WE THE INVESTORS

March __, 2023

By Email

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 205499–1090
rule-comments@sec.gov

Re: Rule Proposal No. 34-96496; File No. S7-32-22 Regulation Best Execution and Rule Proposal No. 34-96494; File No. S7-30-22 Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders

Ms. Countryman:

We The Investors ("WTI")[1] appreciates the opportunity to comment on the U.S. Securities and Exchange Commission's (the "SEC" or "Commission") Proposal Best Execution (the "Best Execution Proposal") and Proposal on Regulation NMS: Minimum Pricing Increment, Access Fees, and Transparency of Better Priced Orders (the "NMS Proposal"), together referred to as "The Proposals".

We The Investors have organized around five key principles as laid out in our Investors' Bill of Rights[2]. These include Transparency; Simplicity and Fairness; Choice and Control; Best Execution; and Better Settlement and Clearing. This comment letter will focus on three of those principles - Transparency; Simplicity and Fairness; and Best Execution.

We are submitting this comment letter into the comment files for both proposals because it is directly relevant to each one. The comment letter concerns two topics that span The Proposals–Payment for Order Flow ("Wholesaler PFOF") and exchange rebates ("Exchange PFOF"). Collectively, these topics are identified as ("PFOF"). While PFOF is primarily seen as an off-exchange inducement to route orders to wholesalers, exchange fee structures and

[1] We The Investors is a grassroots advocacy campaign launched in March 2022. WTI is built by, and for, individual investors. Our mission is to educate individual investors in order to empower them to represent themselves on market structure issues. We are supported by industry firms and over one hundred thousand individual investors.
[2] The Investors' Bill of Rights can be accessed at: https://www.urvin.finance/advocacy

rebates play a similar role in order routing decisions. We believe these issues should be considered in tandem.

Put simply, these inducements should not exist and should be banned. The Commission and FINRA have long recognized the problems that these inducements create, and despite the best efforts of regulators[3], these problems have not been addressed or solved.

PFOF Is Incompatible With the Duty of Best Execution

The research is clear, both from independent academics and from the Commission, as outlined in both The Proposals and the OCR Proposal[4]. Brokers who accept Wholesaler PFOF receive less price improvement, and the practice is incompatible with the duty of best execution. Brokers who do not accept any kind of PFOF route orders differently and consequently, these brokers also see superior execution quality.

This is not simply an academic discussion. These issues have a direct, tangible, and negative impact on individual investors. Doug Cifu, CEO of wholesaler Virtu Financial, explained it succinctly during a CNBC appearance in March 2021[5]. He was asked whether "a retail investor that's not dealing with PFOF at Fidelity [is] ultimately getting a better price than a Robinhood investor?"

Cifu responded in the affirmative, asserting: "Overall, through the course of a month, we will provide more price improvement for Fidelity than we do to Robinhood."

This is a clear violation of FINRA's best execution guidance, which states that "firms may not negotiate the terms of order routing arrangements for those customer orders in a way that reduces the price improvement opportunities that otherwise would be available to those customer orders absent payment for order flow."[6]

In fact, a recent study found that Robinhood does not even provide a statistically significant amount of price improvement relative to exchanges, when controlling for market conditions[7]. This is notable as PFOF is responsible for around 70% of Robinhood's revenue–money that accrues to Robinhood instead of its customers. However, it should not be surprising that

---

[3] These efforts include both regulatory guidance from FINRA as well as enhanced Rule 606 disclosures.
[4] Order Competition Rule. 88 FR 128, ("OCR Proposal"), Federal Register, (Jan. 3, 2023), Available at https://www.federalregister.gov/documents/2023/01/03/2022-27617/order-competition-rule
[5] CNBC, "Virtu Financial CEO on controversy surrounding payment for order flow", Squawk Box, (March 11, 2021), Available at https://www.cnbc.com/video/2021/03/11/virtu-financial-ceo-on-controversy-surrounding-payment-for-order-flow.html
[6] FINRA, "FINRA Reminds Member Firms of Requirements Concerning Best Execution and Payment for Order Flow", (June 23, 2021), Available at https://www.finra.org/rules-guidance/notices/21-23
[7] Lynch, Bradford, "Price Improvement and Payment for Order Flow: Evidence from A Randomized Controlled Trial", Jacobs Levy Equity Management Center for Quantitative Financial Research Paper. (June 27, 2022), Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4189658

Robinhood fails to provide statistically significant price improvement, given the firm's history[8] of lying[9] to its customers, failing[10] to supervise, and failing[11] at their duty of best execution.

