Consumer Federation of America

February 26, 2016

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Number S7-23-15
Regulation of NMS Stock Alternative Trading Systems

Dear Secretary Fields,

I am writing on behalf of the Consumer Federation of America (CFA)[1] regarding the Commission's proposed rules to enhance transparency and oversight of Alternative Trading Systems ("ATSs") that trade stocks listed on a national securities exchange. Since Regulation ATS was adopted in 1998, ATSs, and in particular dark pools, have operated with a stunning degree of opacity, leaving market participants and regulators without basic, critical information about how these venues operate. This rule proposal's requirements for NMS Stock ATSs to disclose detailed information about their operations and potential conflicts of interest is long overdue, and we support it as a necessary first step toward ensuring that these venues operate with integrity and accountability, that market participants can make more informed routing decisions, and that regulators have sufficient information to detect and deter wrongdoing.

However, while we support these new disclosures, we worry that the Commission's approach is insufficient to fully protect investors and provide regulators with all the information necessary to ensure fair and efficient markets. Most notably, the proposal should be revised to:

- cover all ATSs, not just those that trade NMS stocks;
- require disclosure of basic statistics, order data, and other information needed to effectively evaluate the very conflicts of interest the proposal already seeks to identify; and
- protect investors by prohibiting proprietary trading activity and the abuse of customer order information by the operator of the ATS or its affiliates.

In our view, certain conflicts of interest are so acute and pernicious that they cannot be mitigated or absolved merely by disclosing them. Given broker-dealers' strong financial incentive to profit at others' expense and the countless ways in which they can take advantage of their unique

[1] CFA is a non-profit association of nearly 300 national, state, and local pro-consumer organizations. It was formed in 1968 to represent the consumer interest through research, advocacy and education.

position to profit by trading against their subscribers and customers, we do not see how merely disclosing this zero-sum conflict, in which brokers' gains come at the direct expense of other market participants, cures it in any way.

Finally, we question the Commission's proposed filing and review process for determining whether an ATS qualifies for an exemption from the Exchange Act definition of "exchange." We believe this process could very quickly devolve into an unreasonably burdensome exercise for Commission staff while providing little benefit to market integrity or investor protection. And, the process outlined in the proposal may backfire by giving market participants a false sense of security that the Commission's deeming an ATS's Form ATS-N "effective" will be tantamount to the Commission's approval of an ATS's operations on the merits. We urge the Commission to reevaluate this approach so as to preserve the Commission's ability to appropriately respond to incomplete or inaccurate Form ATS-N filings in a timely manner while not crippling the agency staff with a burdensome process or improperly signaling to market participants that the Commission's review process is designed to accomplish something it is not in fact accomplishing.

I. How Did We Get Here?

Given the fact that most ATSs operate in the dark, these venues have long been viewed by market participants and the public with a certain degree of skepticism. However, in the last five years, as details of ATSs' widespread misconduct have come to light, these venues have suffered from a precipitous decline in public trust and confidence, however without a corresponding decline in market share. Market participants have rightly questioned whether they can continue to trust that their orders are being handled in ways that are in their best interests. Brokers, who owe a duty to their clients to seek best execution when making routing decisions, have been forced to reassess whether they have been fulfilling their obligations when routing to certain venues. And, institutional investors, such as mutual funds and pension funds, which often invest on behalf of long-term investors, have expressed fear that the promises ATSs made to them – promises about offering a refuge where they could trade anonymously to execute large blocks without being preyed upon by more sophisticated traders or having the market move away from them when they placed their orders – may not have been kept.

At a basic level, the proliferation of ATSs, their ensuing misconduct, and the resulting erosion of trust should have been foreseeable. Since Reg. ATS was adopted in 1998, ATSs have been allowed to provide substantially similar trading services as registered exchanges, but have been allowed to operate with significantly less transparency and significantly greater complexity and conflicts of interest. As a general rule, these three ingredients of opacity, complexity, and conflicts of interest are likely to create a recipe for disaster that benefits the designers of those features, in this case broker-dealer operators and their affiliates, while undermining market transparency, integrity, and investor protection.

