May 25, 2018

Via Electronic Mail (rule-comments@sec.gov)

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

RE: Transaction Fee Pilot for NMS Stocks (File No. S7-05-18)

Dear Mr. Fields:

TD Ameritrade, Inc.[1] ("TD Ameritrade" or "the Firm") appreciates the opportunity to comment on the U.S. Securities and Exchange Commission's ("Commission") proposal to conduct a Transaction Fee Pilot for NMS Stocks ("Pilot").[2] TD Ameritrade provides a unique perspective as an advocate for our retail investors and their 11 million accounts. TD Ameritrade supports the Commission efforts to generate empirical data before making significant changes to market structure. While the Firm agrees with the Commission's intent in proposing the Pilot, TD Ameritrade believes there needs to be important revisions to the Pilot, as follows:

1. **Clearly Define Objectives and Measurement Criteria**. TD Ameritrade recommends that the Commission clearly identify the objectives of the Pilot and what it is truly trying to accomplish.

2. **Reduce the Scope of the Pilot**. The Pilot uses far too large a sample to collect data and has the potential to significantly impact execution quality for retail investors. The Firm recommends using a much smaller test group population as recommended by the Equity Market Structure Advisory Committee ("EMSAC").[3] A smaller sample will reduce the possible adverse impacts to investors and still generate necessary data to facilitate the Commission's analysis. The Firm also recommends a regular review of the Pilot data and that the Commission include a mechanism for stopping the Pilot if it is causing undue harm to market or execution quality.

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1 TD Ameritrade is a wholly owned broker subsidiary of TD Ameritrade Holding Corporation ("AMTD"). AMTD has a 43-year history of providing financial services to self-directed investors. TD Ameritrade provides investing and trading services to over 11 million client accounts that total more than $1.3 billion in assets, and custodial services for more than 5000 independent registered investment advisors. During the first quarter of 2018, TD Ameritrade's clients placed on average 943,000 trades per day.

2 SEA Rel. No. 82873, 83 Fed. Reg. 11905 (Mar. 14, 2018) ("Proposing Release").

3 <https://www.sec.gov/spotlight/emsac/recommendation-access-fee-pilot.pdf>

3. **<u>Protect Broker Confidential Information</u>**. TD Ameritrade recommends that the Commission protect sensitive broker information by requiring the public disclosure of aggregated data only.

4. **<u>Tiered Access Fees</u>**. Finally, TD Ameritrade believes the Pilot should vary transaction fee caps by liquidity to determine if transaction fees can be used to incentivize more trading in thinly-traded stocks, and allow market forces to determine what the appropriate level is even if it is above the current cap of $.0030 per share (*e.g.*, $.0050 per share).

I. Objectives, Measurement Criteria and Definition of Success

TD Ameritrade recommends that the Commission clearly answer the threshold questions, "What are we trying to accomplish with the Pilot?;" and "What are the measurement criteria to analyze the results?" TD Ameritrade believes that we should take advantage of the lessons learned from the Tick Size Pilot so that we not repeat the same mistakes. Although the Firm believes the Tick Size Pilot did not overall improve market or execution quality, the Tick Size Pilot was initiated without clear metrics for success and, as a result, there is a lack of clarity as to how to evaluate whether adjusting the minimum increment size had a desirable impact on the markets.

In this Pilot, while the Commission states it is focusing on potential conflicts of interest, order routing decisions and the impact that transaction fees have on market and execution quality generally, we believe there needs to be more specificity as to what the Commission hopes to achieve. The Pilot will likely cause significant disruption to the markets, will impose industry-wide implementation costs, and will likely have immediate implications to retail investors. As we examine the Pilot, we should be asking is enough being done to protect the investing public from the potential costs. These factors warrant more thoroughly defined and well communicated goals and measurement criteria.

II. Pilot Design

A. Number of Test Group Securities

In considering the recent Tick Size Pilot[4] the Commission recognized the tension between creating an objective, data-driven test, while weighing the potential costs and benefits of such a program. As the Commission noted:

> The Commission has seriously considered the concerns about costs that implementation of the Tick Size Pilot would create for market participants and the complexity of the Tick Size Pilot, and has tried to mitigate both where possible without undermining the objectives of the Tick Size Pilot.