The Case for Banning Rebates

The Commission makes an excellent case for banning rebates in the NMS Proposal. The only noted disadvantage of this approach "is that it restricts the ability for the exchanges to innovate with respect to rebates."[12]

However, as the NMS Proposal notes, "[a]ccess fees and their associated rebates tend to increase transaction costs for demanders of liquidity as well as exacerbate a problem of liquidity oversupply for stocks with narrow spreads while doing very little to enhance liquidity in stocks with wide spreads."[13]

The Commission recognizes that rebates fail to improve liquidity in stocks with wide spreads while simultaneously magnifying an oversupply of liquidity for stocks with narrow spreads.

Much like Wholesaler PFOF, Exchange PFOF is harmful to market quality. This practice provides a select few firms with unnatural subsidization while intensifying the concentration of market power. In 2017, the SEC's Equity Market Structure Advisory Committee was told by its Customer Issues Subcommittee that "The majority of the buy-side participants felt that addressing exchange rebates was the most important U.S. equity market structure issue currently facing the markets due to the conflicts of interest associated with exchange rebates."[14]

Current solutions fall well short of addressing this systemic issue. To date, the Commission has taken a piecemeal approach, setting an artificial price control[15] for access fees in the NMS

---

[8] Ong, M.; Pellecchia, R.; Williams, A.P. & DeSouza, A., "FINRA Orders Record Financial Penalties Against Robinhood Financial LLC", FINRA, (June 30, 2021), Available at https://www.finra.org/media-center/newsreleases/2021/finra-orders-record-financial-penalties-against-robinhood-financial

[9] Securities and Exchange Commission (SEC), "SEC Charges Robinhood Financial With Misleading Customers About Revenue Sources and Failing to Satisfy Duty of Best Execution", (Dec. 17, 2020), Available at https://www.sec.gov/news/press-release/2020-321

[10] Department of Financial Services (DFS), "DFS SUPERINTENDENT HARRIS ANNOUNCES $30 MILLION PENALTY ON ROBINHOOD CRYPTO FOR SIGNIFICANT ANTI-MONEY LAUNDERING, CYBERSECURITY & CONSUMER PROTECTION VIOLATIONS", (Aug. 2, 2022), Available at https://www.dfs.ny.gov/reports_and_publications/press_releases/pr202208021

[11] Ong, M. & Rote, M., "FINRA Fines Robinhood Financial, LLC $1.25 Million for Best Execution Violations", FINRA, (Dec. 19, 2019), Available at https://www.finra.org/media-center/newsreleases/2019/finra-fines-robinhood-financial-llc-125-million-best-execution

[12] Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better. Release No. 34-96494; File No. S7-30-22 ("NMS Proposal") at 308, Federal Register, (Dec. 14, 2022), Available at https://www.sec.gov/rules/proposed/2022/34-96494.pdf

[13] NMS Proposal at 153

[14] EMSAC Customer Issues Subcommittee, "Customer Issues Subcommittee Status Report", Securities & Exchange Commission, (April 3, 2017), Available at https://www.sec.gov/spotlight/emsac/emsac-customer-issues-subcommittee-status-report-040317.pdf

[15] The very need for a government-mandated price control should serve as evidence that there is economic dysfunction and perverse incentivization. As the Commission attempts to decide what the

Proposal while carving out check-the-box solutions for “conflicted transactions” in the Best Execution Proposal. It is both notable and inexplicable that institutional investors are excluded from such exceptions.

