March 27, 2023

**Re: Rule Proposal No. 34-96496; File No. S7-32-22 Regulation Best Execution and Rule Proposal No. 34-96494; File No. S7-30-22 Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders**

Hello,

My name is Jeffrey Eng, and I am a retail investor.

Just a short time ago, I opened my first brokerage account to learn more about investing and ways of practicing responsible personal finance. Like many other Americans, my goal was, and always will be, to secure financial stability for myself and loved ones in the future.

However, over this time, I've had growing concerns regarding a lack of market transparency, an inability to ensure simplicity and fairness for all, and an inability to ensure best execution.

**Today, I am submitting this letter into the comment files for both of the following: Rule Proposal No. 34-96496; File No. S7-32-22 (the "Best Execution Proposal") as well as Rule Proposal No. 34-96494; File No. S7-30-22 (the "NMS Proposal"), both collectively referred to as "The Proposals".**

**I also urge the SEC to ban Payment for Order Flow ("Wholesaler PFOF") and exchange rebates ("Exchange PFOF"), collectively referred to as "PFOF".**

PFOF is primarily seen as an inducement to route orders, off-exchange, to wholesalers. Similarly, exchange fee structures and rebates play a similar role in order routing decisions. While both the SEC and FINRA recognize the problems that these inducements create, these systemic issues have not been addressed, despite the best efforts of regulators.[1]

**In short, I believe PFOF should be banned.**

[1] These efforts include both regulatory guidance from FINRA as well as enhanced Rule 606 disclosures.

## PFOF Inherently Conflicts With the Duty of Best Execution

At the time of writing, the SEC relies on the best execution guidance provided by the self-regulating body, FINRA[2].

FINRA's best execution guidance states that "firms may not negotiate the terms of order routing arrangements for those customer orders in a way that reduces the price improvement opportunities that otherwise would be available to those customer orders absent payment for order flow."[3]

To support this, research provided by the SEC in The Proposals and the OCR Proposal[4], along with independent researchers and academics show that **brokers who accept Wholesaler PFOF receive less price improvement; therefore, inherently conflicts with the duty of best execution**. **The research also shows that, conversely, brokers who do not accept any kind of PFOF route orders differently and consequently, brokers see superior execution quality.**

Aside from the research, the effects of this conflict of interest have been observed by in the marketplace. The CEO of Virtu Financial, Doug Cifu, publicly stated on CNBC in March 2021 interview that, "Overall, through the course of a month, we will provide more price improvement for [a retail investor that's not dealing with PFOF at] Fidelity than we do to Robinhood."[5] This is a clear violation of FINRA's best execution guidance, and especially concerning for a global market maker 210 unique exchanges, markets and liquidity pools in 30 countries, according to their own filings with the SEC.[6]

To be clear, this is not a mere academic discussion – there are real, tangible, and negative impact on individual investors backed by quantitative research as well as admissions from those directly from those in our markets.

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[2] "SEC's Best Execution Proposal | Office Hours with Gary Gensler" on the SEC's official YouTube channel: https://www.youtube.com/watch?v=54_pnHEoMfQ

[3] FINRA, "FINRA Reminds Member Firms of Requirements Concerning Best Execution and Payment for Order Flow", (June 23, 2021), Available at https://www.finra.org/rules-guidance/notices/21-23

[4] Order Competition Rule. 88 FR 128, ("OCR Proposal"), Federal Register, (Jan. 3, 2023), Available at https://www.federalregister.gov/documents/2023/01/03/2022-27617/order-competition-rule

[5] CNBC, "Virtu Financial CEO on controversy surrounding payment for order flow", Squawk Box, (March 11, 2021), Available at https://www.cnbc.com/video/2021/03/11/virtu-financial-ceo-on-controversy-surrounding-payment-for-order-flow.html

[6] "Virtu Financial, Inc. S-1". www.sec.gov. https://www.sec.gov/Archives/edgar/data/1592386/000104746914002070/a2218589zs-1.htm

## Why Rebates Should Be Banned

Like Wholesaler PFOF, Exchange PFOF is harmful to market quality. This practice provides a select few firms with unnatural subsidization which increases concentration of market power and ultimately hurt retail investors.

