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May 25, 2018

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: Proposed Transaction Fee Pilot (Release No. 34-82873; File No. S7-05-18)

Dear Mr. Fields:

Nasdaq, Inc. ("Nasdaq") appreciates the opportunity to comment on the proposed Transaction Fee Pilot[1] (the "Proposal"). Nasdaq is eager to engage constructively with the Securities and Exchange Commission ("Commission") and with the industry to improve the interactions and outcomes that investors, issuers, and Nasdaq members experience in the U.S. equity markets. In this case, Nasdaq believes that the current Proposal will not help but will likely harm investors and issuers, the very groups the Commission is charged with protecting. Nasdaq respectfully submits that the Proposal is flawed in several meaningful ways:

- ***The record contains no evidence that any Pilot is justified***. The Commission's record is devoid of even the most basic evidence to justify a Pilot. For example: do exchange transaction fees and rebates actually create conflicts of interest and do those conflicts harm investors; do non-exchange fees and rebates create conflicts and do those conflicts harm investors; how much harm exists and does it match the scope of the Proposal?

- ***The Proposal lacks a solid foundation***. Before the Commission can even consider studying how transaction fees impact order routing behavior, it must first gather and analyze existing data and enhance existing transparency tools. For instance, the Commission should enhance the Duty of Best Execution and modify SEC Rule 606 to enhance disclosure of order routing behavior, as recommended by the Treasury Department.[2] The resulting data, combined with existing data from OATS and SEC Rule 605, would allow the Commission to study the

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1 Securities Exchange Act Release No. 82873 (March 14, 2018), 83 FR 13008 (March 26, 2018) (File No. S7–05–18).

2 See United States Department of the Treasury, *A Financial System That Creates Economic Opportunities: Capital Markets*, Report to President Donald J. Trump (October 2017) (available at: https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf).

impact of transaction fees on order routing behavior.

- ***The Proposal as designed will not achieve its stated goal***. The Proposal is both over and under inclusive. It purports to study potential conflicts, but over-includes market making, principal trading, inverted markets and exchanges' unlit orders where such conflicts are not implicated. Simultaneously, it excludes Alternative Trading Systems ("ATSs") and broker-dealer matching venues that account for 39 percent of U.S. trading volume and that provide services similar to those provided by exchanges, are subject to similar potential conflicts, and have no public filing and review process for pricing. The Proposal erroneously assumes a static environment, when it is changing a major variable (access fees) in one segment of the market (exchanges) without properly anticipating or accounting for the dynamic impact of that change on a complex, interconnected, and fluid ecosystem accounting for 39 percent of U.S. trading volume

- ***The Proposal undermines the public reference price.*** The public reference price for trillions[3] of dollars of public company capitalization and investor savings is comprised exclusively of trading interest displayed on public markets such as Nasdaq. The Proposal would limit exchanges' ability to gather liquidity, and would thereby weaken the public reference price, jeopardize a well-functioning, fair and orderly market, and risk damaging companies' ability to efficiently raise capital. This will particularly harm small and medium sized companies, for which the current market structure is already not optimized. By severely restricting fees and rebates only for exchanges, the Proposal could alter the competitive dynamics between exchanges and over the counter markets, undermining price discovery, widening spreads, and costing investors money. Achieving an artificial reduction in fees is no substitute for a narrow NBBO, which is placed at risk by the Proposal.

- ***The Proposal is a risky market experiment with public companies and public investors***. The Proposal would affect 3,000 issuers, more public companies than are currently listed on Nasdaq, and their shareholders. The potential unintended consequences will reverberate throughout the U.S. economy. It cannot properly be considered a mere pilot, and the Commission cannot avoid its burden of conducting accurate cost-benefit analysis by categorizing a risky experiment as a "pilot".

- ***The Proposal imposes impermissible government rate-making.*** Government rate-making is a discredited vestige of intrusive, Depression-era legislation. Courts and policy makers broadly understood that rate-making reduces competition, increases inefficiency and costs, and harms consumers.[4] The Proposal, along with its enormous scope, will be intrusive and costly, imposing far greater costs than the potential benefits sought. The Commission must consider alternatives that impose lower costs and risks on the market, are less arbitrary and harmful to investors and public companies, and less damaging to competition.