Delving more deeply into how this occurred, as electronic trading venues were sprouting up in the 1990s, the Commission sought to better integrate these venues into the national market system, but to do so in a way that would encourage the development of these new, "innovative" market centers. In adopting Reg. ATS, the Commission gave venues a choice: they could either register as exchanges or register as broker-dealers and comply with Reg. ATS by filing basic

disclosures with the Commission about their operations.[2] Under Reg. ATS, ATSs are allowed to operate like exchanges, matching buy and sell orders, and they therefore compete with exchanges for order flow; however, they operate with much less transparency and regulatory scrutiny than registered exchanges. This regulatory approach has created an un-level playing field and has resulted in order flow being diverted from exchanges to ATSs.

When the Commission adopted Reg. ATS, it did not have a clear understanding about how these venues operated. In an effort to "encourage candid and complete filings in order to make informed decisions and track market changes," and "provide[ ] respondents with the necessary comfort to make full and complete filings," the Commission determined that Form ATS should be "deemed confidential when filed." This confidentiality resulted in ATSs' not being required to provide the public with critical details about their operations, including who is trading in the pool, what the pool's rules are, how orders are entered, prioritized, and matched, fee structures, the extent to which certain subscribers may be receiving preferential treatment, whether the broker-dealer operator or its affiliate has access to the pool and, if so, whether it has any advantages relative to anyone else trading in the pool, and any other conflicts of interest that may be relevant to market participants whose orders may be routed there. While some ATSs voluntarily publish their Form ATS, a significant number do not. Based on our review, we were unable to find public Form ATSs for several significant ATSs. Some ATSs' websites specifically state that the form is only available to clients upon request.[3]

Even when ATSs voluntarily publish their Form ATS, they are often missing critical details about their operations. This is largely because, while Reg. ATS requires ATSs to disclose material facts about their operations to the Commission, the Commission has never provided any guidance about what specific details those disclosures should include. As a consequence, Form ATS disclosures often vary widely among ATSs with regard to their contents and their level of detail. According to the proposal, based on Commission experience, "many Form ATS filings currently provide only rudimentary and summary information about the manner of operation of NMS Stock ATSs, which often requires the Commission and its staff to ask the ATSs follow-up questions, and results in ATSs filing follow-up amendments, to fully disclose how they operate."

Our review of publicly available Form ATSs is consistent with the Commission's experience. For example, Form ATSs often provide minimal and often generalized information relating to the classification/segmentation of different subscribers, means of access to the ATS and any resulting differences in that access, matching priority, order interaction, order types, and how the NBBO is calculated using different market data sources. Rarely do Form ATSs provide information relating to their fee structures and potential or actual conflicts of interest. Therefore, based on our review, we agree with the Commission's preliminary assessment that "maintaining the confidentiality of Form ATS filings with regard to NMS Stock ATSs has not resulted uniformly in ATSs 'mak[ing] full and complete filings.'"

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[2] Regulation of Exchanges and Alternative Trading Systems, Securities and Exchange Commission, Release No. 34-40760, 17 CFR 202, 240, 242 and 249 (December 8, 1998) http://1.usa.gov/1pz70QZ.

[3] *See, e.g.*, MS Pool http://www.morganstanley.com/institutional-sales/mset-regulatory-communications; BIDS http://www.bidstrading.com/.

Without full and complete public filings that provide the necessary details to allow market participants to completely understand how each venue operates and compare operations between venues, it is difficult if not impossible for market participants to determine whether routing to a certain ATS is more advantageous to them as compared with routing to another ATS or an exchange. We therefore share the Commission's concern that the lack of operational transparency around ATSs limits market participants' ability to adequate discern how their orders interact, match, and execute on ATSs and to find the optimal market or markets for their orders.

In addition to loosely defined disclosure requirements that have not resulted in full and complete filings that are useful to market participants, ATSs have been allowed to provide different levels of information regarding their operations to different market participants. As our search for public Form ATSs demonstrated, some ATSs make their Form ATS available to clients only upon request. We also understand that ATSs often provide different levels of information to different subscribers. This means that prospective and even current clients may be at an informational disadvantage relative to more informed market participants and, as a result, won't be able to make as informed routing decisions that are most likely to provide the best executions for their interests.

