12/Equity-Market-Structure-Recommendations-with-Cover-Letter.pdf.

Interest, as it has been implemented; and (iii) providing institutional customers with the ability to determine whether and when their transactions would be exempted from the best execution standard.

- With respect to the Reg NMS Proposal, the Commission should: (1) only reduce the minimum tick size to a half-penny increment for tick-constrained securities, but not introduce finer tick sizes (and, once the core change to half-penny increments has been absorbed by the markets, the Commission could consider if further changes in the increments would be fruitful for certain groups of securities); (2) not prohibit trade execution at prices finer than the applicable minimum pricing increment; (3) reduce access fees in a manner that is proportionate to the proposed reduction in tick sizes; and (4) prioritize the acceleration of the implementation of certain aspects of the MDI Rule (defined below).

- With respect to the proposed Order Competition Rule, the Commission should: (1) pause consideration until it implements and assesses the other aspects of the Proposed Rules; (2) not take an overly prescriptive approach, which could result in unintended negative consequences; and (3) ensure that its proposed dealer rule would not discourage institutional investor participation in qualified auctions.

DISCUSSION

I. Rule 605 Proposal

Commission Rule 605 generally requires market centers[4] to make available standardized, monthly reports of statistical information concerning their order executions.[5] The Rule 605 Proposal would, among other things, expand the scope of entities subject to Rule 605, modify the information required to be reported under the rule, and change how orders are categorized for the purposes of the rule.[6] We generally support the Rule 605 Proposal, and we respectfully request that the Commission prioritize its adoption vis-à-vis the other Proposed Rules and ensure that its application is appropriately scoped, as discussed below.

A. The Commission should prioritize adoption of the Rule 605 Proposal.

We support the Rule 605 Proposal. We are generally in favor of efforts to provide greater transparency into the equity securities market, and we think that the Rule 605 Proposal will provide market participants with more (and more helpful) data regarding order execution quality. This data will help promote competition among market centers and executing brokers, and enable investors to exercise their own discretion to achieve best execution without requiring the significant infrastructure changes and imposing the trade-offs that would result from the other

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[4] A "market center" includes any exchange market maker, OTC market maker, ATS, NSE, or national securities association. 17 C.F.R. § 242.600(b)(46).

[5] *See* 17 C.F.R. § 242.605.

[6] *See* 88 Fed. Reg. 3786, 3795; 88 Fed. Reg. 3786, 3803; 88 Fed. Reg. 3786, 3807.

Proposed Rules. Given the likely benefits of revamped Rule 605 reports to market participants (and the relatively modest changes required by this proposal as compared to certain of the other Proposed Rules), we respectfully request that the Commission prioritize adoption of the Rule 605 Proposal ahead of the other Proposed Rules.

Prioritization of this rule is also appropriate because significant aspects of the other Proposed Rules depend upon the data that will be collected and disclosed pursuant to a revised Rule 605. For example, in proposing the Order Competition Rule, the Commission notes that the quantitative measures collected and disseminated pursuant to Rule 605 "are referenced extensively throughout [the Order Competition Rule] release to explain the rationale for and the potential economic effects of [the Order Competition Rule]."[7] We think it is odd for the Commission to propose a market structure change as significant as the Order Competition Rule based upon Rule 605 data that the Commission has, simultaneously, deemed to be insufficient (or at least incomplete).

As another example, the Commission recognizes that compliance with best execution obligations, including those provided in proposed Regulation Best Execution (discussed in detail in Part II, below), is dependent upon receipt of information regarding order execution across market centers: "In adopting Rules 605 and 606 of Regulation NMS, the Commission recognized that the reports required of market centers would provide statistical disclosures regarding certain factors, such as execution price and speed of execution, relevant to a broker-dealer's order-routing decision and that these public disclosures of execution quality should help broker-dealers fulfill their duty of best execution."[8] It follows that the Rule 605 Proposal should be adopted and implemented before requiring compliance with any Commission-level best execution requirements.

B. The Commission should ensure that the Rule 605 Proposal does not require order management systems or execution management systems to provide Rule 605 reports.

In 2022, the Commission proposed a rule (the "**Reg ATS Proposal**") that would, among other things, require additional entities to register with the Commission as ATSs and comply with the rules and regulations applicable to ATSs.[9] In particular, the Reg ATS Proposal, if adopted as proposed, would require "communication protocol systems"[10] to register as ATSs (or

[7] 88 Fed. Reg. 128, 134.

[8] 88 Fed. Reg. 5440, 5443. *See also id.* at 5457 ("In addition, 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.").

[9] *See* Amendments Regarding the Definition of "Exchange" and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities, 87 Fed. Reg. 15496 (Mar. 18, 2022).