The Tick Size Pilot used three Test Groups consisting of 400 securities per group, and a Control Group of approximately 1400 securities. In December 2014, TD Ameritrade voiced its concern that the

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4 SEA Rel. No. 74892, 80 Fed. Reg. 27514 (May 6, 2015).

Tick Size Pilot would result in worse prices to retail investors.[5] The Firm's concerns were correct. From October 2016 through April 2018, the Tick Size Pilot has cost TD Ameritrade clients approximately ***$26.2 million, or $10 per trade***. As noted above, we do not believe the Tick Size Pilot has had a positive impact on the markets – no material increase in retail investors trading in Tick Size Pilot Test Group securities and largely negative results on market quality and execution quality. Moreover, we are not aware of any evidence that market makers have used their increased revenues to hire research analysts to cover small cap issuers, a motivation behind the Tick Size Pilot.

Given the costs retail investors incurred as a result of the Tick Size Pilot, TD Ameritrade believes the Commission should construct the Pilot with a commitment to limiting the impact to retail investors. Surprisingly, rather than scaling back the number of securities included in the Pilot, the Commission has done the opposite – proposing three test groups of 1000 NMS securities each, or 3000 total. TD Ameritrade believes this is far too large a test group, especially when there is no understanding or economic analysis of how reducing rebates may adversely impact trading in thinly-traded securities.

TD Ameritrade believes the Commission must do more to rationalize the use of 3000 test group securities. There is scant discussion of why the Pilot requires the use of almost one half of all NMS stocks. The Commission explains the use of 3000 test securities with the following conclusory statement, "[t]he Commission preliminarily believes that this design would be representative of the size of the overall population of NMS stocks and would provide sufficient statistical power to identify differences among the Test Groups with respect to common stocks and ETPs."[6]

The EMSAC recommended to the Commission that such a pilot use a random sample of 100 common stocks and ETFs within each of three test groups – a total of 300 securities versus 3000 the Commission proposes. Moreover, the EMSAC recommended that the Pilot should begin with a more limited set of 10 stocks for an initial three-month measurement period, and then expand to the full set of pilot stocks.

While the Commission has not provided an estimate of the cost of the Pilot to investors, TD Ameritrade believes that the Pilot has the potential to cause a significant adverse impact on retail investors. Using the Commission's assumption that the trading margin for maker-taker exchanges is $.0002 per share, the average rebate for the three Test Groups will be $.000533 ($.0013 + $.0003 +$.0000 per share, divided by 3), versus the current rebate of $.0028 per share, leading to an average rebate reduction in Test Group securities of $.002267 per share. If we also assume that half of all liquidity-providing market participants will be sensitive to this change by updating their quotes to less aggressive prices commensurate to the reduction in rebates, the cost to cross the spread will increase by $.001134 per share. If we also assume that securities with an average quoted spread less than $.02 will not be negatively impacted by the reduced rebates, the Firm estimates that such a widening of the average quoted spread could cost its clients approximately $24,000,000 annually.

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5 TD Ameritrade originally estimated the potential costs of the Tick Size Pilot at approximately $11 million to $18 million per year. <https://www.sec.gov/comments/4-657/4657-85.pdf>

6 83 Fed. Reg. at 13020.

Consistent with its obligations under the Securities Exchange Act of 1934,[7] TD Ameritrade believes the Commission is required to reconsider the size of the Pilot. The Firm believes that statistical differences among the test groups and control group used in the Tick Size Pilot demonstrate that a smaller number of test group securities can result in actionable data. And, considering the fact that TD Ameritrade clients alone have incurred $26 million in costs related to the Tick Size Pilot, TD Ameritrade strongly supports using the EMSAC recommended phased approach – an initial three month phase of 10 stocks, with a full set of 100 securities per test group thereafter.

A. <u>Applicable Trading Centers</u>

The Pilot would apply to all equities exchanges, including maker-taker and taker-maker exchanges, but not alternative trading systems ("ATSs"), nor non-exchange trading centers.

TD Ameritrade supports the Commission's proposal to include all equity exchanges, both maker-taker and taker-maker, in the Pilot. Since ATSs do not display protected quotations, are not subject to the trade through rule, and have different pricing structures than exchanges, there is good reason for not including them in the Pilot.

