

26 February 2016

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

Re: Regulation of NMS Stock Alternative Trading Systems (Release No. 34-76474; File No. S7-23-15)

Dear Mr. Fields:

CFA Institute¹ appreciates the opportunity to comment on the U.S. Securities and Exchange Commission's (the "SEC" or the "Commission") proposed amendments to Regulation ATS ("Reg ATS") under the Securities Exchange Act of 1934 (the "Act"). CFA Institute represents the views of those investment professionals who are its members before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues that affect the efficiency, integrity and accountability of global financial markets.

Background

Reg ATS, when adopted in 1998, was designed to ensure basic investor protections and to enhance competition. At that time, and in the years since, trading venues could choose to operate in either one of two regimes. The first was to operate as an 'exchange,' which was defined in the Exchange Act Rule 3b-16. The alternative was to apply for an exemption from exchange status by registering as a broker-dealer pursuant to Rule 301(b)(1) of Reg ATS. Currently, Rule 3b-16(a) of the Exchange Act provides a set of criteria to determine whether a trading venue is required to register as a national securities exchange. However, there is an exemption in Rule 3b-16(b) for systems that perform only traditional broker-dealer activities. Rule 3a1-1(a)(2) provides another exemption from the definition of 'exchange' for an organization that complies with Reg ATS.

¹ CFA Institute is a global, not-for-profit professional association of more than 135,000 investment analysts, advisers, portfolio managers, and other investment professionals in 145 countries, of more than 129,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 147 member societies in 73 countries and territories.

Reg ATS provides a definition of an ATS in Rule 300(a) such that a trading venue claiming compliance may not set rules governing the conduct of subscribers other than for their conduct on its system. Nor may they discipline subscribers in any way other than exclusion from trading on the system, since disciplinary actions should be performed by a self-regulatory organization (“SRO”), which would be regulated as such. Rule 301(b)(1) of Reg ATS further requires each ATS to register as a broker-dealer under Section 15 of the Exchange Act and be a member of an SRO, such as FINRA.

Rule 301(b)(2) of Reg ATS requires the filing with the SEC a Form ATS at least 20 days before commencing operations, although the form won’t be approved by the Commission. The information detailed in Form ATS includes:

- Types of subscribers;
- Differences in services offered to different groups of subscribers;
- Securities to be traded;
- Any entity other than the ATS that is involved in its operations;
- The manner in which the system operates, including procedures relating to order entry and execution, trade reporting, and clearance and settlement of trades; and
- How subscribers access the system.

Currently, Form ATS is confidential upon filing and ATSs are not required to publicly disclose such information to market participants.

Since Reg ATS was introduced, there has been significant growth both in the number of ATSs , and in the trading volume executed on ATSs . Further, the complexity of these NMS Stock ATSs has increased and their operations are increasingly linked to their broker-dealer operators.

There is a concern that differences in operational disclosures between exchanges and ATSs may be damaging to market participants, however, as a consequence of reducing investors’ ability to accurately select and monitor the services provided by ATSs. In particular, recent cases of damaging conflicts of interests between the broker-dealer operators of certain ATSs and their affiliates and customers has further put the spotlight on the issue of ATS transparency.

The Commission considers transparency to be a key way for market participants to protect their interests when doing business on ATSs, and to this end has proposed a series of amendments to Reg ATS. The first of these would define the “NMS Stock ATS” as a specific type of ATS subject to the new disclosure requirements. For example, ATSs trading debt or convertible debt securities would not be included. A new rule, Rule 304, would apply to an ATS seeking an exemption from exchange status under rule 3a1-1(a)(2) of the Exchange Act.

The proposed Rule 304 requires an ATS to file Form ATS-N (in lieu of the now abandoned Form ATS), which would be declared by the Commission before an ATS could operate under the 3a1-1(a)(2) exemption. Form ATS-N requires public disclosure of the activities of an ATS’ broker-dealer operator and any of its affiliates in regards to the ATS including:

- Any non-ATS or other NMS Stock ATS trading venues they operate;
- The products and services offered to subscribers;
- Arrangements with unaffiliated trading venues;
- Trading activity of the broker-dealer operator on its own ATS;
- Use of smart order routers;
- Employees shared by the ATS and any third parties involved with operating the ATS;
- Any differences in the services, functionalities or procedures available to subscribers and the broker-dealer operator.