The solution to this problem is simple and clear–the Commission must ban order routing inducements such as PFOF that are not related to execution quality.

The Research–The Negative Impacts of PFOF On Markets

Many studies have investigated the effects of PFOF over the past decade. There is little need to summarize or cite them all here. The Commission’s CAT analysis provides an excellent overview of the problem of Wholesaler PFOF. By contrast, the issue of Exchange PFOF receives little attention. Exchange PFOF harms investors much in the same way as does Wholesaler PFOF:

- The need to compete over high rebates pushes take fees to the limit of the access fee cap, increasing costs for both institutional and individual investors placing marketable orders. This is why the access fee cap is indistinguishable from a government price control.
- The principal-agent conflict drives brokers to place non-marketable orders at the exchanges offering the highest rebates, rather than the best execution quality. This practice creates long queues, reducing the likelihood of execution and maximizing the likelihood of adverse selection. The Commission acknowledges this problem, stating that “Academic literature has shown that the presence of high liquidity fees and rebates on some market centers may impact broker-dealer routing decisions based on where they can receive the highest rebate (or pay the lowest fee), rather than where they can receive better execution quality on behalf of their customers.”[16]
- According to IEX, “In some instances, brokers seeking to maximize rebate payments from exchanges can earn more in rebates per share than the client is paying them in commissions per share (even though the client’s execution quality will suffer greatly).”[17]
- Exchange PFOF serves to increase the number of exchanges as the combination of rebates and the Order Protection Rule ensure that any price queue will get filled. However, it has the opposite effect on the number and diversity of trading participants (exactly as Wholesaler PFOF does). Nearly all net rebates are paid to a small handful of

correct level for the access fee cap should be, we hope that the absurdity of trying to pick a number serves as a wake-up call that no such cap should exist. Should it be 10 mils? 12 mils? 9.25 mils? There is no right answer because the question is wrong.

[16] OCR Proposal at 260

[17] Katsuyama, Bradley, “Testimony before the U.S. House Representatives Committee on Financial Services”, IEX Exchange, (June 27, 2017), Available at https://www.iexexchange.io/blog/testimony-of-bradley-katsuyama-before-the-us-house-of-representatives-committee-on-financial-services

trading firms, increasing concentration by subsidizing the largest high-speed trading firms to the detriment of other firms.[18] [19]

As we can see, the problems of Exchange PFOF and Wholesaler PFOF have some clear and compelling parallels. The Commission's economic analysis of the costs of Wholesaler PFOF provides the most comprehensive, data-driven picture yet available. This analysis quantifies many of the criticisms levied at the practice over the past 15 years. We applaud the SEC for their thorough economic analysis, and the excellent data included as part of the Proposals. This analysis should put to rest many of the sound bites that supporters of the status quote offer on cable networks in an attempt to preserve their exclusive flash order facilities:

- "[W]holesaler price improvement is not commensurate [sic] their lower costs"[20]
- "[T]he isolation of individual investor orders due to wholesaler internalizations may result in larger losses in potential price improvement for individual investors on their orders in less liquid stocks."[21]
- As we know from Doug Cifu's CNBC quote above, "execution quality varies based on whether the retail broker receives PFOF for NMS stock orders."[22] Most importantly, thanks to the Commission's CAT analysis, we also know that "results indicating brokers that receive PFOF receive inferior execution quality are robust to the inclusion of controls for differences in the type of order flow coming from different broker-dealers."[23] Different levels of adverse selection do not explain variability in price improvement. PFOF does.

Public, a retail broker who does not accept Wholesaler PFOF, offered a public analysis of its execution quality relative to its competitors. Public outlined the ways that Wholesaler PFOF is incompatible with the duty of best execution:

---

[18] Securities and Exchange Commission (SEC), "ROUNDTABLE ON MARKET DATA PRODUCTS, MARKET ACCESS SERVICES, AND THEIR ASSOCIATED FEES", (Oct. 25, 2018), Available at https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102518-transcript.pdf
Note: Nasdaq admitted (pg. 54) that "At least one large broker-dealer received more rebates than it paid the Nasdaq fees for its market data, connectivity and equipment use in 2017." BATS-CBOE admitted at the same meeting (pg. 74-75) that "[f]ive out of the top 10 get a check from us after the costs of their connectivity and market data. So we are cutting them a check monthly after their costs."