When researched by SEC's Equity Market Structure Advisory Committee, their Customer Issues Subcommittee informed that "The majority of the buy-side participants felt that addressing exchange rebates was the most important U.S. equity market structure issue currently facing the markets due to the conflicts of interest associated with exchange rebates."[7]

Unfortunately, the SEC has only taken minor steps to address this: setting an artificial price control[8] for access fees in the NMS Proposal and carving out check-the-box solutions for "conflicted transactions" in the Best Execution Proposal**. Also note that institutional investors are excluded from such exceptions which defeats the purpose of these measures.**

To date, these measures have not been effective at addressing these issues, and **it has become clear that the only solution to this problem is a clear ban on order routing inducements, such as PFOF, that are not related to execution quality.**

To illustrate the impact, the SEC's CAT analysis provides a comprehensive overview of the problems introduced by Wholesaler PFOF, which are similar to those introduced by Exchange PFOF:

- The need to compete over high rebates pushes take fees to the limit of the access fee cap, increasing costs for both institutional and individual investors placing marketable orders. This is why the access fee cap is indistinguishable from a government price control.
- The principal-agent conflict drives brokers to place non-marketable orders at the exchanges offering the highest rebates, rather than the best execution quality. This practice creates long queues, reducing the likelihood of execution and maximizing the likelihood of adverse selection. The SEC has acknowledged this problem, stating that "Academic literature has shown that the presence of high liquidity fees and rebates on some market centers may impact broker-dealer routing decisions based on where they can receive the highest rebate (or pay the lowest fee), rather than where they can receive better execution quality on behalf of their customers."[9]

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[7] EMSAC Customer Issues Subcommittee, "Customer Issues Subcommittee Status Report", Securities & Exchange Commission, (April 3, 2017), Available at https://www.sec.gov/spotlight/emsac/emsac-customer-issues-subcommittee-status-report-040317.pdf

[8] The very need for a government-mandated price control should serve as evidence that there is economic dysfunction and perverse incentivization

[9] OCR Proposal at 260

- According to IEX, “In some instances, brokers seeking to maximize rebate payments from exchanges can earn more in rebates per share than the client is paying them in commissions per share (even though the client’s execution quality will suffer greatly).”[10]
- Exchange PFOF serves to increase the number of exchanges as the combination of rebates and the Order Protection Rule ensure that any price queue will get filled. However, it has the opposite effect on the number and diversity of trading participants (exactly as Wholesaler PFOF does). Nearly all net rebates are paid to a small handful of trading firms, increasing concentration by subsidizing the largest high-speed trading firms to the detriment of other firms.[11] [12]

**Simply put, the problems of Exchange PFOF and Wholesaler PFOF have direct and compelling parallels.**

That being said, the SEC’s comprehensive, data-driven economic analysis helps visualize the impacts brought about by Wholesaler PFOF, and quantifies many of the criticisms of the practice voiced over the past 15 years. **I give credit to the SEC for their thorough analysis and included data as part of the Proposals.**

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[10] Katsuyama, Bradley, “Testimony before the U.S. House Representatives Committee on Financial Services”, IEX Exchange, (June 27, 2017), Available at https://www.iexexchange.io/blog/testimony-of-bradley-katsuyama-before-the-us-house-of-representatives-committee-on-financial-services

[11] Securities and Exchange Commission (SEC), “ROUNDTABLE ON MARKET DATA PRODUCTS,

MARKET ACCESS SERVICES, AND THEIR ASSOCIATED FEES”, (Oct. 25, 2018), Available at https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102518-transcript.pdf

Note: Nasdaq admitted (pg. 54) that “At least one large broker-dealer received more rebates than it paid the Nasdaq fees for its market data, connectivity and equipment use in 2017.” BATS-CBOE admitted at the same meeting (pg. 74-75) that “[f]ive out of the top 10 get a check from us after the costs of their connectivity and market data. So we are cutting them a check monthly after their costs.”