[10] The Reg ATS Proposal defines Communication Protocol Systems as systems that offer protocols and the use of non-firm trading interest to bring together buyers and sellers of securities. *Id.*

NSEs). As we described in our comment letter to the Reg ATS Proposal ("**ATS Comment Letter**"), the communication protocol systems definition is too broad.[11] In particular, it would be inappropriate for order and execution management systems ("**OMS**" and "**EMS**," respectively) to fall within the communication protocol systems definition.[12]

Many practical concerns would arise if OMS and EMS were required to register as ATSs, given that the ATS regulatory framework presupposes, in many cases, that transactions are executed on the ATS, which is not the case for an OMS or EMS. A key example would be Rule 605. OMS or EMS providers should not be required to produce Rule 605 reports, either because they are required to register as ATSs or because the OMS or EMS provider is registered as a broker-dealer and Rule 605 is expanded to cover broker-dealers. OMS and EMS, which are essentially software systems that help to facilitate and manage trade executions, do not have (and should not be required to develop) the operational capabilities to gather and disseminate information required by Rule 605 reports given that in most cases an OMS or EMS provider does not have access to the information required to be included in the reports due to its limited role.

By contrast, we expect that requiring OMS or EMS providers to comply with Rule 605, either as registered ATSs or otherwise, would incentivize them to reduce their services or end them altogether—this would result in fewer options for market participants and higher costs. Therefore, we recommend that the Commission (1) consistent with our ATS Comment Letter, ensure that the communication protocol systems definition is appropriately tailored and (2) thereby confirm that OMS and EMS providers need not comply with Rule 605.[13]

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[11] MFA, Comment Letter, Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange"; Regulation ATS for ATSs That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSs That Trade U.S. Treasury Securities and Agency Securities, File No. S7-02-22 (Apr. 18, 2022), *available at* https://www.sec.gov/comments/s7-02-22/s70222-20123993-280134.pdf.

[12] *Id.* at 9 ("MFA does not believe that order/execution management systems used by a single entity to buy and sell securities are intended to be captured by the Proposal. As noted in the Proposal in respect of the current rule, "[t]he term 'multiple' was added to Rule 3b-16(a) to help reinforce that single counterparty systems were not included in the definition of 'exchange.'" Despite proposing to remove the word "multiple" from the rule, the Proposal does not appear to be intended to change this approach; however, given the breadth with which communication protocol systems are described, the Commission should make its position on this issue clear. Clarification is essential to create regulatory certainty. Unless the order management system allows other persons to interact with each other, as opposed to with the entity operating the system, the system should not be covered by the new definition of exchange. Currently, traders do not look at their order management systems as exchanges even if they receive firm orders. Broadening the scope of the rule by replacing "orders" with "trading interest" should not affect the analysis.").

[13] For similar reasons, we do not believe that single firm trading interest communication systems or order-routing systems should be required to provide Rule 605 reports. *See id.* at 9.

Recommendations

We recommend that:

- The Commission should prioritize adoption of the Rule 605 Proposal ahead of the other Proposed Rules.
- The Commission should ensure that the Rule 605 Proposal does not require order management systems or execution management systems to provide Rule 605 reports.

II. Regulation Best Execution

Proposed Regulation Best Execution would subject broker-dealers to a Commission-level best execution obligation with respect to all securities transactions. Specifically, the proposed rule would provide that "[i]n 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."[14]

The rule would exempt broker-dealers from the best execution standard under certain circumstances, including when an institutional customer, exercising independent judgment, executes its order against the broker-dealer's quotation.[15] The proposed rule would also require broker-dealers to establish, maintain and enforce written policies and procedures reasonably designed to ensure compliance with the best execution standard—additional requirements apply with respect to conflicted transactions.[16]

As the Commission acknowledges, broker-dealers are already subject to best execution standards set by SROs, including the Financial Industry Regulatory Authority ("**FINRA**").[17] In fact, the Commission asserts that "[t]he proposed best execution standard is consistent" with those existing standards.[18] Given that a best execution standard already exists and applies, it is not clear to us why the Commission believes an additional, repetitive standard is required. In this regard, we worry that a new, Commission-level standard could introduce uncertainty if the rules (or interpretations or guidance regarding such rules) overlap or conflict with the existing FINRA rule. If the standards and requirements are consistent, then at best the Commission's rule is unnecessary. If they are not consistent, then the Commission's rule will foster uncertainty and operational and compliance burdens. Therefore, it would be preferable either for the Commission

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[14] 88 Fed. Reg. 5440, 5451.

[15] *See id.* at 5452.

[16] *See id.* at 5464.