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3 The market capitalization of all Nasdaq listed companies is approximately $11.8 trillion.

4 See *Time Warner Entm't Co., L.P. v. FCC*, 56 F.3d 151, 171 (D.C. Cir. 1995) (noting that the lack of "an incentive to be efficient" "is a notorious drawback of cost-of-service regulation").

- ***The Proposal violates the Exchange Act and the Administrative Procedure Act.***[5] The Proposal fails adequately to consider whether the action will promote efficiency, competition, and capital formation, making the rule arbitrary and capricious, and not in accordance with law.[6] Prior Commissions have promulgated rules that violate the APA for failing to adequately perform a cost-benefit analysis.[7] Under the APA, the Commission must have "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choices made."[8] The Commission has a "statutory obligation to determine as best it can the economic implications of the rule."[9] Failing to apprise itself of the economic consequences of a proposed regulation makes its promulgation arbitrary and capricious and not in accordance with law.[10]

Simply stated, the Proposal is inconsistent with the Exchange Act and the APA, reflects poor regulatory policy, and would not withstand judicial scrutiny. The Commission asserts without evidence that this risky experiment is necessary in order to study and control the theoretical conflicts of interest that brokers face when routing orders. However, the Proposal is so clearly not designed to accomplish its stated goal, it appears to be a pretext for other motivations.

I. The Proposal Lacks a Solid Foundation

Nasdaq believes that a transaction fee experiment is inappropriate at this time because there are alternatives and prerequisites the Commission must further evaluate.[11] The Treasury Department, in its report on the U.S. Capital Markets, recommended that the Commission adopt its long-standing proposals to enhance the operational transparency of ATS and to reform SEC Rules 600 and 606, in addition to studying potential misaligned incentives between broker-

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5 5 U.S.C. § 551 et seq.

6 Under the APA, courts will set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A).

7 See, e.g., *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011); *American Equity Investment Life Insurance Company v. SEC*, 613 F.3d 166 (D.C. Cir. 2010), *Chamber of Commerce v. SEC*, 412 F.3d 133 (D.C. Cir. 2005).

8 See *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (internal quotation marks omitted).

9 See *Chamber of Commerce*, 412 F.3d at 143.

10 See *Chamber of Commerce*, 412 F.3d at 144; *Pub. Citizen v. Fed. Motor Carrier Safety Admin.*, 374 F.3d 1209, 1216 (D.C. Cir. 2004).

11 Nasdaq, together with CBOE and NYSE, submitted a joint letter to the EMSAC on October 13, 2017, concerning the Access Fee Pilot. Therein, the exchanges noted that a clear problem had not been quantified and called for a holistic review of Regulation NMS – not just one aspect of Regulation NMS (i.e., access fees). See Letter from CBOE, Nasdaq and NYSE to Honorable Jay Clayton, Commission, dated October 13, 2017 (available at: https://www.sec.gov/comments/265-29/26529-2641078-161300.pdf).

dealers and their customers.[12] Nasdaq believes implementing these important disclosure and transparency requirements would be essential to a meaningful study potentially misaligned incentives impacting routing behavior.

The Commission has completed none of the steps the Treasury Department recommended. It has not reviewed Tick Pilot data, reformed Rule 606 disclosure, or clarified the duty of best execution; each is vital to a full understanding of order routing incentives, and each would be less risky and costly than the current Proposal. For example, analysis of Tick Pilot data will provide crucial information on whether tick size impacted routing behavior, and if so, whether it is more impactful than fees and rebates. Reforming Rule 606 will provide meaningful disclosure by broker-dealers on their current routing decisions, including fees and inducements provided by over-the-counter markets that potentially create the same conflicts the Proposal purportedly studies. Formal and more systematic guidance on best execution obligations would help harmonize behavior among broker-dealers making critical routing decisions based on exchange and non-exchange inducements that currently exist.

Additionally, the Commission already has more efficient and less costly tools by which to study the impact of fees and rebates without arbitrarily subjecting only exchange trading to a risky experiment that will likely harm displayed quotations and price discovery. As noted above, the Commission's record is devoid of even the most basic evidence to justify a pilot, particularly one as potentially harmful as the Proposal. Instead, the Commission should leverage existing data and tools that are available to it, such as Order Audit Trail System data.[13] If the Commission believes that the currently available data needs supplementation, it could request information from broker dealers such as routing priority tables and how firms consider exchange and ATS fees and incentives. With this data, the Commission can determine whether a problem exists without risking the potential negative impact of a pilot.