Existing ATSs would need to reapply for the 3a1-1(a)(2) exemption by submitting a Form ATS-N. Unlike prospective ATSs, which could not operate until their Forms ATS-N are declared effective, existing ATSs will be allowed to operate under their legacy arrangements for a limited period until their Forms ATS-N submissions are declared effective by the Commission. In either case, if the Commission declares a Form ATS-N ineffective, the ATS would be prohibited from operating as an NMS Stock ATS.

General comments on Questions 4 – 44.

CFA Institute agrees with the Commission that there is insufficient transparency currently with respect to NMS Stock ATSs, and we share the concern that this limits the ability of market participants to make informed choices about trading venue options. We believe recent controversies surrounding ATS dark pools reflect this issue.

We therefore agree with the principles behind the Commission's proposals and, particularly, we agree with the need to make the improved disclosures required from ATSs publicly available. We agree that the activities of the broker-dealer operator of an ATS should also be made known to market participants as this constitutes an important potential conflict of interest that may serve to disadvantage investors.

It is difficult to believe that additional disclosures of the type proposed by Form ATS-N would produce detrimental effects on the ATS industry or market participants. Following recent controversies, several ATSs have increased their own market disclosure voluntarily in an attempt to attract business by signaling enhanced credibility. Consequently, it is possible that a general increase in disclosure will increase investor confidence in these venues as a whole.

As a general principle, we are cautious about allowing numerous exemptions from any financial regulation as this tends to increase the incentives and opportunities for regulatory arbitrage and the unintended consequences deriving from such misplaced incentives. We therefore caution the Commission about applying different levels of disclosure based on metrics such as dollar volume, trading volume, or number of subscribers. We do not believe that Form ATS-N is sufficiently onerous relative to the existing Form ATS to justify such small-scale exemptions.

Similarly, CFA Institute would support the inclusion of fixed-income ATSs, ATSs trading government securities, OTC equities or any other securities in the Rule 304 Form ATS-N

regime. It is not clear that there is a compelling case that the public disclosure of relatively fundamental organizational structures would harm trading venues and should therefore be hidden from market participants².

CFA Institute supports the processes suggested for declaring the effectiveness or ineffectiveness of Form ATS-N filings. Specifically, we strongly support the requirement for legacy ATSs to re-apply for exchange-waiver status by submitting a Form ATS-N. Pursuing a different approach where only new ATSs are subject to Form ATS-N filings would significantly dilute the transparency benefits of the proposed Reg ATS amendments. It is, after all, the legacy ATSs that have been subject to criticisms of their transparency and management of conflicts of interest. Permitting them to enjoy any form of legacy benefits would be inconsistent with a uniform regulatory treatment of the ATS industry, would unfairly burden potential new competitors, and may entrench existing sub-optimal practices.

The Commission's proposal to introduce a mechanism for the suspension, limitation, or revocation of the exemption from the definition of 'exchange' for a period not exceeding 12 months is also something CFA Institute supports. There must be a clear mechanism for removing non-compliant trading venues from the exchange-waiver regime rather than relying on more general enforcement powers. The inclusion of accurate and timely Form ATS-N filings as a consideration in determining exclusion from the exchange exemption is necessary to ensure the credibility of these public disclosure documents and the accountability of the entities seeking the exemption.

Questions 50-53 – Form ATS-N Submission and Declarations of Effectiveness

With regards to the submission process for Form ATS-N, we broadly agree that a 120-day turnaround seems like a reasonable amount of time for the Commission to process each filing. The optional 120-day extension in cases of particular complexity or novelty is also agreeable. However, there is the issue of what should happen if the Commission for whatever reason fails to make a declaration within the 120-day period and also fails to claim the 90-day extension.

CFA Institute believes that the default decision in the case of the Commission failing to declare a Form ATS-N filing effective or ineffective, or claiming an additional 90-day extension, should be that the Form ATS-N filing be declared effective. The reason for our position on this issue is that we believe the Commission should accept the burden of taking a positive action in declaring an ATS-N filing ineffective, and should not have the option of inaction resulting in the declaration that operations of a candidate ATS are ineffective.