[17] *See id.* at 5441. Firms are also subject to a Municipal Securities Rulemaking Board best execution rule.

[18] *Id.*

to withdraw the proposal or, if the Commission's believes FINRA's rule should be improved, for the Commission to work with FINRA to revise that rule.

To the extent the Commission nonetheless believes that a Commission-level best execution standard is still needed, we believe that certain aspects of the proposal should be tailored to be consistent with the FINRA standard and to ensure that the rule (i) allows broker-dealers to consider appropriate factors when making best execution determinations and (ii) provides institutional customers with appropriate protection.

A. The best execution standard should, consistent with the FINRA best execution standard, require broker-dealers to take into consideration factors other than price.

As noted, the proposed best execution standard would require a broker-dealer to use reasonable diligence to provide customers with a *price* as favorable as possible under prevailing market conditions. Although price is, of course, an important consideration in determining whether and where to transact, it is not the only consideration that market participants currently take into account (and should continue to be able to take into account). For example, a market participant looking to execute a larger transaction might be particularly concerned about the potential for information leakage, which could result in best execution occurring in a market that does not offer the best price but rather is more likely to minimize the risk of information leakage.[19] This is particularly the case for institutional investors. A best execution standard that appropriately protects customers, therefore, should take into account all of the factors, including but not limited to price, that affect the total cost of transacting. In this regard, we note that the Commission has recognized that "[n]ot all customer orders have the same attributes or size and a broker-dealer's best market determination is affected by the attributes of customer orders and the size of customer orders."[20] It follows that any final Regulation Best Execution should explicitly require (or at least allow for) consideration of other factors in addition to price.

FINRA's best execution rule is informative on this point. Like the Commission's proposed best execution standard, FINRA Rule 5310 requires a broker-dealer to, "[i]n any transaction for or with a customer or a customer of another broker-dealer . . . 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."[21] However, FINRA's rule sets out additional factors that "*will* be considered in determining whether a [broker-dealer] has used 'reasonable diligence.'"[22] Those factors include: (1) the character of the market for the security (e.g., price, volatility, relative liquidity, and pressure on available communications); (2) the size and type of transaction; (3) the number of

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[19] *See id.* at 5462.

[20] *Id.*

[21] FINRA Rule 5310(a)(1).

[22] *Id.* (emphasis added).

markets checked; (4) the accessibility of the quotation; and (5) the terms and conditions of the order which result in the transaction, as communicated to the broker-dealer.

We respectfully request that the Commission incorporate these factors into any final rule. Not only would this approach require broker-dealers to consider the full range of factors that could affect the cost of a transaction to their customers, but it would also further align the rule with FINRA's existing rule, which we understand is an important Commission goal, and would also minimize the potential for conflicting best execution standards.[23]

B. The treatment of institutional customers should be revised and clarified.

Proposed Regulation Best Execution would not apply where "an institutional customer, exercising independent judgment, executes it order against the broker or dealer's quotation."[24] In addition, although the rule would require enhanced procedures with respect to any conflicted transaction, which is defined as "any transaction for or with a *retail customer*, where the broker or dealer executes an order as principal, including riskless principal; routes an order to, or receives an order from, an affiliate for execution; or provides or receives payment for order flow,"[25] that requirement would not apply to non-retail (*i.e.*, institutional) customers.

We agree with the Commission that institutional customers should be treated differently from retail customers. In particular, institutional customers should be able to exercise their independent judgment with respect to the execution of their orders, and the enhanced standards for conflicted transactions need not apply with respect to transactions with institutional customers. Such firms are sophisticated, and the requirements of the rule, especially the enhanced procedures for conflicted transactions (including the obligation to search for additional markets in which a transaction may be executed), could be challenging to meet with respect to the types of orders in which institutional investors may transact (*i.e.*, such orders may be larger than the typical retail order or include instruments that are less typical in retail customer orders).

However, this treatment of institutional customers should be revised and clarified in three respects:

First, the proposed rule does not define "institutional customer." Without a definition, it will be hard for market participants and broker-dealers to understand when the institutional customer exemption might apply. We believe it would be appropriate for "institutional customer" to be defined as any customer other than a "retail customer."

Second, the definition of "retail customer" should be refined to be more consistent with Regulation Best Interest, as it has been implemented. As proposed, Regulation Best Execution would define a "retail customer" in the context of a "transaction for or with a retail customer," which is itself defined as "any transaction for or with the account of a natural person or held in

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[23] *See* 88 Fed. Reg. 5440, 5441.

[24] *Id.* at 5555.