Adopting the Treasury Department recommendations and employing existing tools, will place the markets on a sound footing to understand and control for potential conflicts, and allow the Commission to determine properly whether a transaction fee experiment is even necessary and, if so, how best to structure it. Moving forward with the transaction fee experiment at this point is premature, will likely harm investors and issuers, and is unlikely to deepen the Commission's knowledge of the causes or even the symptoms of potential conflicts of interest. Consequently, Nasdaq believes that in its current form the Proposal is arbitrary and capricious and would not withstand judicial scrutiny.

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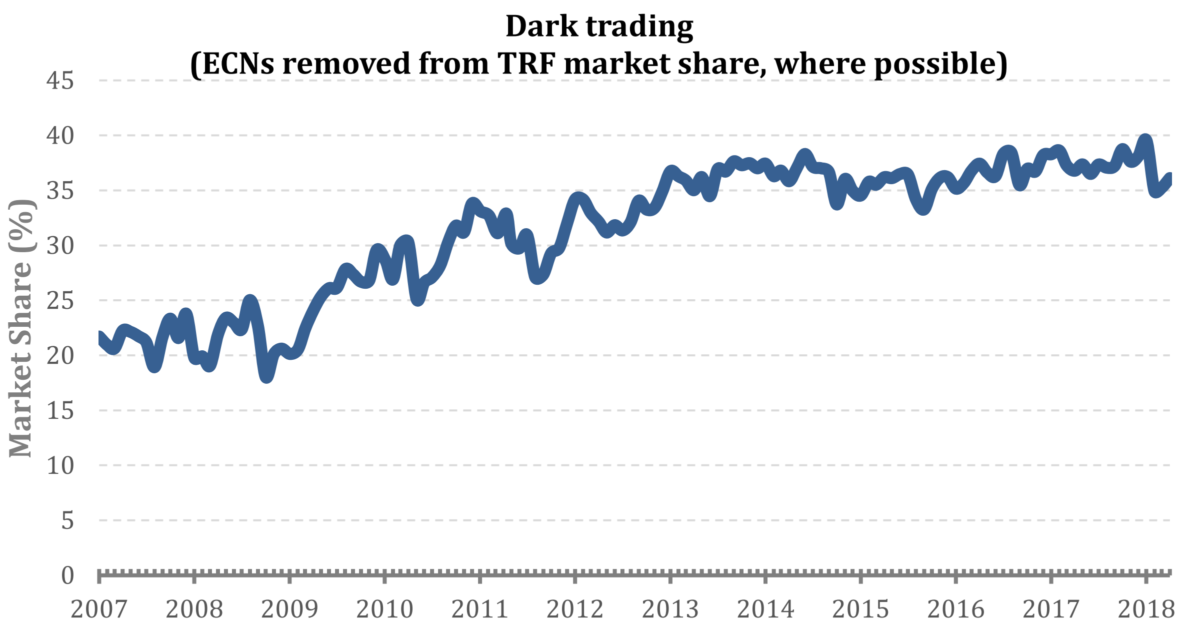
[12] See supra note 2.

[13] See FINRA Rule 7000 Series. As the Commission stated in approving the OATS rules "OATS is required at a minimum, to (a) provide an accurate, time-sequenced record of orders and transactions, beginning with the receipt of an order at the first point of contact between the broker-dealer and the customer or counterparty and further documenting the life of the order through the process of execution, and (b) provide for market-wide synchronization of clocks used in connection with the audit trail." See Securities Exchange Act Release No. 39729 (March 6, 1998), 63 FR 12559 (March 13, 1998) (SR-NASD-97-56).

II. The Proposal Will Not Achieve its Ostensible Goal

The Proposal is flawed in design because of its unbalanced and incomplete approach. The Proposal is unbalanced because, among other things, it includes only exchange orders (both lit and dark) while ignoring over-the-counter trading. As a consequence, the Proposal will not give the Commission meaningful data upon which to make informed analysis and conclusions. The Proposal would experiment with the whole lit U.S. equities market, and simultaneously ignore off-exchange trading representing approximately 39 percent of total U.S. equities market trading. Puzzlingly, the Commission appears willing to impact liquidity and potentially increase the overall cost of trading for investors in an effort to manage potential conflicts when there are readily available tools for the Commission to assess and address its stated concerns. The Proposal would have the Commission engage in rate-making, which would reduce choices for market participants and distort competition between over-the-counter venues and exchanges.