As ATSs have grown in both number and trading volume as a percentage of total NMS trading volume, they have sought ways to distinguish themselves and the services that they offer in an effort to compete with each other and registered exchanges for order flow. In distinguishing themselves, they have come to offer vastly different services that cater to different market participants. These different services have increased the complexity of their operations. For example, some ATSs offer subscribers the ability to customize trading parameters, including a variety of price instructions, time-in-force, and peg instructions, as well as optional configurations for their order flow to interact with (or not interact with) certain other subscribers. Some ATSs have different methods for subscribers to access the ATS, including through a direct FIX connections or through the broker-dealer smart order router. Furthermore, the terms and conditions for using these different services often vary among subscribers. We understand, for example that ATSs' fee structures can be just as complex as, if not more complex than, those of registered exchanges, with various pricing structures and schedules that may apply to different subscribers. This complexity creates opportunity to structure business in ways that appear to serve their subscribers' interests but in reality advantage the broker-dealer operator.

Moreover, ATSs also have been allowed to operate with significant structural conflicts of interest that further increase these venues' operational complexity and create additional opportunities to exploit that complexity to their advantage in order to obscure any harm to market participants. As the proposal explains, the majority of dark pool trading volume is executed by dark pools that are operated by multi-service broker-dealers that engage in significant brokerage and dealing activities in addition to their operation of their ATS. Broker-dealer operators or their affiliates also typically offer order routing services to their own pools on behalf of their clients and trade as principal in the ATS that they are operating. Thus, ATSs' operations have become increasingly intertwined with their broker-dealer operator and, in many cases, the business interests of the broker-dealer operator or its affiliates compete with the interests of market participants that access and trade on the ATS.

Given ATSs' opacity, complexity, and conflicts of interest, their recent misconduct was predictable. Recent enforcement actions by the Commission and state regulators provide what may be only a limited window into the depth and breadth of their wrongdoing.[4] These cases against some of the "oldest, largest, and most-respected ATS operators"[5] disprove any argument that this is just a problem of a few bad actors. In fact, these cases show a market and regulatory design in which ATSs' incentives are to disclose very little meaningful information, create extraordinarily complex operations that make it difficult for others to understand and to discover any misconduct, with operating structures that are rife with conflicts of interest, and use their position within the ATS to benefit the broker-dealer operator or its affiliates at their customers' expense.

This fundamentally flawed regulatory approach should serve as a case study in what can happen when, in the name of fostering innovation, new, unknown entrants are allowed into the market to provide substantially similar products or services as existing market participants but with significantly less transparency and significantly greater complexity and conflicts of interest. Market activity is likely to migrate to the new, unknown entrant; however, without comparable scrutiny and safeguards as the existing market participants, the investors that migrated are ultimately likely to suffer. And, as a result, market integrity and confidence is likely to suffer as well.

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[4] *See, e.g.*, In the Matter of ITG Inc. and Alternet Securities Inc., Securities Exchange Act Release No. 75672 (Aug. 12, 2015), https://www.sec.gov/litigation/admin/2015/33-9887.pdf (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order) ("ITG Settlement"); In the Matter of UBS Securities LLC, Securities Exchange Act Release No. 74060 (Jan. 15, 2015), http://www.sec.gov/litigation/admin/2015/33-9697.pdf (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order) ("UBS Settlement"); In the Matter of Lavaflow, Inc., Securities Exchange Act Release No. 72673 (Jul. 25, 2014), http://www.sec.gov/litigation/admin/2014/34-72673.pdf (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order) ("LavaFlow Settlement"); In the Matter of Liquidnet, Inc., Securities Exchange Act Release No. 72339 (Jun. 6, 2014), http://www.sec.gov/litigation/admin/2014/33-9596.pdf (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order) ("Liquidnet Settlement"); In the Matter of eBX, LLC, Securities Exchange Act Release No. 67969 (Oct. 3, 2012), http://www.sec.gov/litigation/admin/2012/34-67969.pdf (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order) ("LeveL Settlement"); In the Matter of Pipeline Trading Systems LLC, Fred J. Federspiel, and Alfred R. Berkeley III, Securities Exchange Act Release No. 9271 (Oct. 24, 2011) (order instituting administrative and cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order), https://www.sec.gov/litigation/admin/2011/33-9271.pdf ("Pipeline Settlement"); *In the Matter of Credit Suisse Securities (USA) LLC*, 34-77002 (Jan. 31, 2016); *In the Matter of Credit Suisse Securities (USA) LLC*, 34-77003 (Jan. 31, 2016); Press Release, *A.G. Schneiderman Announces Landmark Resolutions With Barclays And Credit Suisse For Fraudulent Operation Of Dark Pools; Combined Penalties And Disgorgement To State Of New York And Sec Of Over $154 Million*, New York State Office of the Attorney General (Feb. 1, 2016), http://www.ag.ny.gov/press-release/ag-schneiderman-announces-landmark-resolutions-barclays-and-credit-suisse-fraudulent.