[25] *Id*. (emphasis added).

legal form on behalf of a natural person or group of related family members." As written, this definition would appear to encompass Institutional Family Offices, which are currently covered by no-action relief from Regulation Best Interest. [26] We think a similar carve-out from Regulation Best Execution's "retail customer" definition would be appropriate. Doing so would provide that Institutional Family Offices are, like other non-natural person investors, treated as institutional customers, such that they are eligible for the institutional customer exemption and not subject to the conflicted transaction requirements.

Third, institutional customers should have the ability to determine whether and when their transactions would be exempted from the best execution standard. As drafted, the institutional customer exemption would apply automatically if the conditions of the exemption were met (*i.e.*, that there is an institutional customer, exercising independent judgment, with respect to executions against a broker-dealer's quote). The Commission believes that an automatic exemption is reasonable because, in certain debt markets, institutional customers "often handle and execute their own orders …[,] commonly request prices from broker-dealers for particular securities … and exercise their own discretion concerning the execution of a particular transaction."[27] In other words, because institutional customers often provide direction to their broker-dealers regarding trade execution, the best execution standard would be rendered moot.

Although this may often be the case, the Commission should not be so prescriptive with respect to how the best execution standard would apply to sophisticated institutional customers. Instead, the Commission should generally apply the proposed best execution standard to institutional customers but allow those customers, in their discretion, to opt out of the standard with respect to some or all of their transactions. That way, institutional customers can consider the costs and benefits of the application (or disapplication) of the best execution standard (*i.e.*, whether certain broker-dealers would be more or less likely to interact with an institutional customer) and determine how to proceed with respect to particular transactions. Any such opt-out should be provided to the broker-dealer in writing and could apply to a single transaction, a specified set of transactions (*e.g.*, for specified types of securities or execution methods), or an overall trading relationship.

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[26] *See* Division of Trading and Markets, *Status of Institutional Family Offices for Purposes of Regulation Best Interest, SEC File No. S7-07-18 (Sept. 10, 2019)* and *Form CRS Relationship Summary, SEC File No. S7-08-18 (Sept. 10, 2019)* (Dec. 23, 2020), *available at* https://www.sec.gov/divisions/marketreg/mr-noaction/2020/sifma-122320-regbi.pdf (defining Institutional Family Office generally as a family office that has one or more experienced securities or financial services professionals, manages total assets of $50 million or more, does not rely on the broker-dealer for recommendations, and has professionals who are independent representatives of their family clients).

[27] 88 Fed. Reg. 5440, 5452 (noting further that broker-dealers would still need to comply with other applicable rules, including FINRA Rule 2121 regarding markups).

Recommendations

We recommend that:

- The best execution standard should require broker-dealers to take into consideration factors other than price.

- The treatment of institutional customers should be revised and clarified by (1) defining the term as other than a "retail investor"; (2) refining the definition of "retail customer" to be more consistent with Regulation Best Interest, as it has been implemented; and (3) providing institutional customers with the ability to determine whether and when their transactions would be exempted from the best execution standard.

III. Reg NMS Proposal

The Reg NMS Proposal would, among other changes: (1) reduce minimum pricing increments (or "tick sizes") for many equity securities, (2) apply tick size restrictions to order execution, (3) reduce access fee caps for protected quotations and (4) accelerate the implementation of Commission market data rule changes. Although we agree with some of the changes included in the Reg NMS Proposal, we think that others would go too far in making fundamental changes to equity market structure that seem likely to reduce liquidity and harm execution quality, especially for institutional investors, which today comprise the majority of the market.

A. *The Commission should reduce the minimum tick size to a half-penny increment for tick-constrained securities, but not introduce finer tick sizes.*

Today, Rule 612 of Reg NMS ("**Rule 612**") sets a minimum pricing increment of one penny for quotes and orders in NMS stocks priced at or greater than $1.00.[28] The Reg NMS Proposal would amend Rule 612 to establish a variable minimum pricing increment for NMS stocks that could be as small as a *tenth* of a penny, depending on the quoted spread for any such stock over a certain period of time.[29] In proposing this change, the Commission noted that, currently, "[a] majority of the trading volume for NMS stocks is tick-constrained, which indicates that the one cent minimum pricing increment is too large for such stocks, that a smaller sub-penny increment would be an economically meaningful increment for such stocks to be able to quote and trade, and that the current minimum pricing increment is constraining the ability of market participants to trade consistent with the principles of supply and demand."[30]

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[28] *See* 17 C.F.R. § 242.612.

[29] *See* 87 Fed. Reg. 80266, 80280.

[30] *Id.* at 80278. A stock is "tick-constrained" when it has a time-weighted quoted spread of $0.011 or less calculated during regular trading hours because this spread indicates that these stocks are frequently quoted in the smallest increment possible under Rule 612. *See id.* at 80268.