The Proposal will not achieve its ostensible objective of producing meaningful data on the effect of capping transaction fees and rebates because it does not include all trading centers as defined by Regulation NMS.[14] As previously mentioned, the Proposal purposefully excludes over-the-counter markets, which represent approximately 39 percent of the U.S. equities trading by share volume. The incentives and remuneration, such as payment for order flow, applied to nearly half of equities market trading in the securities covered by the Proposal will not be accounted for by the Proposal. As shown by the graph below,[15] off-exchange dark trading has increased by roughly 82 percent between January 2007 and January 2018.



[14] Regulation NMS defines a "trading center" as a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent. See 17 CFR 242.600(b)(78).

[15] Calculation of dark trading excludes ECNs that posted displayed quotations.

The Proposal's justification for excluding over-the-counter markets from the Proposal is tautological:[16]

> [E]xpanding the proposed Pilot to non-exchange trading centers, such as ATSs, whose fees currently are not subject to Rule 610(c) would have the effect of imposing, in the terms of a pilot, an entirely new regulatory regime on entities whose fees are not currently subject to the substantive and process requirements applicable to exchanges, and that are currently not subject to access fee caps in any respect. The Commission, therefore, believes that doing so would introduce a number of complexities that it preliminarily does not believe are warranted for purposes of this proposed Pilot.

The Proposal lacks internal coherence on this point, arguing that ATSs should be excluded because they do not have protected quotes, but then including unlit exchange orders that also are unprotected.

The Commission baselessly states that the Proposal may even "improve the competitive position of exchanges vis-à-vis ATSs."[17] And yet, the Proposal does not properly evaluate the potential shift in competitive dynamics between exchange and off-exchange trading, particularly in light of the "fair and equal access" requirements applicable only to lit markets. The Commission's description of exchanges' market power is off the mark; exchanges engage in extensive price competition including offering incentives to post liquidity.[18] The Proposal, as designed, risks disincentivizing liquidity providers from posting displayed limit orders thus either increasing spreads or reducing the depth of displayed market liquidity or both which will harm the US equities market ecosystem – particularly for less liquid securities.

As discussed below, the Proposal wrongly presumes that protected quotations give exchanges dominant market power, and that Rule 610(c) is the only check against unreasonable exchange access fees. In reality, it is market participants that have significant market power because market participants have ample choice to make their own routing decisions. Thus, excluding over-the-counter markets from the Proposal may decrease liquidity on the exchanges as market participants may seek better remuneration from other venues that are not subject to the pilot nor required to publicly disclose their pricing schedules. The Proposal ignores markets that play a material part in the competitive U.S. equities landscape. Accordingly, the Proposal cannot be expected to provide meaningful data on which to make decisions concerning what exchanges may or may not charge their members for transactions.

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16 See Proposal at 31.

17 See Proposal at 34. Paradoxically, the Commission places great value on protected quote in its arguments supporting the Proposal, but the Proposal itself would undermine the formation and, ultimately, the value of the protected quote.

18 See, e.g., *In the Matter of the Application of Sec. Indus. & Fin. Markets Ass'n for Review of Actions Taken by Self-Regulatory Organizations*, File No. 3-15350, at 31 (June 1, 2016).

Trading on exchanges is not isolated; it is inextricably linked to activity in off-exchange trading centers. Restricting the fees that exchanges can assess will undoubtedly impact how securities are traded off-exchange in ways that the Proposal cannot foresee and will not measure. How will the Commission set the baseline for remuneration occurring off-exchange, [19] or know what impact the Proposal has on that baseline? Excluding off-exchange venues from the Proposal will confound the Proposal's ability to properly understand the potential conflicts of interest. Ultimately, excluding off-exchange markets from the Proposal will benefit those venues because the remuneration occurring off exchange will be less regulated and transparent. Again, the Commission logically should first improve off-exchange disclosure and transparency before considering whether to pursue a transaction fee pilot. The Proposal does not describe how the Commission will evaluate the data collected under the Proposal to identify potential conflicts of interest, market quality, or execution quality. The Pilot requires exchanges to significantly alter their fee structures and collect data on their members' order routing responses to those alterations in order to evaluate the impact of the Proposal's test groups on execution quality and market quality. Tellingly, while the Proposal requires exchanges to provide routing data the Proposal does not require routing firms to provide comparable routing data. Nor does it require exchanges or any other market participant to provide data on either execution quality or market quality. The implicit assumption appears to be that members' responses to altered fee structures would provide evidence of a conflict of interest.