² Concerns about reduced dealer activity and interest were cited as reasons for rejecting greater post-trade transparency in U.S. bond markets prior to the introduction of the Trade Reporting and Compliance Engine in the early 2000s. The experience in those markets following the introduction of TRACE showed that such concerns were unwarranted. See <http://www.cfapubs.org/toc/ccb/2011/2011/5>, "An Examination of Transparency in European Bond Markets" (October 2011).

However, CFA Institute believes that within the initial 120-day period, Form ATS-N should be considered ineffective on filing with the Commission until the Commission affirmatively declares it effective or ineffective. Then, if no declaration is made by the Commission with regards to the filing's effectiveness or any extension of consideration prior to the deadline, the Form ATS-N filing should default to being declared effective.

Questions 54-60 - Legacy ATSS

We have already stated that CFA Institute considers two distinct processes for legacy ATSS and new ATSS to be undesirable in the interests of fair competition and avoiding regulatory arbitrage. We believe 120 days is a sufficient amount of time for an incumbent ATS that has already filed a Form ATS to produce a Form ATS-N filing given the reasonable assumption that the operators of the ATS should be very familiar with the operational structure of said ATS.

However, CFA Institute considers that it would be an undue burden for legacy ATSS to lose their exchange exemption while the transition of their exemption status from Reg ATS compliance to compliance with the new Form ATS-N is taking place. That is, while their Form ATS-N filings are being considered, legacy ATSS should be allowed to continue operations. Given this would be a one-time concession to legacy ATSS, we do not believe this consideration should impact on the position stated above that a Form ATS-N filing should, going-forward, be considered ineffective on filing until such time that the Commission positively declares it effective or ineffective with default being considered effective if the Commission fails to positively declare its position.

Questions 94 – 100 - Suspension and Revocation of the Exchange Exemption

CFA Institute agrees with the Commission that the proposed disclosure requirements require a disciplinary mechanism that does not rely on the SEC's general enforcement powers and could, therefore, be implemented in a more flexible and timely manner. We broadly agree with the Commission's proposals for the criteria determining whether to suspend, limit, or revoke an NMS Stock ATS's exemption, as well as the maximum 12-month period of suspension.

However, there are two issues that are not made completely clear in the proposed regulation. First, what mechanism does the ATS have for re-establishing its exemption once its Rule 3a1-1(a)(2) exemption has been revoked for non-compliance under the proposed Rule 304(a)(4)? We assume that a revised Form ATS-N filing would provide the mechanism, but it is not clear if there will be penalties for the non-compliance or whether the Commission's deliberations on the re-submitted Form ATS-N would in any way be different relative to the initial submission. Second, if the ATS were to not endeavor to re-establish its exemption in any way for the entirety of the 12-month maximum suspension period, it is not clear what the mechanism will be for dealing with the ATS's continued non-compliance.

Questions 101- 119 - Public Disclosure

CFA Institute acknowledges that some ATSs have chosen to voluntarily disclose certain aspects of their operations in the hope of gaining a competitive edge by signaling their credibility. However, these efforts have been inconsistent and piecemeal, and therefore of limited benefit to market participants.

We agree with the Commission's proposals to make public Form ATS-N filings that have been declared effective. We believe in the general principle that transparency must be promoted actively and not simply provided passively. We therefore support the proposals requiring ATSs to post the effective Form ATS-Ns on their own websites and not simply provide links to the Commission's website.

The same position is held for amendments to an ATS's Form ATS-N filings. We do not think it is necessarily in the public interest to publish Form ATS-Ns that have been deemed ineffective as this may place undue suspicion from market participants on ATSs that fail to gain exemption status on the first attempt.

Conclusion

We generally support the proposed amendments as appropriate changes aimed at bolstering transparency in capital markets, which should enable and enhance investor protections. Should you have any questions about our positions, please do not hesitate to contact Kurt N. Schacht, CFA at [REDACTED] or James C. Allen at [REDACTED].

Sincerely,

/s/ Kurt Schacht

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