We agree with the Commission that the current, one-penny tick size needs to be reduced. As we noted in our 2022 Market Structure Recommendations, a smaller minimum tick size for the most liquid securities "would further increase savings for investors … [and] improve market quality and benefit investors by improving price discovery and greatly reducing transaction costs in the most commonly traded securities."[31]

However, there are trade-offs to reducing tick sizes. In particular, reducing tick sizes to as small as a tenth of a penny based on quoted spread levels as narrow as eight-tenths of a penny, and extending reduced tick sizes to stocks with quoted spread levels as wide as four cents, seems likely to reduce liquidity and increase costs for several reasons:

- ***Quote Fragmentation*****:** Substantially smaller tick sizes will lead to substantially more price points at which market makers and other liquidity providers could quote, which, from a risk management perspective, and taking into account queue-jumping dynamics (as described below), would likely lead to fragmentation of liquidity across price points and smaller displayed size at each price point, which would harm execution quality and increase volatility;

- ***Queue Jumping*****:** Tenth-of-a-penny tick sizes may also allow market participants to gain execution priority ("jumping the queue") by stepping ahead of other limit orders by an economically insignificant amount (*i.e.*, by $0.001).[32] Jumping the queue could disincentivize market participants from submitting limit orders altogether, which could reduce liquidity and increase spreads;

- ***Flickering Quotes*****:** Tick sizes that are too small would cause flickering quotations,[33] which the Commission notes may make it more difficult for broker-dealers to satisfy their best execution and other regulatory obligations.[34] These difficulties would likely result in broker-dealers limiting their activity—particularly with respect to tick-constrained stocks for which flickering quotations become prevalent—which will increase costs to customers and could result in worse order executions; and

- ***Excess Message Traffic*****:** A far larger number of ticks across a large number of stocks (up to 80% of shares traded, according to the Commission) would necessarily increase message traffic to a very considerable degree. Increased message traffic would increase data and infrastructure costs and market latency.

[31] 2022 Market Structure Recommendations at 3.

[32] *See* 87 Fed. Reg. 80266, 80268.

[33] The Commission has described "flickering quotations" as occurring when the price of a trading center's best displayed quotations changes multiple times in a single second. *See id.* at 80271.

[34] Others have noted that flickering quotations can complicate broker-dealer routing decisions, "hindering their ability to get the best prices for investors." *Id.* at 80277.

Research by industry participants, academics, and regulators has evaluated these potential negative impacts of a reduced tick size against the potential benefits, including narrower spreads. This research indicates that a spread of around two to three ticks is optimal.[35] Consistent with this finding, MFA has previously recommended that the Commission reduce the minimum tick size to a half-penny increment for stocks trading above $1.00 that are tick constrained in that they have a penny spread the overwhelming majority of the time. We continue to think that is the right approach, particularly if, as we recommend below, the Commission does not proceed with its proposal to extend the minimum price increment to trade executions. Once the core change to half-penny increments has been absorbed by the markets, the Commission could consider if further changes in the increments would be fruitful for certain groups of securities.

B. The Commission should not prohibit trade execution at prices finer than the applicable minimum pricing increment.

Rule 612 currently prohibits NSEs, ATSs and certain other trading platforms from displaying, ranking or accepting quotes and orders in NMS stocks in increments finer than the applicable minimum pricing increment.[36] However, the rule does not prohibit orders from being *executed* at prices finer than the applicable tick size. Although trades on NSEs and displayed ATSs are typically executed in pricing increments equal to the applicable tick size (due to the receipt and price/time priority ranking of orders based on those tick sizes), trades routed for execution elsewhere (*e.g.*, to an internalizing OTC market maker) can be executed in sub-minimum pricing increment amounts, allowing for price improvement.

The Commission should not prohibit trades from being executed at prices smaller than the applicable minimum pricing increment, particularly if the Commission accepts our recommendation to set the minimum tick sizes at a half-penny increment. First, expanding the minimum pricing increment to trade execution would reduce the potential for price improvement, which will harm market participants. We expect there to be ample opportunity for price improvement within the half-penny price increments, and market participants should not be prohibited from realizing lower prices as a result.