A free and competitive market depends on price changes that induce behavioral changes in customers. Exchanges routinely alter their fee structures in order to affect members' behavior. It is both unnecessary and illogical for the Commission to pursue a pilot to gather evidence that exchange members respond to significant restrictions in exchange fees since it is universally accepted that fee changes alone produce such a response. In sum, the Proposal lacks detail on how and what will be measured, and what success or failure would be.

III. The Proposal is a Risky Experiment that will Harm the Lit Markets, Companies and ETPs

Inexplicably, the Commission concludes that the Proposal would not place exchanges at a competitive disadvantage to their direct competitors, some of which perform very similar functions to exchanges.[20] The Proposal absolutely will alter the competitive balance and will result in winners and losers. As noted above, the Commission has more efficient means by which to study the market and to determine the impact of rebates without subjecting investors and issuers to an experiment that will harm the lit markets and price formation. The Commission

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[19] The Commission has not made any attempt to gather data about ATS and non-ATS inducements or other metrics that would allow the public to better understand what drives over-the-counter trade activity.

[20] Electronic Communications Networks or "ECNs" are a form of ATS that may choose to facilitate compliance by a market-maker with its obligations under the Commission's Quote Rule by transmitting its best bid/offer to a national securities exchange or registered securities association for public display. In this way, they are similar to exchanges, yet the Commission has not considered including ECNs in the Proposal.

has not considered the data and tools that it has available to it presently,[21] and could request information from broker-dealers or exchanges to supplement the data already available. For example, the Commission could request information concerning routing logic and how firms consider exchange and ATS fees and incentives.

Nasdaq is also concerned that the Commission has not fully considered the effect of the Proposal on ETPs. First, consider the costs of accounting for additional complexity in pricing an arbitrage opportunity for market makers when corporate stocks and ETPs will have a variety of rebates and transaction fees to be included in the pricing models. Second, if ETPs tracking similar indexes are included in different test groups, an issuer in the lower rebate groups would find themselves at a competitive disadvantage to their competitors and may lose market share during the pilot as a result.

The Commission also fails to consider the economic impact of the Proposal on small or illiquid ETPs. Including all sizes of ETPs in the Proposal, will make it even harder to grow small and illiquid ETPs included in low rebate buckets, which are predicated on market maker support and require those same firms to provide seed capital (e.g., capital investments). Nasdaq also highlights that, although the costs to investors and issuers of lower rebates may seem clearer in ETPs – the detrimental impact will affect all stocks.

Ultimately, the Proposal is a blunt tool lacking nuance that will negatively affect efficiency, competition, and capital formation – none of which have been adequately addressed by the Commission. Accordingly, Nasdaq believes that the Proposal is arbitrary and capricious and not in accordance with law.

The Proposal would on one hand severely restrict exchange fees and inducements, which support market making in thinly-traded securities among other things, while on the other hand it would allow over-the-counter markets to continue to assess fees and provide inducements unabated. The Commission has failed to adequately consider the impact on issuers, treating all issuers the same without consideration for the very significant differences in how the securities of different sized and priced companies trade.

In fact, the Proposal does not appear to consider the impact it would have on public companies. The markets must work effectively for all public companies regardless of their trading characteristics: from a market capitalization of $50 million to $750 billion; from an average daily share volume of 50,000 to 50 million; from start-up to a centuries-old mature company. As acknowledged by Chairman Clayton, "one size regulatory structure does not fit all."[22] The Proposal is likely to have a significant impact on small to medium issuers since exchanges will not be able to provide incentives to market makers to support trading in those

[21] Such information includes OATS data and other information held by FINRA.