B. <u>Pilot Securities</u>

The Commission proposes including all NMS stocks, including all common stock and exchange traded products ("ETPs") with an initial share price of at least $2. TD Ameritrade agrees with the Commission that the Pilot should include both common stock and ETPs. The Firm also believes that the Commission should not include rights, warrants, or options.

C. <u>Pilot Start Date and Duration</u>

The Commission proposes a two-year term with an automatic sunset at one year unless the Commission extends it for another year. In addition, the Commission proposes a six-month pre-Pilot Period as well as a six-month post-Pilot Period. Finally, the Commission proposes alternative Test Groups depending on whether the Pilot overlaps with the Tick Size Pilot.

TD Ameritrade believes that a two-year term with one year automatic sunset is an improvement on the two-year pilot approach used in the Tick Size Pilot. As an alternative, TD Ameritrade also would support shortening the length of the Pilot. The proposal of a two year term with an automatic sunset after one year is longer than necessary to ascertain the necessary data sought by the Commission. As noted in the Proposing Release:

> The Commission staff estimates that it would require a minimum Pilot duration of six months to achieve sufficient statistical power to detect whether an effect is actually present; therefore,

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[7] Whenever the Commission engages in rulemaking and is required to determine whether an action is necessary or appropriate in the public interest, Section 3(f) of the Exchange Act of the Exchange Act requires the Commission to consider whether the action would promote efficiency, competition, and capital formation, in addition to the protection of investors. *See* 15 U.S.C. 77b(b) and 15 U.S.C. 78c(f).

> any Pilot duration shorter than six months would have limited benefits for detecting the effect of transaction-based fees and rebates on order routing decisions, execution quality, and market quality. [8]

TD Ameritrade believes there will be immediate and measurable impact upon implementation of the Pilot. Therefore, in the alternative, the Firm believes the Pilot should be for one year with an automatic sunset after six months. This format will allow the industry to address possible significant negative outcomes more quickly and move to the assessment of the data more expeditiously.

Regardless of what period is used, the Firm believes that the Commission should add a mechanism by which it can order a halt to the Pilot in the event Pilot securities (or a subset of Pilot securities) experience a significant decline in market or execution quality. Such a "kill switch" could not stop the Pilot immediately as the industry would need time to unwind the Pilot. Therefore, we recommend that upon a finding of harm to the markets, the Commission reserve the right to order the halt of the Pilot with 30 day's advance notice.

Finally, the Firm also believes that the Commission should not extend the Tick Size Pilot beyond its two-year term ending in October 2018, and that the Pilot should thereafter follow. There should be no overlap of the two pilots. Given that some Tick Size Pilot securities also may be included in the Pilot, TD Ameritrade also believes that there should be an interim six-month period between the end of the Tick Size Pilot and the beginning of the Pilot. Moreover, as noted above, TD Ameritrade supports the EMSAC proposal that the Pilot begin with 10 securities per test group and expand to 100 securities three-months later.

III. Data Collection

TD Ameritrade supports the Commission's proposed data collection to facilitate the analysis of Pilot's data. The publishing of the data will assist the Commission, market participants and academia in studying the impacts of the Pilot.

The Firm, however, does not support the Commission's proposal to require the public disclosure of order routing data by broker through an anonymized identifier. TD Ameritrade believes that market participants and others will be able to identify certain broker-dealers routing strategies by comparing the Pilot data to publicly available Rule 606 disclosures, or by other means. This is especially true for broker-dealers that route a material portion of trading volume in NMS stocks. Although we understand the Commission's need to understand broker-dealer routing practices down to the day, security and exchange, we do not believe such sensitive data should be disclosed publicly as that information potentially could be used for inappropriate purposes.

Given such concerns, TD Ameritrade recommends that the Commission require aggregated data broken out by day, security and exchange, but not by broker-dealer. Furthermore, as the Commission notes:

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[8] 83 Fed. Reg. at 13071, n. 430.

> Once CAT [Consolidated Audit Trail] Phase I becomes operational, the Commission and SROs will have information on all exchange routing and exchange executions for all NMS securities. In CAT Phase I, exchanges would record and report order events on every order they receive for NMS securities. Order events include order receipt, order routes, order modifications, order cancelations, and order executions.[9]

TD Ameritrade believes that for cost and efficiency purposes, it makes sense to begin the Pilot in conjunction with CAT Phase I. Moreover, the Firm believes that rather than have the data dispersed over the public websites of the five listing equity exchanges, the data should be consolidated on the Commission's website.