[5] Healthy Markets Association, Dark Side of the Pools: What Investors Should Learn from Regulators' Action, September 15, 2015, http://www.healthymarkets.org/dark-side-of-the-pools/.

II. Where Do We Go Now?

A. Disclosures

In this release, the Commission has proposed to require ATSs that trade NMS stocks (but not other types of ATSs) to disclose new, detailed, meaningful and current information about how they operate in a new Form ATS-N that is publicly available to all market participants. Form ATS-N requires these NMS Stock ATSs to provide information about their trading services, matching priority, order interaction, order types, means of access to the ATS and any resulting differences in that access, classification/segmentation of different subscribers, fee structures, how the NBBO is calculated using different market data sources, their smart order router and the algorithms they use to send or receive orders, and conflicts of interest. We support these disclosure requirements, as they will provide a fuller and more complete understanding to both regulators and market participants about what ATSs do and how ATSs work.

Requiring Form ATS-N to provide detailed, public information about ATSs' operations and trading services information will enable market participants to better understand the terms and conditions under which their orders will be handled and executed. It will also remove many of the informational disadvantages that certain market participants currently suffer from when Form ATS is not made publicly available and the often minimal and generalized information that they have access to when Form ATS is made publicly available.

Armed with detailed qualitative information about all the potential venues they could be trading at, including registered exchanges and ATSs, market participants will be able to scrutinize and make more complete comparisons between the different trading operations of those different venues, evaluate differences in order handling that might result in the superior or inferior treatment of their orders, and assess differences in fee structures that may result in costlier or less costly executions on a particular trading platform. Consequently, they will be in a better position to route their orders to the venues that are most likely to result in the best executions for their particular interests. The new disclosures could also enhance brokers' ability to meet their best execution obligations to their customers and allow their customers to review and assess whether they are in fact complying with their duties.

Requiring all ATSs to publicly disclose their Form ATS-N should also foster greater competition for order flow among ATSs and exchanges, based on terms that are beneficial to investors. Those venues that provide valuable services can expect to attract more order flow, which in turn will provide investors with more dependable and deeper sources of liquidity, higher fill rates, and better executions. Subjecting Form ATS-Ns to market participants' and third party analysts' scrutiny and forcing ATSs to compete on terms that are beneficial to investors should also force ATSs to improve their operations so that they act with more integrity and accountability, decreasing the potential for misconduct.

We encourage the Commission to broaden the scope of these proposed disclosure requirements to apply to all ATSs, not just NMS Stock ATSs. While the details regarding certain reporting requirements may not translate to other assets being traded on non-NMS Stock ATSs, that should not dissuade the Commission from enhancing all ATS disclosures and making them public. Requiring all ATSs to disclose more detailed and relevant information about their

respective operations would certainly result in a better understanding of those venues' operations by market participants and regulators, which will provide public accountability for ATSs' operations and help inform any future regulatory efforts in those spaces.

The Commission should not repeat its previous mistake of maintaining confidentiality of Form ATSs based on the faulty reasoning that non-NMS Stock ATSs are still developing and they should be allowed to innovate without disclosing specific details about how they work and what they do. This approach didn't result in ATSs' "mak[ing] full and complete filings" last time, and there's no reason to believe there would be a different outcome for other markets. Certainly, the Commission should not wait for non-NMS Stock ATS markets to proliferate and for misconduct to occur before requiring public disclosure of those venues' operations and conflicts of interest.