[22] Testimony of Chairman Jay Clayton on "Oversight of the U.S. Securities and Exchange Commission" Before the Committee on Banking, Housing and Urban Affairs, United States Senate Testimony, available at: https://www.sec.gov/news/testimony/testimony-clayton-2017-09-26.

companies' securities. Moreover, the Commission is ignoring other factors that drive trading decisions, such as tick size, which will result in only a partial view of what drives trading on-exchange versus off-exchange. In a one size fits all approach, the Commission is not considering the needs of less liquid companies.

The very incentives that the Commission seeks to limit are meant to directly benefit small and medium sized companies, which may have less liquidity in the trading of their securities. Liquidity rebates can be critical for such securities to motivate market makers to support the stock with aggressive and actionable quotations.[23] The Commission itself states that "[it] preliminarily does not believe that including smaller capitalization stocks in the proposed Proposal should disproportionately harm those issuers, even though it may result in the reduction or elimination of transaction-based rebate incentives that would otherwise be used to attract posted liquidity in those stocks on maker-taker exchanges…."[24] While the Commission acknowledges that liquidity will be affected, noting the relationship between the fees and incentives, it nonetheless speculates that "any potential degradation of the effective bid-ask spread due to lower or reduced rebates could be mitigated by lower access fees." This speculation is not supported by empirical data or substantive analysis.[25]

Through this pilot structure, it appears that the Commission is treating trillions of dollars in U.S. public company capital as a giant field for experimentation, rather than considering that stocks are not "symbols" or "tickers", they are, in fact the companies that serve as the foundation of the U.S. economy. These companies rely upon their public capital to drive their growth and success that then accrue to the benefit of the U.S. economy. The companies that are represented with their stock symbols have worked relentlessly for years, decades, and in some cases over a century to build businesses that serve the broad public needs of our economy. The companies are owned by millions of investors, who are relying upon those companies to provide savings opportunities that give them a more secure future. If the Commission experiments on these companies with market structure pilots that are ill-conceived or ill-executed, it risks increasing the cost of capital for thousands of companies, thus negatively affecting millions of investors representing trillions of dollars in public capital.

In sum, the Proposal gives short shrift to the concerns expressed by Nasdaq and other exchanges regarding the impact of a transaction fee cap and outright rebate ban on listed issuers, particularly thinly traded small and medium sized operating companies and ETP. Nasdaq believes the Proposal is arbitrary and capricious and not in accordance with law.

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23 The Commission acknowledges that "transaction rebates may facilitate the provision of beneficial liquidity for mid- and small capitalization securities, and may outweigh any negative distortive impact on broker-dealer incentives, market complexity, or price transparency." Proposal at 41. See also Proposal at Section V.C.2.f, generally.

24 See Proposal at 42-43.

25 See Proposal at 217.

IV. The Proposal is a Risky Market Experiment, not a Pilot

The scope of the Proposal is unprecedented among historical "pilots".[26] The Equity Market Structure Advisory Committee ("EMSAC")[27]recommended a pilot program limited to *a total of 300 test securities*, with a suggested phase-in of ten stocks for three months. By contrast, the Commission is recommending that the Proposal contain *a total of 3,000 test securities*. What accounts for the vast disparity between what was recommended by the EMSAC and what the Commission proposes? The EMSAC understood the impact a fee pilot would have and exercised great restraint in the number of securities included in its proposal. The Commission seemingly lacks this concern by including such a large number of securities in the Proposal. There are currently 7,989 securities that are eligible for inclusion in the Proposal and the Proposal will include 37.5% of them. The sheer size of the Proposal would cause significant problems not addressed by the Commission. Nasdaq believes that the all-encompassing nature of the Proposal will make it very difficult for the Commission to avoid picking winners and losers when selecting securities of the test groups, which has not been adequately addressed by the Commission in the Proposal.[28]

The Commission speculates that "any of the direct effects of [the Proposal] on efficiency, competition and capital formation would likely be temporary in nature and affect markets only for the duration of the [Proposal]."[29] Nasdaq strongly disagrees. The broad scope of the Proposal will represent a significant undertaking by both exchanges and market participants that must recode their systems to implement the Proposal. Because the largest and most liquid companies would be included in the Proposal, market participants will not treat the Proposal as a true pilot, but rather will code their systems to best trade these large and liquid securities. The Proposal's scope and duration is a *de facto* change to market structure that will absolutely require burdensome expenditures by public companies, exchanges, and many market participants at both the start and at the conclusion of the Proposal.