IV. <u>Trading in Small Cap Securities</u>

In recent years, the Commission has considered how to address concerns presented by thinly-traded securities. From the Tick Size Pilot to the recent Roundtable on Thinly-Traded Securities, the Commission has focused on whether there are market structure changes that could incentivize market participants to post more liquidity and tighten spreads on the less liquid securities of generally small to mid-cap companies. TD Ameritrade supports the idea, originally proposed by the Bats exchange,[10] that the Commission consider tiered access fees that would start at $.0005 per share for the most liquid securities and increase based on the liquidity of the security. The Firm believes the Commission could even consider setting the access fee for the least liquidity stocks above the current cap (*e.g.*, $.0050 for the least liquid securities). This approach would reduce access fees for the most actively traded securities, while incenting liquidity providers to post liquidity for thinly-traded issues.[11]

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9 83 Fed. Reg. at 13044.

10 In a January 6, 2015 letter to industry participants, Bats stated its proposal as follows:

> BATS believes that exchange liquidity rebates, which are transparent, rule-based, and open to all, provide a meaningful incentive for liquidity providers to display narrow spreads by mitigating the potential impact of being adversely selected. That said, BATS does not believe that highly liquid securities require as great a rebate as less liquid securities and, therefore, BATS would advocate for an access fee reduction for the most liquid securities to $0.0005 (5 cents per 100 shares) from the current $0.0030 (30 cents per 100 shares). Access fee caps, and their corresponding liquidity rebate, would be tiered upward from $0.0005 for moderately liquid and illiquid securities based on a security's characteristics. BATS believes that a more tiered and dynamic approach to access fees would preserve the benefits the current market structure has delivered, while offering enhanced opportunities to improve the trading experience for illiquid securities. In addition, the substantial reduction in access fees, and their corresponding rebates, would help remove conflicts or a perception of conflicts with respect to those highly liquid securities that no longer require liquidity incentives.

<http://cdn.batstrading.com/resources/newsletters/OpenLetter010615.pdf>

11 To the extent that each Test Group is representative of the market as a whole, including securities of small, mid and large cap companies, the Pilot will include some data on the impact that varying transaction fees will have thinly traded securities. It is for this reason that TD Ameritrade is not

V. <u>Trade-at</u>

The EMSAC recommended that the Commission not include a trade-at provision in the Pilot. And, the Commission did not propose the inclusion of a trade-at provision in the Pilot. TD Ameritrade agrees with this decision. First, since the Tick Size Pilot included a trade-at provision, the Commission has data concerning the costs/benefits of a trade-at rule. Second, the Pilot will reduce the costs of trading on exchanges, which may increase trading volumes on the exchanges. Third, the inclusion a trade-at provision to the Pilot would add unnecessary complexity by doubling the number of Test Groups, and could impact the data and obscure the impact of the pricing changes. And, finally, the trade-at provision unfairly promotes the competitiveness of exchanges over ATSs and market makers and, therefore, acts as a significant anti-competitive factor that runs afoul of the Commission's goals in designing a national market system built on competition between market centers.

VI. <u>Conclusion</u>

TD Ameritrade supports the Commission's approach of collecting data before making important policy decisions impacting market structure and ultimately retail investors. The Firm, however, also believes that when designing any pilot the Commission should clearly define the objectives and measurement criteria. With the significance and implications of this Pilot, clearly defined objectives and measurements are even more imperative. The Commission should ensure that the cost to retail investors is minimized to the greatest extent possible. The Commission should structure the data collection by using CAT Phase I and publicly disclose the aggregated data without anonymized broker-dealer identifiers. And finally, TD Ameritrade believes the Commission should consider varying transaction fees by liquidity to determine if transaction fees can be used to incentivize more trading in thinly-traded securities.

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recommending that the Commission incorporate a minimum market capitalization of $3 billion in the Pilot.

Please feel free to contact Joseph Kinahan, at [redacted], with any questions regarding our comments.

Respectfully Submitted,

Joseph Kinahan
Managing Director, Client Advocacy and Market Structure