Furthermore, we strongly urge the Commission to bolster the required ATS-N disclosures by requiring enhanced quantitative metrics regarding ATSs' operations, orders, and trading. This information is essential to evaluate:

- whether the ATS poses operational risks, such as if it has unexpectedly high system failures;
- the characteristics of the participants and typical trading in the pool, so that market participants can get a better understanding of the benefits and likely risks associated with trading in the ATS;
- the magnitude of potential conflicts of interest facing the ATS operator and its affiliates; and
- the execution quality across a wide spectrum of characteristics.

The purpose of this quantitative disclosure would be to provide detailed operational information, liquidity and order flow profiles, and information about the levels of toxicity in each pool in order to provide concrete data to market participants about the effects of their routing decisions. Specifically, we believe that this tangible data is essential for brokers seeking to comply with their best execution obligations, and will enable their customers—the investors—a way of testing and verifying that they are indeed complying with their obligations. Toward this end, Healthy Markets Association has provided concrete recommendations to modernize Rules 605 and 606 metrics to better reflect the dramatic changes that have occurred in our equity markets.[6] These updated metrics would allow for better assessments of ATSs' order execution quality and brokers' order routing practices which, in turn, would better serve investors' interests. The Commission should adopt those recommendations without delay.

B. Conflicts of Interest

While we support the Commission's proposal to require NMS Stock ATSs to disclose their conflicts of interest, certain conflicts of interest are so acute and pernicious that they cannot be mitigated or absolved merely by disclosing them. This is especially the case when a broker-dealer operator of an ATS or its affiliate is trading on a proprietary basis in its own ATS. Given broker-dealers' strong financial incentive to profit at others' expense, and the countless ways in

[6] SEC Rule 605/606 Reform, Healthy Markets Association, http://static1.squarespace.com/static/5576334ce4b0c2435131749b/t/56d0bdb4b09f95cc0f323de2/1456520638872/Healthy+Markets+605+and+606+Reforms.pdf

which they can take advantage of their unique position to profit by trading against their subscribers and customers, we do not see how merely disclosing this zero-sum conflict cures it in any way. As such, the Commission should prohibit broker-dealer operators of ATSs or their affiliates from trading on a proprietary basis in their own ATS. At a bare minimum, the Commission must reconsider its current severely deficient economic analysis that concluded that such outright prohibitions were unnecessary. (Discussed further below.) And, if the Commission still allows broker-dealer operators and their affiliates to trade proprietarily in their own ATS, it must require them to publish significantly more detailed information to demonstrate they are not using their favored position to their benefit and others' detriment. Again, even if the Commission elects to allow this conflict to continue, it should nevertheless prohibit the ATS operator or its affiliate from ever trading on a principal or agency basis in the ATS using faster connections, with more information, or some other advantage that is not identical to the access and information provided to an unaffiliated third-party.

As discussed above, ATSs' operations have become increasingly intertwined with their broker-dealer operator. In many cases, the business interests of the broker-dealer operator or its affiliates compete with the interests of market participants that access and trade on the ATS. The broker-dealer operator of an NMS Stock ATS controls all aspects of the operation of the ATS, including, among other things: means of access; who may trade; how orders interact, match, and execute; market data used for prioritizing or executing orders; display of orders and trading interest; and determining the availability of ATS services among subscribers.

In its release, the Commission correctly recognizes both the devastating conflicts of interest that exist when a broker-dealer operator or an affiliate trades in its own ATS, specifically when they do so on a proprietary basis, and the many opportunities they have to use their position to their advantage. If a broker-dealer operator of an ATS or its affiliate is able to trade on its own ATS, the operator may have an incentive to design and operate its ATS in a way that favors its own trading activity or the trading activities of its affiliates. The operator would likely have informational advantages over all other subscribers, such as a more nuanced understanding of how the ATS operates, who else is trading, and how they are trading. Knowing this information, it can design its own trading strategies to its or its affiliate's advantage. As the Commission points out in its release, in the most egregious case, an operator of an ATS might use the confidential trading information of other traders to advantage its own trading on its ATS. While this activity would constitute a clear violation of Rule 301(b)(10), it could be difficult if not impossible to discover the full scope of such violations in a timely manner. In fact, this appears to be precisely what occurred in some of the recent enforcement actions.