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26 While the *Plan to Address Extraordinary Market Volatility* ("LULD Plan") covered more securities, it was approved as a National Market System Plan, with self-regulatory organization involvement in the development of the LULD Plan and representation in its governance. See https://www.sec.gov/news/press/2011/2011-84-plan.pdf.

27 Of the 16 members of the EMSAC, no listing exchanges were represented.

28 In 2015, Nasdaq conducted a limited fee reduction pilot, whereby we found that liquidity providers reacted to the reduced fees while liquidity takers generally did not. See Securities Exchange Act Release No. 73967 (December 30, 2014), 80 FR 594 (January 6, 2015) (SR-NASDAQ-2014-128). The Commission discusses our explanations for this, including the small sample size of 14 stocks, its limited duration of four months, and that the experiment was limited to Nasdaq. See Proposal at 15 – 17. Nasdaq does not believe that our explanations for the behavior of the fee experiment in any way supports the design or scope of this Proposal.

29 See Proposal at 219.

V. The Proposal Imposes Impermissible Government Rate-Making and Violates the Exchange Act and APA

The only outcome guaranteed by the Proposal is intrusive, inefficient, and anti-competitive government rate-making. As stated by Commissioner Atkins:[30]

> In the 1930s, the government attempted to pull the country out of the depression by continued intervention, which included everything from price controls to an anti-free market domestic regulatory policy. These policies, most economists today would agree, were failures. We are still living with many of those market distortions two generations later.

Government price controls in free markets that were questionable during the Great Depression are far more dubious today in light of their lengthy record of failure.

The Commission lacks the administrative record needed to justify such drastic government intrusion into free markets. When the Commission is engaged in rulemaking, Section 3(f) of the Act obligates the Commission "to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[31] The Commission also has a "statutory obligation to determine as best it can the economic implications of the rule" and failing to apprise itself of the economic consequences of a proposed regulation renders it arbitrary and capricious and not in accordance with law.[32] For the Proposal to be consistent with the APA, the Commission must have "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choices made."[33] Failure to adequately consider whether the action will promote efficiency, competition, and capital formation makes promulgation of the rule arbitrary and capricious, and not in accordance with law.[34] Nasdaq believes that, as discussed below, the Commission has failed to conduct a comprehensive consideration as required by Section 3(f) of the Act.[35] Instead, Nasdaq believes that the Commission has only partially framed the costs and benefits of the Proposal, ignoring important and significant factors and costs. The Proposal, as drafted, is inconsistent with the APA.

Government-imposed price controls are well understood to have a negative impact on

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30 See Remarks before the Atlanta Chapter of the National Association of Corporate Directors, Commissioner Paul S. Atkins, Commission, February 23, 2005 (available at: https://www.sec.gov/news/speech/spch022305psa.htm).

31 15 U.S.C. § 78c(f).

32 See Supra note 10.

33 See Supra note 8.

34 See Supra note 10.

35 See Supra note 31.

competition and innovation. Courts have found them to be costly to administer[36] and lacking in an incentive to be efficient.[37] Therefore, they are only indicated where they overcome severe market imperfection such as monopoly ownership of a critical resource. In the case of the equity fee cap, it is the presence of a posted order at the NBBO which causes the Commission to be concerned that no force prevents exchanges from imposing unreasonable fees on traders seeking to access the best price.[38] The justification for the fee cap under Rule 610(c), and ultimately the Proposal, depends on the existence of sustained market power created by the requirement of best execution and the prohibition against trading through.

The perception that transaction fees should be constrained is based on a simplistic view that exchanges wield market power and that further artificial government price constraints are needed. No evidence has been offered to support this alleged perception. In fact, with no exchange group controlling even 25 percent of market share, it is difficult to understand the Commission's position on market power. Last, the Commission assumes, again without evidence or analysis, that the market power presumably wielded by equities exchanges is so great that they may charge excessive fees now and in the future. None of these assumptions is valid. Indeed, the perception of market power is largely perpetuated by those that would directly and indirectly benefit from the Proposal, either by reducing their own costs of doing business or undermining the exchanges' competitive position.