Second, the concerns raised with respect to quoting or submitting orders in too-fine increments do not apply with respect to trade execution. For example, while jumping the queue might be an issue with respect to allowing quotes in smaller increments (*i.e.*, because of the potential reduction in displayed liquidity), these concerns are not relevant to trading, where

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[35] *See, e.g.*, Phil Mackintosh, *A Data-driven Summary of the SEC's New Proposals* (Feb. 13, 2023), *available at* https://www.nasdaq.com/articles/a-data-driven-summary-of-the-secs-new-proposals (noting that "a stock has optimal trading with a 2-3 tick spread"); Sida Li and Mao Ye, *The Tradeoff between Discrete Pricing and Discrete Quantities: Evidence from U.S.-listed Firms*, *available at* https://microstructure.exchange/papers/mao.pdf ("We predict that a firm achieves its optimal price when its bid–ask spread is two ticks wide."); *see also* Autorite des Marches Financiers, *MIFID II: Impact of the New Tick Size Regime* (March 2018), *available at* https://www.amf-france.org/sites/institutionnel/files/contenu_simple/lettre_ou_cahier/risques_tendances/MiFID%20II%20Impact%20of%20the%20New%20Tick%20Size%20Regime.pdf.

[36] *See* 17 C.F.R. § 242.612(a).

orders may be executed in price increments finer that the minimum tick sizes, provided that execution occurs at the national best bid or offer, or better.

We also think that extending the minimum pricing increment requirement to trade executions would force an artificial trade-off between preserving price improvement opportunities (which would favor smaller tick sizes) versus maximizing displayed liquidity (which would favor larger tick sizes). Although we understand that the Commission believes that extending the minimum pricing increment requirement to trade executions would increase displayed liquidity by leveling the playing fields as between NSEs and displayed ATSs, on the one hand, and OTC market makers, on the other hand, we question whether the net impact of that change would be so beneficial if it also necessitated either adopting tick sizes so small that they harm liquidity and execution quality—which would be self-defeating—or maintaining larger tick sizes—which would harm price improvement.

C. The Commission should reduce access fees in a manner that is proportionate to the proposed reduction in tick sizes.

Rule 610 of Reg NMS regulates the fees that a trading center may permit or impose with respect to accessing protected quotations.[37] The Reg NMS Proposal would reduce the access fee cap for most stocks from the current $0.003/share to $0.001/share.[38] We generally support the Commission's proposal to reduce access fee caps. As we noted in our 2022 Market Structure Recommendations, "[a] reduction from the current maximum access fee amount, 30 cents per 100 shares, for the most liquid securities [would] reduce[] trading costs and benefit[] the price discovery process by encouraging exchange trading."[39]

Given that the Commission proposed four minimum pricing increments ($0.001, $0.002, $0.005, and $0.01) based on the quoted spread for the particular NMS stock, we would have expected the Commission to propose four access fee caps, each proportionate to the relevant reduction in minimum pricing increments. Instead, the Reg NMS Proposal would impose only two tiers of access fee caps, which could result in potential distortions to quoting and trading activity compared to what one would expect from the new tick sizes due to the fact that the proportion of access fees (and likely rebates) relative to tick size and spread would not be consistent across different tick sizes. To avoid these distortions, the Commission should instead adopt access fee caps that are consistently proportional to the relevant tick size (whether the Commission accepts our recommendation to set a half-penny minimum pricing increment for tick-constrained stocks or it takes another approach).

D. We support the Commission's proposal to accelerate certain aspects of its MDI Rule.

The Reg NMS Proposal also proposed accelerating the implementation of the "new round lot" and "odd-lot information" definitions provided in the Commission's 2020 Market Data

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[37] *See* 17 C.F.R. § 242.610(c).

[38] *See* 87 Fed. Reg. 80266, 80358.

[39] 2022 Market Structure Recommendations at 3.

Infrastructure Rule ("**MDI Rule**").[40] We support the accelerated implementation of these aspects of the MDI Rule. As stated in our 2022 Market Structure Recommendations, implementation of the new round lot definition "will provide investors with information about better-priced orders in high-priced stocks, help investors make more informed order routing decisions, and allow investors to receive best execution."[41] We think that the revised odd-lot information definition will similarly provide market participants with better execution quality information, which would, in turn, improve decision-making with respect to order routing.

We also believe that the Commission should prioritize implementation of this aspect of the Reg NMS Proposal. As with the Rule 605 Proposal, MDI Rule acceleration will provide market participants and the Commission with more useful market information sooner, which can be used to inform whether it is necessary or appropriate to adopt other aspects of the Proposed Rules; also, the Rule 605 Proposal depends in certain respects on MDI Rule implementation. Furthermore, given the complexities associated with certain other aspects of the Proposed Rules (and the likelihood of significant comments), it would be helpful to implement this change first—along with the Rule 605 Proposal—separate and apart from the other, more debatable, aspects of the Proposed Rules.

Recommendations

We recommend that:

- The Commission should reduce the minimum tick size to a half-penny increment for tick constrained securities, but not introduce finer tick sizes.
- The Commission should not prohibit trade execution at prices finer than the applicable minimum pricing increment.
- The Commission should reduce access fees in a manner that is proportionate to the proposed reduction tick sizes.
- The Commission should prioritize the acceleration of certain aspects of its MDI Rule.