[19] Spatt, C.S. Is Equity Market Exchange Structure Anti-Competitive? Carnegie Mellon University. (Dec. 28, 2020), Available at https://www.cmu.edu/tepper/faculty-and-research/assets/docs/anti-competitive-rebates.pdf
Note: Spatt explains that such an arrangement represents "significant cross-subsidization of some customers" and that "smaller brokers face a significant relative burden." This is a critical point to understand. Exchange rebates act as a cross-subsidy from firms trading less to firms trading more, and broadly from firms trading slowly to firms trading faster, which creates an anti-competitive feedback loop, increasing concentration of the largest and fastest rebate-collecting firms.

[20] OCR Proposal at 228
[21] Ibid. at 230
[22] Ibid. at 236 - and again worth noting that this wouldn't happen if FINRA appropriately enforced its Best Execution rule.
[23] Ibid. at 240

> "The market maker has significant discretion on what price to deliver for an order, as long as that price is at or better than the National Best Bid and Offer (NBBO). Every dollar they deliver in extra price improvement is a dollar less they earn on that trade, so their incentives are to deliver a price that is just good enough to retain the contract with the broker, but may not be as good as other pricing that is available in the market."[24]

The result of this wholesaler discretion is "good-enough execution," a standard which falls well short of the Best Execution threshold.

Will Banning PFOF End Zero-Commission Trading?

Of course not. Regardless of whether the existence of zero-commission trading is a good thing or not, the elimination of PFOF and exchange rebates will not impact zero-commission trading. How can we be so certain? There are two primary reasons:

1. As the SEC's analysis in the OCR Proposal shows, many brokers offer zero-commission trading without accepting PFOF[25] [26] [27] [28].
2. Zero-commission trading exists in other countries, including those with trade-at rules or where PFOF is banned[29] [30] [31].

While preserving zero-commission trading may or may not be an objective of the Commission, the industry simply loves to conflate zero-commission trading with zero cost trading - and it could not be more misleading. There is no such thing as a free lunch on Wall Street, and there are absolutely material costs to trading in a zero commission model. Those costs are simply hidden and implicit, rather than transparent and explicit. If investors must bear costs for trading

---

[24] Sikes, Stephen, "Delivering on Price Execution Without PFOF", Medium (December 2, 2021)
[25] OCR Proposal footnote 583: "It's also important to note that even brokers that do not accept PFOF experienced increased revenue and profits, despite adopting zero commissions."
[26] Corbin, Kenneth, "Fidelity Posts 6th Straight Record Profit", Barron's. (March 9, 2022), Available at https://www.barrons.com/advisor/articles/fidelity-earnings-2021-51646853970
[27] OCR Proposal at 302: "the majority of PFOF received by retail brokers comes from transactions in the options market." and "the retail broker industry did not experience a drop in profits following the end of commissions. This includes non-PFOF brokers, who did not choose to make up for lost commission revenue by charging wholesalers PFOF."
[28] OCR Proposal at 303-304: "The average PFOF payment that brokers receive on a 100 share order is 10 to 20 cents, far less than the commission fees previously charged by broker-dealers"
[29] Michaels, Cody, "Commission Free Trading UK 2023—Best Zero Fee Brokers", Traders Best. (March 4, 2023), Available at https://www.tradersbest.com/uk/stocks/commission-free/
Note: There are many zero-commission brokers in the UK, where neither internalization nor PFOF is permitted., See https://www.tradersbest.com/uk/stocks/commission-free/

