

## MEMORANDUM

TO: File No. S7-23-15

FROM: Matthew J. Cursio  
Special Counsel  
Office of Market Supervision, Division of Trading and Markets  
U.S. Securities and Exchange Commission

DATE: May 2, 2018

SUBJECT: Meeting with Representatives from Liquidnet, Inc.

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On May 2, 2018, representatives from the U.S. Securities and Exchange Commission (“SEC”) met with representatives from Liquidnet, Inc. (“Liquidnet”). The SEC representatives were Brett Redfearn, John Roeser, Tyler Raimo, Daniel Gray, Christie March, Andrea Orr, David Garcia, Marsha Dixon, Megan Mitchell, and Matthew Cursio from the Division of Trading, and Markets. The Liquidnet representatives were Howard Meyerson, David Spotts, Thomas Scully, and Adam Sussman. The participants in the meeting discussed, among other things, regulation of NMS Stock Alternative Trading Systems and provided the attached slides to be posted to the public comment file [Release No. 34-76474].

**(1) REG ATS-N**  
**(2) SUSPENDING UTP  
PRIVILEGES FOR THINLY-  
TRADED SECURITIES**

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**LIQUIDNET MEETING WITH SEC TRADING  
AND MARKETS DIVISION**

**MAY 2, 2018**

# AGENDA

## AGENDA

Regulation of NMS stock alternative trading systems (Reg ATS-N)

- Overview
- Disclosure and filing issues
- ATS order display rule

Suspension of UTP Privileges for thinly-traded securities

# REG ATS-N: GENERAL

## OVERVIEW

Liquidnet supports the SEC's objective to enhance transparency of ATS activities and many of the proposals in the rule

- Our concerns relate to some details of the rule proposal
- Our focus is anticipating and seeking to address the practical issues that will arise after the rule takes effect

All the points that we raised in our comment letter (submitted February 26, 2016) are important to us

In this meeting, given time considerations, we focus on a subset of these points

# REG ATS-N: DISCLOSURE AND FILING ISSUES

## DEFINITION OF MATERIALITY

Liquidnet agrees with the Commission's proposed standard for materiality: "substantial likelihood that a reasonable participant would consider the change important when evaluating the NMS Stock ATS as a potential trading venue."

Concerned about the eight enumerated "scenarios that are particularly likely to implicate a material change"

- For example:
  - "Change of a service provider to the operations of the NMS Stock ATS that has access to confidential subscriber trading information"
    - Liquidnet's ATS developers include full-time on-site consultants; we do not identify them to our customers
- Similar concerns apply for the other scenarios

**Recommendation:** The Commission should apply the eight enumerated scenarios in line with the Commission's proposed standard for materiality

# REG ATS-N: DISCLOSURE AND FILING ISSUES

## ADVANCE NOTICE PERIOD FOR MATERIAL CHANGES

Liquidnet agrees with the Commission's approach to require prior notice of material changes without prior approval

Increasing the notice period from 20 to 30 days would impede our ability to make ongoing improvements to our products without benefit to the markets or the regulators

- Other than Canada (where prior approval of material changes is required), none of the other 44 markets where we operate requires more than one days' prior notice of a material change
- Liquidnet has submitted numerous material change filings over the years
  - Not aware of any scenario where extending the notice period from 20 to 30 days would have provided any benefit to the regulators or the market
- With filings being public, competitors and independent third-parties can promptly notify the SEC of any concerns
- After the notice period, the SEC (as well as any competitor or independent third-party) can continue to question or challenge any ATS rule change

# REG ATS-N: DISCLOSURE AND FILING ISSUES

## ADVANCE NOTICE PERIOD FOR MATERIAL CHANGES (CONTINUED)

Extending the notice period would provide limited benefit for regulators and the market while impacting the ability of ATs to operate their business to meet customer expectations

**Recommendation:** Maintain the current prior notification period of 20 days

# REG ATS-N: DISCLOSURE AND FILING ISSUES

## CONFIDENTIAL FILINGS PRIOR TO THE PUBLIC FILING DATE

It would be helpful to have a process where an ATS could file a proposed change with the division staff in advance of the required public filing date, without filing publicly

This would allow the ATS to get feedback from the division staff prior to the public filing date

- In a number of cases, for significant changes such as when we launched our fixed income negotiation system, we submitted our filing months in advance (but would not do so if the filing were made public)