[12] Spatt, C.S. Is Equity Market Exchange Structure Anti-Competitive? Carnegie Mellon University. (Dec. 28, 2020), Available at https://www.cmu.edu/tepper/faculty-and-research/assets/docs/anti-competitive-rebates.pdf

Note: Spatt explains that such an arrangement represents “significant cross-subsidization of some customers” and that “smaller brokers face a significant relative burden.” This is a critical point to understand. Exchange rebates act as a cross-subsidy from firms trading less to firms trading more, and broadly from firms trading slowly to firms trading faster, which creates an anti-competitive feedback loop, increasing concentration of the largest and fastest rebate-collecting firms.

## How Other Countries, Governments, and Institutions Support a Ban on PFOF

There is international support to eliminate PFOF, citing very similar issues to those observed in the United States:

- **United Kingdom reducing PFOF** – The Financial Conduct Authority's (FCA) long-held position that "PFOF in relation to retail and professional client business is incompatible with our rules on conflicts of interest and inducements, and risks compromising firms' compliance with best execution."[13] It specifically cites both the incompatibility of PFOF with the duty of best execution and the "wider bid-ask spreads from market makers and other liquidity providers who agree to pay PFOF to attract order flow from brokers."[14]

- **Singapore has banned PFOF** – stating that "PFOF introduces conflicts of interest and is likely to cause harm to customers as the CMS Broker may be incentivized to pursue commissions or other forms of payment … in return for routing customers' orders to that broker or counterparty for its own benefit. This is inconsistent with a CMS Broker's duty to provide Best Execution to its customers."[15] In addition, like the UK, Singapore identified "wider bid-ask spreads" as a direct consequence of this practice.

- **The EU has pushing hard for a continent-wide ban over PFOF** – by financial regulatory authorities and the European Parliament. However, individual countries are being lobbied heavily by PFOF brokers and high-speed middlemen to allow for PFOF in their respective jurisdictions. Regardless, ESMA is clear in its guidance: "ESMA is of the view that, in most cases, it is unlikely that the receipt of PFOF by firms from third parties would be compatible with MiFID II."[16]

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[13] Financial Conduct Authority (FCA), "Payment for Order Flow (PFOF)", (April 2019), Available at https://www.fca.org.uk/publication/multi-firm-reviews/payment-for-order-flow-pfof.pdf

[14] Ibid.

[15] Monetary Authority of Singapore (MAS), "SECURITIES AND FUTURES ACT (CAP. 289)", (Sept. 3, 2020), Available at https://www.mas.gov.sg/regulation/guidelines/guidelines-to-notice-sfa04-n16

[16] European Securities and Markets Authority (ESMA), "ESMA warns firms and investors about risks arising from payment for order flow", (July 13, 2021), Available at https://www.esma.europa.eu/press-news/esma-news/esma-warns-firms-and-investors-about-risks-arising-payment-order-flow

Additionally, large institutional asset managers have also publicly expressed their views on PFOF:

- **T Rowe Price welcomed the idea of reducing or eliminating rebates** – by writing a particularly important comment letter–in its capacity as both an institutional asset manager and a publicly-listed company–for the Transaction Fee Pilot Proposal[17]. T Rowe Price: "[w]e do not expect that a reduction or outright removal of rebates will have any significant or harmful effects on the quality of prices displayed in the public lit market, interfere with genuine liquidity and price formation, or negatively impact our stock's trading volume, spread, or displayed size."[18]

- **Vanguard does not receive any form of payment for PFOF** – as directly stated on their Investor Education website that "we don't receive (or take) any form of payment for order flow. Our approach is rooted in our 'client first'" philosophy and our drive to maximize investment outcomes… We consider ourselves caretakers of your investments, and that permeates every decision we make."[19]

- **Capital Group has been a leader on this issue for years** – where, in his testimony[20] before the SEC's Equity Market Structure Advisory Committee in 2015, Matt Lyons, SVP, Global Trading Manager, said simply, "The Capital Group strongly recommends that we should eliminate rebates … that in and of itself will alleviate a lot of the issues I've discussed."