IV. Order Competition Rule

The Order Competition Rule (which, if adopted, would become Rule 615 of Reg NMS) generally would require that certain individual investor orders be exposed to order-by-order competition in auctions designed pursuant to specific Commission requirements, before such orders could be internalized by wholesalers or any other type of trading center that restricts order-by-order competition. Adoption of the Order Competition Rule would represent a fundamental shift in U.S. equity market structure by imposing specific, prescriptive requirements on how certain orders are executed. As detailed below, we question the desirability of adopting

[40] Market Data Infrastructure, 86 Fed. Reg. 18596 (Apr. 9, 2021).

[41] 2022 Market Structure Recommendations at 3.

the Order Competition Rule at this time, before the Commission can assess the impact of other aspects of the Proposed Rules.

A. The Commission should pause consideration of the Order Competition Rule until it implements and assesses the other Proposed Rules described above.

The Commission's stated goal in proposing the Order Competition Rule is to protect individual investors by, as noted above, requiring that certain of their orders be exposed to competition in auctions before such orders could be executed internally by trading centers (such as wholesalers) that restrict order-by-order competition.[42] In particular, the Commission believes that these required auctions would allow their orders to receive more favorable prices and interact with a greater number of market participants, including institutional investors.[43]

It is not clear to us how the Commission can determine at this time that the Order Competition Rule would benefit investors (or is the most appropriate and cost-effective way to benefit investors), particularly since the Commission has proposed other rules and amendments that are also intended to support investors. For example, the Rule 605 Proposal and the acceleration of certain aspects of the MDI Rule are both intended to provide market participants with more and better information in order to inform decisions regarding order routing and execution. Moreover, these changes would also provide the Commission with greater clarity regarding the equity securities markets. It would be logical, in our view, to implement these proposals first such that the Commission can review additional data before determining whether the Order Competition Rule is appropriate.

The same holds true for the proposed tick size amendments in the Reg NMS Proposal. As noted, the reduction in tick sizes is supposed to benefit market participants by providing them with tighter spreads and better prices. The Commission should consider implementing and analyzing the impacts of that rule on order routing, pricing and execution before moving forward with an even more fundamental change to equity securities trading. Likewise for Regulation Best Execution—the Commission wants to task broker-dealers with an obligation to ascertain the best markets for their customers' orders, with heightened obligations for the same retail customers who would be covered by the Order Competition Rule, but it seems that the Commission has already determined, without having implemented proposed Regulation Best Execution, that broker-dealers are "likely to obtain better prices" for customer orders by routing them to auctions.[44]

In short, given how fundamentally the Order Competition Rule would alter equity market structure, we believe it would be prudent to implement other aspects of the Proposed Rule (starting with the Rule 605 Proposal and the MDI Rule acceleration, as noted above) before considering whether to adopt the Order Competition Rule.

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[42] *See* 88 Fed. Reg. 128, 129.

[43] *See id.*

[44] *Id.* at 148.

B. The Order Competition Rule is too prescriptive and could result in unintended negative consequences for equity markets and market participants.

As proposed, the Order Competition Rule sets out, in specific detail, the requirements for operating qualified auctions. As just one example, the proposal specifies that auction responses must be accepted for a period of at least 100 milliseconds, but not more than 300 milliseconds, after an auction message is provided for dissemination in consolidated market data.[45] In so prescribing the configuration of the auctions (and, as noted above, stating that best execution is likely to be achieved through the auction process), the Commission is declaring that it knows the precise execution method that will optimally benefit certain investors.

Respectfully, we do not believe the Commission—or any individual market participant for that matter—can state with certainty which execution method is optimal, across all market conditions, securities, and retail participants. Indeed, we know from experience that different market structures have developed to serve the varied needs of securities market participants. For this reason, the Commission should be less prescriptive, instead favoring a market-based approach in which trading centers can compete to design competitive execution protocols and market structures that might benefit investors, subject to Commission oversight.[46]

We are also concerned that this Commission's overly prescriptive approach could result in a number of unintended negative consequences. For example, because the Order Competition Rule would result in a large volume of orders being routed to covered auctions, market participants might reduce their resting displayed orders on NSEs in order to "save" their best bids and offers for use in the auctions. Proposed Rule 615(f)(2), in particular, could reduce NSE liquidity, since that rule would prohibit a broker-dealer that routes a covered order to a covered auction from submitting orders to an NSE if that order "could have priority to trade with the segmented order"[47]—which could prevent broker-dealers handling covered orders from also routing institutional investor orders to NSEs. Any resulting reduction in displayed orders would reduce liquidity and market depth, which would likely result in larger spreads and greater volatility, to the detriment of market participants trading on those platforms.