**Recommendation:** We do not interpret the rule to prohibit this type of process



# REG ATS-N: DISCLOSURE AND FILING ISSUES

## FILING OF MATERIALS PROVIDED TO SUBSCRIBERS

Form ATS-N would require ATSs to attach “a copy of any materials currently provided to subscribers or other persons, related to the operations of the NMS Stock ATS or the disclosures on Form ATS-N”

- This could require the filing of any email or IM communication by an ATS employee to a customer

**Recommendation:** The Commission should instead identify specific categories of documents that should be filed as Exhibits

- See, for example, documents referenced by the Commission in the rule proposal (FIX protocol procedures, rules of engagement, user manuals, frequently asked questions and marketing materials)

# REG ATS-N: DISCLOSURE AND FILING ISSUES

## PUBLIC DISCLOSURE OF MATERIALS

The requirement for public disclosure of materials as proposed raises security, confidentiality and competitive issues

- Examples:
  - Liquidnet's Head of Security and Risk Management has identified 14 Annexes to our current Form ATS that "would pose a threat to the security of Liquidnet's online systems and would potentially harm our Members and clients, as they could provide attackers with valuable technical information"
  - One of our current ATS annexes is a list of our US liquidity partners; we are not authorized by our liquidity partners to disclose their names publicly
  - Other annexes contain information specific to our vendors, which we are not authorized to disclose publicly
  - We provide extensive detail regarding our algos, which is primarily broker information; making this information public puts us at a competitive disadvantage versus other brokers

The requirement to publicly file materials would result in less information being filed with the Commission

# REG ATS-N: DISCLOSURE AND FILING ISSUES

## PUBLIC DISCLOSURE OF MATERIALS (CONTINUED)

**Recommendation:** We propose that materials be made public only where required to accurately respond to any of the questions on Form ATS-N

# REG ATS-N: DISCLOSURE AND FILING ISSUES

## AGREEMENTS WITH SUBSCRIBERS

The Commission proposes that ATSs disclose the differences in terms among subscribers to the ATS

- We currently have in place almost 2,000 participant agreements
- Some were signed 18 years ago
- The agreements are not limited to a subscriber's participation in the ATS and also cover any trading activity through our broker-dealer and other services we provide

Not practical to highlight the differences across each agreement

**Recommendation:** We propose tailoring this provision to require disclosure of any terms in a subscriber agreement that contradict or are inconsistent with the information in an ATS's Form ATS-N or where required to fully and accurately respond to a specific Form ATS-N question

# REG ATS-N: DISCLOSURE AND FILING ISSUES

## FEES

We do not currently break out our commission between brokerage and ATS services

We would need to impute an ATS portion to our commission

**Recommendation:** We would recommend that the commission remove this requirement

# REG ATS-N: DISCLOSURE AND FILING ISSUES

## ATS FILINGS FOR NON-NMS STOCKS

**Recommendation:** An ATS should have the option to include non-NMS stocks in its Form ATS-N to avoid having to maintain multiple filings

## PROCESS FOR APPROVING NEW ATS FILINGS

**Recommendation:** An ATS should have the ability to make material changes during the 120-day period for new ATS-N filings without delaying the approval of the new Form ATS-N filing

## CROSS-REFERENCING

**Recommendation:** ATSs should be permitted in one response to Form ATS-N to reference another response in the same Form ATS-N

- This would avoid duplication of information and improve the clarity of the Form ATS-N filing

# REG ATS-N: ATS ORDER DISPLAY RULE

## ORDER DISPLAY RULE

The Liquidnet ATSs block trading of certain orders in specific stocks each month because of the ATS order display rule

**Recommendation:** The ATS order display rule should be amended to provide that, if the 5% threshold is exceeded in a stock, the display obligation should only apply for non-block orders

# SUSPENDING UTP PRIVILEGES FOR THINLY- TRADED SECURITIES

## BACKGROUND

On April 23, the SEC held a roundtable on the market structure for thinly-traded securities

One proposal under consideration is to allow issuers of less liquid stocks to suspend UTP

## LIQUIDNET DATA

Liquidnet reviewed its ATS executions during 2017 in stocks with an ADV of 100K or less:

- Liquidnet executed 98% of our executed volume in these stocks at the mid-point
- Weighted average spread in these stocks was 19.2 cents
- Liquidnet provided a weighted average price improvement of 9.6 cents to each side

## BENEFITS OF LIQUIDNET FOR THINLY-TRADED SECURITIES

Reduces trading costs for long-term investors through reduced market impact and price improvement

Reduced trading costs incentivize additional liquidity from long-term investors



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# QUESTIONS?