Operators could also advantage themselves or their affiliates by retaining or providing preferential treatment or access to the ATS, such as faster or more direct access to the ATS, priority status to execute their orders over those of other subscribers, or the ability to further customize with whom their order flow interacts. These are only a few of what we imagine are the countless ways a broker-dealer operator of an ATS and its affiliates would be able to use their favored position to extract rents from other subscribers and customers. And, we suspect that broker-dealer operators would constantly be evolving new tactics to achieve the same goals, but which would be extraordinarily difficult for market participants and regulators to understand and detect with regularity and precision.

The risk and severity of this conflict are not merely theoretical. Several of the recently settled enforcement actions against ATSs highlight the likelihood and potential gravity of harm that can occur when a broker-dealer operator or one of its affiliates proprietarily trades in its own pool.[7] While the violations in several of those cases related to inadequate disclosures, it is not at all clear that more or better disclosures by the violators would have changed either the ATSs', their subscribers', or customers' business and trading practices. If market participants are in search of pools with deep liquidity and they see a high potential for their orders to be filled, they may still route to a venue in which they know the venue's operator or its affiliate is trading. In fact, most of the largest ATSs have this conflict of interest, so market participants may be unable to avoid it. Thus, we have no reason to believe that providing a general disclosure, warning that, "We may trade for our own account in our own pool," is either sufficiently protective of market participants or will materially change anyone's conduct. Even with heightened disclosure, the risk for abuse remains too high. As such, the Commission should prohibit broker-dealer operators of ATSs or their affiliates from trading on a proprietary basis in their own ATS. We worry that, in this release, the Commission seems to be resigning itself to the view that conflicts are just a part of life and a cost of doing business, but it doesn't have to be that way.

At a bare minimum, the Commission must reconsider its current severely deficient economic analysis that concluded that such outright prohibitions were unnecessary. The proposal states that the Commission "considered" mitigating these conflicts by "requiring NMS Stock ATSs to operate on a stand-alone basis" or imposing new requirements designed to limit potential conflicts," however the proposal dispensed with either of those two options in one sentence: "[T]he above alternatives could be significantly more intrusive and substantially affect or limit the current operations of ATSs that trade NMS stocks relative to requiring additional disclosures about the operations of the broker-dealer operator and its affiliates, and therefore is not proposing such alternatives at this time." The Commission provides no meaningful support, either qualitative or quantitative, for either of these contentions, nor for its conclusion.

The conflicts of interest that arise as a result of a broker-dealer operator's or an affiliate's proprietary trading in its own pool represent the single-most critical issue in the entire proposal. The Commission's discussion should not be reduced to under a page. Instead, the Commission should engage in a more rigorous analysis that quantifies the nature and extent of these conflicts, the harms that these conflicts can produce, the extent to which disclosures can mitigate those harms appropriately and the costs and benefits (both to industry and investors) associated with that approach, the extent to which other approaches, including the above alternatives, can mitigate those harms appropriately and the costs and benefits (both to industry and investors) associated with those approaches, and the extent to which the Commission can detect broker-dealer operator or affiliate activity that is adverse to subscribers' interests under each alternative scenario.

If, based on a thorough analysis, the Commission still determines that it is appropriate to allow broker-dealer operators and their affiliates to trade proprietarily in their own ATS, it must (1) prohibit them from trading on any better terms than any third-party subscriber; and (2) require them to publish significantly more detailed information to demonstrate they are not using

[7] *See, e.g.,* Pipeline Settlement, ITG Settlement, *supra* note 4.

their favored position to their benefit and others' detriment, specifically including any profits they are making as a result of their proprietary trading. Without this information, it would be virtually impossible for market participants and regulators to distinguish instances in which an operator or affiliate is providing liquidity when their subscribers and customers demand it which, if disclosed, would show up as a loss or no net profit, from those in which they are using their unique position with informational and technological advantages to profit at others' expense, which, if disclosed, would show up as a profit.

C. Approval Process

In this release, the Commission has proposed creating a new process for the Commission to determine whether an entity qualifies for the exemption from the definition of "exchange" and declare an NMS Stock ATS's Form ATS-N either effective or, after notice and opportunity for hearing, ineffective. In making these determinations, the Commission could deem filings ineffective because the filings were "materially deficient with respect to their accuracy, currency, or completeness" or because "one or more disclosures reveals non-compliance with federal securities laws, or the rules or regulations thereunder."