In another example, the Commission's prescriptive approach could hinder existing efforts to encourage interaction between retail and institutional investor order flow. For example, certain NSEs today offer retail liquidity programs that segment the marketable order flow of individual investors in order to allow liquidity suppliers and other institutional investors to interact with

[45] *See id.* at 244.

[46] The Commission has been open to permitting market structure innovation in other areas. For example, the Commission adopted Regulation ATS in order to encourage innovation with respect to the development of securities-trading platforms and protocols. Regulation of Exchanges and Alternative Trading Systems, 63 Fed. Reg. 70844 (Dec. 22, 1998). We expect that most market participants agree that having a variety of platform options has been beneficial. The Commission has also recognized that "innovations in trading protocols have increased efficiencies and access to discover liquidity and prices, search for a counterparty, and agree upon the terms of a trade." 87 Fed. Reg. 15496, 15498.

[47] 88 Fed. Reg. 128, 245.

retail order flow while reducing adverse selection risk.[48] The Order Competition Rule would likely eviscerate these programs, given that retail order flow will, with limited exceptions, be routed to auctions.

On the other hand, we question whether institutional investors could, without undue cost, participate in covered auctions. At a minimum, to do so, they would need to configure their order routing and execution algorithms to react extremely quickly to auction messages, and more generally take into account the added market complexity associated with mandatory covered auctions. It would involve a major business decision to undertake such a significant operational and technological build and necessitate hiring additional personnel. The majority of our members engage in fundamental research and are not likely to be interested in expanding their business to engage in covered auctions, particularly given the extremely short timeframe to react to auction messages. They also would need to consider potential information leakage concerns associated with their orders executing within a covered auction. Finally, as noted below, providing liquidity in covered auctions could raise questions regarding broker-dealer registration, if expanded as the Commission has separately proposed.

C. The Commission should ensure that its proposed dealer rule would not discourage institutional investor participation in qualified auctions.

As noted, one of the Commission's aims in proposing the Order Competition Rule is to encourage greater interaction between retail and institutional investor orders. We are concerned, however, that other Commission proposals could discourage institutional investors from submitting bids to qualified auctions. In particular, the Commission proposed a rule last year that would, if adopted, require additional firms to register as broker-dealers (the "**Dealer Proposal**").[49] The Dealer Proposal includes a qualitative test that would require a firm that "routinely express[es] trading interests that are at or near the best available prices on both sides of the market and that are communicated and represented in a way that makes them accessible to other market participants" to register as a broker-dealer.[50]

Institutional investors might determine that routinely submitting competitive auction responses could trigger this qualitative standard and require registration. We expect that many such firms would decide to avoid qualified auctions altogether, given that the benefits of participation are likely to be outweighed by the burdens associated with broker-dealer registration. While we have registered our significant concerns with respect to the Dealer Proposal in a separate comment letter,[51] for purposes of the Order Competition Rule specifically,

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[48] *See id.* at 186.

[49] *See* Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer, 87 Fed. Reg. 23054 (Apr. 18, 2022).

[50] *Id.* at 23068.

[51] *See* MFA, Comment Letter, Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer, File No. S7-12-22 (May 27, 2022), *available at* https://www.sec.gov/comments/s7-12-22/s71222-20129911-296085.pdf.

and in order to encourage institutional investor participation in auctions, we urge the Commission to provide, in any final rule, that such participation would not require such firms to register as broker-dealers.

Recommendations

We recommend that:

- The Commission should pause consideration of the Order Competition Rule until it implements and assesses the other Proposed Rules described above.
- The Commission should not take an overly prescriptive approach that could result in unintended negative consequences for equity markets and market participants.
- The Commission should ensure that its proposed dealer rule would not discourage institutional investor participation in qualified auctions.

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We appreciate the opportunity to provide our comments to the Commission regarding the Proposed Rules, and we would be pleased to meet with the Commission and its staff to discuss our comments. If the staff has questions or comments, please do not hesitate to call Matthew Daigler, Vice President & Senior Counsel, or the undersigned, at (202) 730-2600, with any questions regarding this letter.

Very truly yours,

/s/ Jennifer W. Han

Jennifer W. Han
Executive Vice President
Chief Counsel & Head of Global Regulatory Affairs

cc: The Hon. Gary Gensler, SEC Chair
The Hon. Hester M. Peirce, SEC Commissioner
The Hon. Caroline A. Crenshaw, SEC Commissioner
The Hon. Mark T. Uyeda, SEC Commissioner
The Hon. Jaime Lizárraga, SEC Commissioner
Dr. Haoxiang Zhu, Director, Division of Trading and Markets