

By electronic mail to rule-comments@sec.gov

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington DC 20549-0609

September 27, 2022

Re: Exemption for Certain Exchange Members (File Number S7-05-15)

Dear Ms. Countryman:

Modern Markets Initiative (“MMI”)¹, the education and advocacy organization devoted to the role of technological innovation in creating the world’s best markets, appreciates the opportunity to provide written comments to the U.S. Securities and Exchange Commission (the “SEC” or “Commission”) in connection with the Exemption for Certain Exchange Members (File Number S7-05-15)(the “Proposal”).

Introduction

The Proposal would require any registered proprietary broker-dealer (“Proprietary BD”) that effects securities transactions elsewhere than on a national securities exchange of which it is a member to obtain Association membership. This essentially requires any Proprietary BD that trades off-exchange to become a member of the Financial Industry Regulatory Authority, Inc. (“FINRA”), as the sole national securities association.

In particular, the Proposal asks whether the proprietary trading exemption should be removed, which allows a broker-dealer that does not have customers and is registered as a member of a national exchange to opt out of membership with FINRA. Although some MMI members do maintain FINRA memberships, those MMI members that are not currently FINRA members believe that this exemption should not be removed; and that removing it would have a negative cost-benefit effect, and potentially harm liquidity in some markets.

¹ MMI members collectively employ more than 2000 people in over 50 markets globally, and account for approximately 20 percent of daily trading volume in the US equity markets. MMI’s members deploy automated trading technology systems to enhance efficiency of trading for retail and institutional investors.

The Proposal notes that the securities markets have transformed dramatically since the 1980s, when Rule 15b9-1 was adopted.² Indeed, a study by Modern Markets Initiative, *A Report on Market Automation* (July 2022), details the electrification of the markets since the 1980s, and the benefit to investors of narrowed bid-ask spreads and 30% more lifetime savings as a result of market automation.³ The equities markets have evolved to become the most transparent, low-cost and deeply liquid markets in the world – so we must be sure new proposals continue to support these important gains.

The stated purpose of requiring Proprietary BDs to become members of FINRA is so that FINRA can provide additional regulatory oversight. However, the Proposal does not sufficiently explain what additional oversight would be enabled, nor how it would benefit investors or the industry.

Such a firm (an SEC-registered broker-dealer, member of a national exchange) must necessarily designate an exchange as its Designated Examining Authority (“DEA”). That exchange, as DEA, has wide latitude to examine the firm’s trading activity on- and off-exchange, as well as to examine the firm’s policies and procedures, on a regular and ongoing basis. Exchange DEAs have served this oversight role for Proprietary BDs for many years and have specific experience supervising their trading activities, market conduct and compliance with exchange rules, while having a deep understanding of the proprietary trading business model. The Proposal fails to explain where exchange DEA supervision of Proprietary BDs falls short, nor how such a deficit would be remedied by FINRA, which has historically primarily focused on broker-dealers with customer business.

In fact, FINRA already has the ability to monitor the full scope of Proprietary BDs’ trading activity. Both on- and off-exchange equity trading data is available for surveillance since the implementation of the Consolidated Audit Trail (“CAT”), and the expanded scope of mandatory TRACE reporting effectively captures all Proprietary BD U.S. Treasury transactions.

However, requiring such firms to become FINRA members does introduce significant new costs and resource overhead. When the Commission last contemplated this change in 2015, there were several comments submitted regarding costs, and the Trading Activity Fee (“TAF”) in

² See Rule 15b9-1 at 48 FR 53691 (Nov. 29, 1983), as amended at 70 FR 37618, June 29, 2005. § 240.15b9-1 Exemption for certain exchange members. (a) Any broker or dealer required by section 15(b)(8) of the Act to become a member of a registered national securities association shall be exempt from such requirement if it: (1) is a member of a national securities exchange, (2) carries no customer accounts, and (3) has annual gross income derived from purchases and sales of securities otherwise than on a national securities exchange of which it is a member in an amount no greater than \$1,000. (b) The gross income limitation contained in paragraph (a) of this section, shall not apply to income derived from transactions (1) for the dealer's own account with or through another registered broker or dealer or (2) through the Intermarket Trading System. (c) For purposes of this section, the term Intermarket Trading System shall mean the intermarket communications linkage operated jointly by certain self-regulatory organizations pursuant to a plan filed with, and approved by, the Commission pursuant to § 242.608 of this chapter.