The review and approval process outlined in this release is loosely patterned on the existing SRO rules approval process, which can be extraordinarily labor intensive for Commission staff. As Chair White recently indicated, the Trading and Markets Division reviewed more than 2,100 filings from exchanges and other SROs in 2015.[8] This means the Commission is required to review, analyze, and pass judgment on about eight filings per business day, every day. Adding potentially hundreds of new NMS Stock ATS filings to this process, as the Commission proposes, would likely just further overwhelm agency staff. Their activities could easily be redirected toward complying with their procedural obligations instead of trying to better understand the substance, merits, and potential misconduct of ATSs' trading operations and activities, and how they fit into the broader market structure. In short, we worry that Commission staff might get caught in a procedural morass and miss the forest for the trees.

There are already significant questions about the depth and quality of the reviews provided by the Commission for these filings. Despite the fact that many filings raise complex and novel issues, the Commission seems to nearly always approve them, which suggests it may be rubber stamping them and not be giving them the full consideration they deserve. This is an area that has been focused on by the Commission's own Investor Advocate with regard to the Commission's review of exchanges' filings.[9] Unless the Commission is more willing than it has previously been to challenge applications, we fear this process will very quickly devolve into an unreasonably burdensome exercise for Commission staff while providing little benefit to market integrity or investor protection

This review process may also backfire by giving market participants a false sense of security that the Commission's deeming an ATS's Form ATS-N "effective" will be tantamount

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[8] Chair Mary Jo White, "Beyond Disclosure at the SEC in 2016," Chairman's Address at SEC Speaks, February 19, 2016, https://www.sec.gov/news/speech/white-speech-beyond-disclosure-at-the-sec-in-2016-021916.html

[9] Rick A. Fleming, Statement of Investor Advocate Rick A. Fleming Regarding His First Official Recommendation to the Securities and Exchange Commission, October 16, 2015 https://www.sec.gov/news/statement/investor-advocate-recommendation-nyse.html

to the Commission's approval of an ATS's operations on the merits. The release makes clear that a Form ATS-N will be deemed ineffective if the filings are "materially deficient with respect to their accuracy, currency, or completeness" or otherwise violate securities laws. However, market participants may not fully understand that the Commission's declaration of effectiveness of a Form ATS-N only implies that the ATS has facially met the bare minimum requirements, and that the Commission has made no judgment about the ATS's substantive operations or conflicts of interest. Many market participants may believe that, by deeming a Form ATS-N "effective," the Commission is providing its seal of approval about the ATS. This mistaken belief could result in market participants' routing to venues that are not in their best interests. And while the Proposal further explains that the Commission's declaration of "effectiveness" is not an "approval," we still worry that investors may not understand the difference and that this process may be used inappropriately by ATS operators to immunize themselves from liability.

We urge the Commission to reevaluate this approach so as to preserve the Commission's ability to appropriately respond to incomplete or inaccurate Form ATS-N filings in a timely manner while not crippling the agency staff with a burdensome process or improperly signaling to market participants that the Commission's review process is designed to accomplish something it is not in fact accomplishing.

Conclusion

ATSs are critical trading venues for a variety of asset classes. As we've seen in the equities markets, changes can happen incredibly quickly and the regulatory regime needs to function effectively and adapt to those changes. If the regulatory regime allows ATSs to operate with opacity, complexity, and unmanageable conflicts of interest, those venues likely will engage in misconduct and investors will be harmed as a result. Our recent experience shows that the current regulatory regime is insufficient to foster market integrity and protect investors and other market participants.

This rule proposal's requirements for NMS Stock ATSs to disclose detailed information about their operations and potential conflicts of interest is long overdue, and we support it as a necessary first step toward ensuring that these venues operate with integrity and accountability, that market participants can make more informed routing decisions, and that regulators have sufficient information to detect and deter wrongdoing. However, it is only a first step. Much more must be done, in this proposal and in future rulemakings, to fully protect investors in our modern market structure.

Respectfully submitted,

Micah Hauptman
Financial Services Counsel