[30] Gallagher, Anthony, "6 "Best" Singapore Stock Brokers", Securities.io. (March 5, 2023), Available at https://www.securities.io/top-5-singapore-stock-brokers/
Note: There are many zero-commission brokers in Singapore, where PFOF is not permitted.
[31] Rapaport, Emma, "$0 commissions: Australia's trading fee shakedown gathers steam", MorningStar,(June 1, 2020), Available at https://www.morningstar.com.au/insights/stocks/202847/0-commissions-australias-trading-fee-shakedown-gathers-steam
Note: There are many zero-commission brokers in Australia, where internalization without material price improvement is not permitted and PFOF is not prevalent.

and investing, the Commission should prefer explicit costs. As Allison Bishop notes in an article for Medium, “Trading fees are more transparent to consumers than missed price improvement, and so are better subject to competitive forces.”[32]

International Support for Eliminating PFOF

Other countries have taken steps to reduce or eliminate the issue of PFOF.

In the UK, it has been the Financial Conduct Authority’s (FCA) long-held position that “PFOF in relation to retail and professional client business is incompatible with our rules on conflicts of interest and inducements, and risks compromising firms’ compliance with best execution.”[33]

It specifically cites both the incompatibility of PFOF with the duty of best execution and the “wider bid-ask spreads from market makers and other liquidity providers who agree to pay PFOF to attract order flow from brokers.”[34]

Most recently, Singapore banned PFOF, stating quite simply that “PFOF introduces conflicts of interest and is likely to cause harm to customers as the CMS Broker may be incentivized to pursue commissions or other forms of payment … in return for routing customers’ orders to that broker or counterparty for its own benefit. This is inconsistent with a CMS Broker’s duty to provide Best Execution to its customers.”[35]

In addition, like the UK, Singapore identified “wider bid-ask spreads” as a direct consequence of this practice.

The EU has been embroiled in a huge fight over PFOF, with financial regulatory authorities and the European Parliament pushing hard for a continent-wide ban. Simultaneously, individual countries are being lobbied heavily by PFOF brokers and high-speed middlemen to allow for PFOF in their respective jurisdictions. Regardless of the ultimate political decision here, ESMA is clear in its guidance: “ESMA is of the view that, in most cases, it is unlikely that the receipt of PFOF by firms from third parties would be compatible with MiFID II.”[36]

---

[32] Bishop, Allison, “The SEC Isn’t Mad at PFOF, They’re Just Disappointed.” Medium. (Jan. 6. 2023), Available at https://medium.com/prooftrading/the-sec-isnt-mad-at-pfof-they-re-just-disappointed-f5252fbbf6df

[33] Financial Conduct Authority (FCA), “Payment for Order Flow (PFOF)”, (April 2019), Available at https://www.fca.org.uk/publication/multi-firm-reviews/payment-for-order-flow-pfof.pdf

[34] Ibid.

[35] Monetary Authority of Singapore (MAS), “SECURITIES AND FUTURES ACT (CAP. 289)”, (Sept. 3, 2020), Available at https://www.mas.gov.sg/regulation/guidelines/guidelines-to-notice-sfa04-n16

[36] European Securities and Markets Authority (ESMA), “ESMA warns firms and investors about risks arising from payment for order flow”, (July 13, 2021), Available at https://www.esma.europa.eu/press-news/esma-news/esma-warns-firms-and-investors-about-risks-arising-payment-order-flow

The US is an outlier on both types of PFOF. In most other markets, exchange rebates are not permitted. Once again the US can learn from other markets such as Hong Kong[37], Japan[38], Australia[39], Euronext[40] and others.

Institutional Support For Eliminating PFOF

While it is easy to understand the views of other jurisdictions, the views of public company issuers are harder to ascertain. However, there are few issuers in the market that are as sophisticated, knowledgeable and impacted as significantly by these practices as publicly traded institutional asset managers. Several of these managers have expressed public views on the issues.