³ A Report on Market Automation and Dependable Liquidity in Times of Uncertainty: Investor Savings from Narrowed Bid Ask Spreads, Markets Functioning as Intended, Modern Markets Initiative (July 2022) at <https://www.modernmarketsinitiative.org/wp-content/uploads/2022/07/MMI-BME-Study-Q2-2022.v7.5.pdf>

particular, that are still valid today. In addition to explicit one-time fees for membership, there will be significant recurring costs associated with continuing membership applications, examinations, reporting and a regular cadence of inquiries and reviews. The Proposal does not address these additional costs, nor justify them with a clear benefit to investors or the industry. The MMI members who are not already FINRA members strongly believe that the costs associated with FINRA membership outweigh the anticipated benefits.

The Proposal does not only affect existing Proprietary BDs, but may also affect additional proprietary trading firms who could be required to register as broker-dealers should the Commission's pending proposal to change the dealer definition⁴ also proceed. While principal trading firms have evolved over the past decades from human floor traders to humans using electronic automated trading systems, the core value proposition remains the same: providing liquidity to investors. If these firms are saddled with significant new costs, for which there is no well-articulated benefit, then they will naturally be forced to re-evaluate the profitability and feasibility of continuing to make markets.

Support for Well Regulated Markets

MMI supports the holistic, broad review of market structure, rather than piecemeal changes. We recommend that changes in Rule 15b9-1 should be considered first with cost-vs-benefit in mind; but also taking into account alternative solutions to specific needs.

Notably, MMI is a supporter of the CAT, as a tool for the SEC and SROs to properly monitor their members' activity across markets. MMI invites further discussion and consideration of the extent to which CAT data could be used by the Exchanges (in their role as DEA) as a less burdensome alternative to elimination of the Rule 15b9-1 exemption.⁵

Support for Review of Varying Perspectives

MMI supports further discussion from varying perspectives related to the SEC's 2015 proposal, for which some commenters had discussed a proposal to exempt on-exchange activities of proprietary trading firms from the FINRA Trading Activity Fee ("TAF") as a way to mitigate the cost-benefit analysis of the Proposal.⁶ Although MMI members have varying perspectives on this approach, MMI supports further broad review to ensure that any changes to market structure in the Proposal do not have an unintended negative impact on market liquidity.

⁴ See File No: S7-12-22 - "Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer," March 28, 2022.

⁵ For example, in equities trading, where any two parties trade over-the-counter, one of the parties must be a FINRA member, because one of them has to report the trade to the Tape. In this case, FINRA already has a large degree of authority to surveil and inquire about this activity, and a cost-benefit analysis could be conducted on whether this would be a less burdensome alternative than eliminating the Rule 15b9-1 exemption.

⁶ Exemption for Certain Exchange Members (File No. S7-05-15), Adam Nunes, Hudson River Trading (June 1, 2015) at <https://www.sec.gov/comments/s7-05-15/s70515-16.pdf>.

Conclusion

MMI supports well-regulated markets and the assurance that retail investors have a strong cop on the beat. The SEC and exchanges as DEAs are already regulating principal trading firms without customers, and the SEC should conduct a careful cost-benefit analysis regarding adding a third regulator, FINRA, to the US equities markets that are already the most liquid and transparent in the world. MMI appreciates the opportunity to submit these comments and is available to meet and discuss them with the SEC and its staff in order to respond to any questions.

Thank you for your consideration.

Very truly yours,

A handwritten signature in black ink, appearing to read 'K. Wegner', with a stylized flourish at the end.

Kirsten Wegner
Chief Executive Officer
Modern Markets Initiative