The Proposal assumes incorrectly that any market power created by the best execution policy and trade through prohibition rests with the exchange displaying the bid or offer. The Proposal gives this assumption great weight, treating it as the ultimate justification offsetting very real concerns of harm that the Proposal would cause. In reality, the market power is controlled by the market participants that control order flow and choose the market in which to display bids and offers. Exchanges compete vigorously to attract limit orders. They compete using many costly features, including rebates, incentive programs, superior execution systems, regulatory quality, and customer service. This vigorous competition is evidence that the market power associated with displayed orders does not reside with exchanges. Exchanges also compete for liquidity-taking orders. When multiple venues have quotes at the same price, participants route their order to the venue that has the best combination of access fees and other features. A venue with a high access fee that is not justified by high service or other execution quality metrics will be at the

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36 See *Nat'l Rural Telecomm. Ass'n v. FCC*, 988 F.2d 174, 178 (D.C. Cir. 1993) (explaining that cost-based regulation "is costly to administer, as it requires the agency endlessly to calculate and allocate the firm's costs").

37 See *Time Warner*, 56 F.3d at 171.

38 The Commission's imposition of a fee cap rested on its belief that access fees added significant non-transparent costs to transactions, potentially encouraged locked markets, and created an unequal playing field as non-ECN broker-dealers were not permitted to charge access fees in addition to their posted quotations. The Commission was also concerned that in the absence of a cap on access fees, exchanges would charge high access fees thereby undermining Regulation NMS's price protection and linkage requirements. See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37502 (June 29, 2005) (File No. S7-10-04; adopting Regulation NMS).

bottom of broker routing tables, creating a powerful headwind against the market's ability to attract and maintain market share. It will also lower execution rates for brokers that route their limit orders to that venue, reducing the success of their trading strategies. Even under the best execution policy and trade through obligation, powerful competitive forces are clearly present that discourage exchanges from exercising unabated pricing power.

Competition is robust between and among equities exchanges, and between and among exchanges and over-the-counter markets; however, the Proposal is narrowly focused on the reduction of rebates and not on testing what would occur in a competitive and unconstrained market. Notably, the Commission is not proposing a test group in which there are no fee caps or restrictions on rebates. How can the Proposal be comprehensive if it does not test for the very harm that it believes would occur if free markets were allowed to compete? Nor is the Commission proposing a bucket designed to support displayed liquidity. Why is there not a bucket of securities subject to a higher fee cap? In fact, the Proposal is at best neutral on these points, and at worst designed to dissuade price formation through the lit quote.

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Nasdaq welcomes comprehensive study and meaningful reform of market structure, but it cannot support experimentation that ignore material parts of that structure and risks harming the very investors and issuers that Nasdaq and the Commission seek to serve. Liquidity displayed on Nasdaq helps form the public reference price that millions of investors rely on, not only for valuing individual stocks, but also for valuing trillions of dollars of equities exchange traded funds and mutual funds, not to mention the larger pool of options, futures, and other derivatives tied to that reference price. Publicly-traded companies and their shareholders should not be forced to risk an "exogenous shock" to the public reference price in the interest of gathering incomplete data on conflicts of interest.

The Proposal is inconsistent with the APA, represents impermissible government rate-making, and is additionally flawed for the reasons discussed above. On one hand, the Proposal would experiment with 3,000 publicly-listed companies; on the other, it would ignore the approximate 39 percent of equities trading in the U.S that occurs off-exchange. The Proposal goes beyond the issues related to Regulation NMS by including inverted exchanges, proprietary trading, and market making models that do not present the conflicts ostensibly being studied; it limits investor choice; it impairs exchanges' ability to compete with over-the-counter venues; and it has the potential to significantly harm the U.S. economy. As such, Nasdaq respectfully suggests that the Commission withdraw the Proposal, implement the Treasury Department recommendations, and use the tools currently available to understand and study the market in a comprehensive and balanced manner.

Sincerely,

Edward S. Knight

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cc: Chairman Jay Clayton
Commissioner Robert J. Jackson, Jr.
Commissioner Hester M. Peirce
Commissioner Michael S. Piwowar
Commissioner Kara M. Stein
Director Brett Redfearn, Division of Trading and Markets