T Rowe Price wrote a particularly important comment letter–in its capacity as both an institutional asset manager and a publicly-listed company–for the Transaction Fee Pilot Proposal[41]. T Rowe Price welcomed the idea of reducing or eliminating rebates: "[w]e do not expect that a reduction or outright removal of rebates will have any significant or harmful effects on the quality of prices displayed in the public lit market, interfere with genuine liquidity and price formation, or negatively impact our stock's trading volume, spread, or displayed size."[42]

The company explained that the goal of any effort to reduce or eliminate rebates should be "improving the overall market to be one where prices can be set by long-term investors without distortion from speculative market participants."[43]

Vanguard explains on its Investor Education website that "we don't receive (or take) any form of payment for order flow. Our approach is rooted in our 'client first'" philosophy and our drive to maximize investment outcomes… We consider ourselves caretakers of your investments, and that permeates every decision we make."[44]

---

[37] Hong Kong Exchange (HKEX), "Rules, Forms & Fees", Available at https://www.hkex.com.hk/Services/Rules-and-Forms-and-Fees/Fees/Securities-(Hong-Kong)/Trading/Transaction?sc_lang=en

[38] Tokyo Stock Exchange (JPX), Trading Participation Fees, (Apr. 4, 2022), Available at https://www.jpx.co.jp/english/rules-participants/participants/fees/tvdivq000000v276-att/fee(English)20220808.pdf

[39] Australian Securities Exchange Ltd. (ASX), "ASX Trade: Markets Participant and Trading Schedule of Fees", (Jan. 1, 2022), Available at https://asxonline.com/content/dam/asxonline/public/documents/schedule-of-fees/asx-trade-markets-participant-and-trading-schedule-of-fees.pdf

[40] Euronext Cash Markets, "Trading Fee Guide For Cash Market Members", (Feb. 24, 2023), Available at https://www.euronext.com/sites/default/files/2023-02/euronext_cash_markets_trading_fee_guide_effective_27mar2023.pdf

[41] Ramsay, John, "Comment Later: Transaction Fee Pilot; Securities Exchange Act Release No. 82873; File No. S7-05-18", IEX Group, Inc., (June 12, 2018)

[42] Ibid.

[43] Ibid.

[44] Vanguard, "Payment for order flow—What you need to know", (Feb. 10, 2022), Available at https://investor.vanguard.com/investor-resources-education/article/payment-for-order-flow-what-you-need-to-know

Quite clearly Vanguard recognizes that being a caretaker of client investments is incompatible with PFOF.

Finally, Capital Group has been a leader on this issue for years. In his testimony[45] before the SEC's Equity Market Structure Advisory Committee in 2015, Matt Lyons, SVP, Global Trading Manager, said simply, "The Capital Group strongly recommends that we should eliminate rebates … that in and of itself will alleviate a lot of the issues I've discussed."

Said issues include nearly all of the points addressed above–increased fragmentation, complexity and fragility; fee-sensitive (or fee-avoidance) routing; excessive quote-to-trade ratios; and exchange fee structure complexity.

Alternatives to a Ban

If the Commission continues to allow this conflicted practice, which clearly causes harm to individual investors, then we urge changes that can reduce the conflicted nature of these inducements. For example, the access fee cap acts effectively as a rebate cap. As the Commission notes in the NMS Proposal: "analysis suggests that the primary reason that access fees remain near 30 mils on most exchanges is to fund rebates."[46]

As the Commission stated in harmonizing quote and trade increments for both on- and off-exchange trading, "investors may benefit overall from harmonizing trading and quoting increments regardless of the effect on price improvement because of the potential long-term competitive effects."[47]

Similarly, the access fee cap should be complemented with a rebate cap for Wholesaler PFOF in much the same way that it constrains Exchange PFOF. A universal fee and rebate cap in this context would be sensible and consistent with the overall objectives of The Proposals.

If the Commission insists on maintaining government-mandated price controls in the form of an access fee cap, and further insists that a number must be chosen, then 10 mils seems as good as any other number. Should it be lower? Higher? Who knows? The original 30 mil cap was chosen by someone at the Commission sticking their finger in the air (or so the story has been related to us in the past), so a similar methodology seems reasonable here[48].