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[17] Ramsay, John, "Comment Later: Transaction Fee Pilot; Securities Exchange Act Release No. 82873; File No. S7-05-18", IEX Group, Inc., (June 12, 2018)

[18] Ibid.

[19] Vanguard, "Payment for order flow—What you need to know", (Feb. 10, 2022), Available at https://investor.vanguard.com/investor-resources-education/article/payment-for-order-flow-what-you-need-to-know

[20] Lyons, Matt, "EMSAC—Presentation on Maker Taker Pricing", Capital Group, (Oct. 27, 2015), Available at https://www.sec.gov/spotlight/capital-group-presentation-matt-lyons-emsac.pdf

## Some Institutions Who Benefit from PFOF Once Voiced Their Concerns Against It

Ironically, some of the most compelling reasons to ban PFOF have come from the brokers and exchanges themselves. While they directly profit from PFOF now, they publicly voiced their concerns in the past, including:

- **Citadel in 2004** – asserted that "the practice of payment for order flow creates serious conflicts of interest and should be banned … payment for order flow creates fundamental conflicts of interest that cannot be cured by disclosure." In 2021[21], Citadel Securities founder Ken Griffin said he would be "quite fine" if payment for order flow was banned.

- **Virtu in 2015** – was a founding working group member of the Healthy Markets Association, whose mission was to eliminate PFOF and rebates along with eliminating off-exchange trading of retail orders with a trade-at rule, and was extremely supportive of these reforms. In fact, current employees of Virtu have been clear, in both private correspondence and public forums, about the problems that PFOF presents[22]:

    - "PFOF Presents an Undeniable Conflict of Interest"
    - "PFOF is a flawed and conflict-ridden practice"
    - "Wholesalers use the press to falsely claim that they can provide retail investors with prices inside the public spread while exchanges can't, but they often set the spread and its[sic] widening."
    - "A ban on PFOF should lead to more competition and better prices for retail, not less"
    - "Arnuk remarked that … banning payment for order flow (PFOF) would guide our markets to the best state of price and demand as well as eliminate market fragmentation."[23]

These institutions are already heavily opposing The Proposals, because they currently benefit from PFOF and do not want to interrupt their existing business model. **However, it's worth reminding that at one point in time, these very same institutions recognized the dangers this practice introduces, which is even more reason to end PFOF.**

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[21] Darbyshire, Madison, "Citadel Securities founder 'quite fine' with ending payment for order flow", Financial Times, (October 4, 2021)

[22] Arnuk. Saul, "Testimony before the House Financial Services Committee: GAME STOPPED? WHO WINS AND LOSES WHEN SHORT SELLERS, SOCIAL MEDIA, AND RETAIL INVESTORS COLLIDE", U.S. GOVERNMENT PUBLISHING OFFICE, (March 17, 2021) Ret.

https://democrats-financialservices.house.gov/uploadedfiles/hhrg-117-ba00-wstate-arnuks-20210317.pdf

[23] Investor Advisory Committee (IAC), "SEC Investor Advisory Committee Meeting", SIFMA.org, (June 10, 2021), Available at https://www.sifma.org/resources/general/sec-investor-advisory-committee-meeting-6/

### A Call to Ban Payment for Order Flow

It's clear:  the practice of PFOF introduces inducements and incentives which distort order routing and violate duty of best execution.  As a result, PFOF has undermined the fairness, simplicity, and transparency of the markets, creating a warped system which disfranchises retail investors for the benefit of high-speed speculators and rent-seekers.

I hope I have provided compelling reasons to put an end to this unequal and troubling practice. As a concerned retail investor, I hope to engage with the SEC and other fellow retail investors going forward to ensure that we are on a path towards better market transparency, ensuring simplicity and fairness, and, most importantly, enforcing best execution for all investors alike.

Thank you,

Jeffrey Eng