---

[45] Lyons, Matt, "EMSAC—Presentation on Maker Taker Pricing", Capital Group, (Oct. 27, 2015), Available at https://www.sec.gov/spotlight/capital-group-presentation-matt-lyons-emsac.pdf

[46] NMS Proposal at 176

[47] NMS Proposal at 220

[48] IEX, "The Cost Of Exchange Services: Disclosing the Cost Of Offering Market Data and Connectivity as a National Securities
Exchange", (Jan. 2019), available at
https://iextrading.com/docs/The%20Cost%20of%20Exchange%20Services.pdf
Note: All joking aside, we do believe that as long as exchanges are able to markup their market data costs between 201% and 4,891% while being allowed to pay rebates to brokers, the Commission should ensure exchanges are able to make money based on facilitating trading instead of charging monopolistic markups to sell firms their own data back to them. Therefore, based on current market access fee structures, 10 mils does seem like the right cap at this moment in time.

WTI believes strongly in simplicity and transparency. Exchange fee and rebate structures are the exact opposite. The complexity of existing fee structures is overwhelming. A 2018 report by RBC analyzed pricing data across public exchanges, and found that both the fee structures and changes add "significant amounts of complexity to US equity markets … The data identifies no fewer than 1,023 separate pricing "paths" – i.e., separate fees or rebates -- across these exchanges. That number is almost 22 percent more than the 839 pricing paths we identified in our initial report in February of 2016. We also note that 381 of the paths in our current study, or 37 percent, consist of rebates. In total, we found at least 3,762 separate pricing variables across the exchanges–that is, 3,762 factors that ultimately determine the fees charged and rebates offered by exchanges. These 3,762 variables strongly suggest that exchange prices are tailored and offered on a bespoke basis."[49]

The Commission recognizes that simple fee structures are important. As discussed in the OCR Proposal, all fees and rebates for auctions "must be the same rate for segmented orders in all auctions and must be the same rate for auction responses in all auctions."[50]

The OCR Proposal goes on to explain that "[t]his proposed uniform rate for fees is designed to promote a level playing field among all potential market participants that may wish to trade with segmented orders. It would, for example, prohibit any volume discount that could give the largest participants an economic advantage in pricing their auction responses compared to other market participants."[51]

Why would the Commission acknowledge the reality that tiered fee structures promote an unlevel playing field in the OCR Proposal without extending this principle to the NMS Proposal?

WTI urges the Commission to take this principle from the OCR Proposal and apply it broadly to exchanges in order to eliminate the complex fee structures and fee tiering that create intractable conflicts-of-interest and warp order routing behavior.

Endorsements From The Proposals' Staunchest Critics

Various firms are already lining up to lambast The Proposals offered by The Commission. Indeed, these proposals are a clear threat to their earnings per share and annual bonuses. However, it is critical to remember that nearly every one of these firms has felt differently about these issues in the past. Despite their ad hominem attacks on supporters of The Proposals[52], these firms have at one time or another endorsed nearly all of the reforms for which WTI advocates. That was before they made money from these practices.

---

[49] Steiner, Rich, "Comment Letter—Re: Proposed Rule to Establish a Transaction Fee Pilot for National Market System Stocks, File No. S7-05-18F", RBC Capital Markets,(Oct. 16, 2018), Available at https://www.sec.gov/comments/s7-05-18/s70518-4527261-176048.pdf

[50] OCR Proposal at 115

[51] OCR Proposal at 116

[52] Rubenstein, Marc, "SEC's Stock Proposals Fix What Ain't Really Broken", Washington Post,(Jan. 5, 2023), Available at https://www.washingtonpost.com/business/secs-stock-proposals-fix-what-aint-really-broken/2023/01/05/021b80ae-8cbf-11ed-b86a-2e3a77336b8e_story.html

Intercontinental Exchange CEO Jeffrey Sprecher once said he would “have the regulators outlaw maker-taker pricing”[53]

“I think maker-taker pricing or payment for order flow is bad for markets,” Sprecher said. “It creates false liquidity by attracting people who are there solely to try to make rebates and not actually trade and hold risk. That liquidity leaves quickly and is not subject to any contractual obligation like a market-maker would be.”[54]

In 2021[55], Citadel Securities founder Ken Griffin said he would be “quite fine” if payment for order flow was banned. “Payment for order flow is a cost to me,” Griffin said, addressing The Economic Club of Chicago. “So if you’re going to tell me that by regulatory fiat one of my major items of expense disappears, I’m OK with that.”

In 2004, Citadel asserted that “the practice of payment for order flow creates serious conflicts of interest and should be banned … payment for order flow creates fundamental conflicts of interest that cannot be cured by disclosure.”

Virtu was a founding working group member of the Healthy Markets Association in 2015, which had as its mission to eliminate PFOF and rebates (along with eliminating off-exchange trading of retail orders with a trade-at rule). Virtu was extremely supportive of these reforms. In fact, current employees of Virtu have been clear, in both private correspondence and public forums, about the problems that PFOF presents[56]:

- “PFOF Presents an Undeniable Conflict of Interest”
- “PFOF is a flawed and conflict-ridden practice”
- “Wholesalers use the press to falsely claim that they can provide retail investors with prices inside the public spread while exchanges can’t, but they often set the spread and its[sic] widening.”
- “A ban on PFOF should lead to more competition and better prices for retail, not less”
- “Arnuk remarked that … banning payment for order flow (PFOF) would guide our markets to the best state of price and demand as well as eliminate market fragmentation.”[57]

The Commission will hear a lot of arguments from the brokers and exchanges to preserve the status quo. These arguments will include the idea “that PFOF added lots of liquidity to the

---

[53] Popper, Nathaniel, “Study Says Broker Rebates Cost Investors Billions”, New York Times. (May 6, 2012)
[54] Stebbins, Christine, “ICE CEO Sprecher wants regulators to look at ‘maker-taker' trading”, Reuters, (January 26, 2014)
[55] Darbyshire, Madison, “Citadel Securities founder ‘quite fine’ with ending payment for order flow”, Financial Times, (October 4, 2021)
[56] Arnuk. Saul, “Testimony before the House Financial Services Committee: GAME STOPPED? WHO WINS AND LOSES WHEN SHORT SELLERS, SOCIAL MEDIA, AND RETAIL INVESTORS COLLIDE”, U.S. GOVERNMENT PUBLISHING OFFICE, (March 17, 2021) Ret. https://democrats-financialservices.house.gov/uploadedfiles/hhrg-117-ba00-wstate-arnuks-20210317.pdf
[57] Investor Advisory Committee (IAC), “SEC Investor Advisory Committee Meeting”, SIFMA.org, (June 10, 2021), Available at https://www.sifma.org/resources/general/sec-investor-advisory-committee-meeting-6/

markets”[58] and that the wholesalers are “getting investors the same prices as the “best” quotes posted on the exchanges.”[59]

Those arguments are direct quotes from Bernie Madoff.

Fortunately, as demonstrated above, some of the best arguments in favor of banning PFOF come from the brokers and exchanges themselves.

Our Duty to Best Execution

It’s time to turn the page. The inducements and incentives underlying PFOF distort order routing and violate the principles and duty of best execution. In doing so, PFOF undermines the fairness, simplicity, and transparency of the markets, creating a warped system in which investors are unable to find each other or interact directly, and in which their orders are productized for the benefit of high-speed speculators and rent-seekers.

There are few reasons to preserve the current system and numerous compelling reasons to put an end to this deeply unequal practice. Chief among them, the duties outlined by Best Execution denote that we are legally obligated to do so.

Sincerely,

[YOUR NAME]
[ANY OTHER INFO, SUCH AS YOUR TITLE/POSITION AND FIRM]

[58] Tully, Shawn, “No such thing as a free trade: How Robinhood and others really profit from ‘PFOF’—and why it harms the markets”, Fortune, (March 1, 2021), Available at https://fortune.com/2021/03/01/robinhood-trading-app-free-trades-pfof-stock-market
[59] Ibid.