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April 5, 2024

Ms. Vanessa Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, Release No 34-96494; File No. S7-30-22

Dear Ms. Countryman:

Cboe Global Markets, Inc. ("Cboe") appreciates the opportunity to file an additional comment letter on the above-referenced proposed rule change ("the Proposal") to Regulation NMS published by the Securities and Exchange Commission ("SEC" or "Commission") in 2022.[1] The Proposal, which seeks to implement a new minimum pricing increment ("tick size") regime for NMS stocks, also seeks to further impose price controls on registered stock exchange transaction fees.[2] Despite significant industry pushback to date, it is not clear whether the Commission plans to address the varied concerns raised with respect to this Proposal.

Cboe believes it bears emphasizing the SEC would be ill-advised in pursuing further compression of transaction/access fee caps. This is especially true for securities priced less than $1.00, for which the Commission does not propose to change tick sizes but nevertheless proposes to lower the access fee from 0.3% of the quotation price per share to 0.05%. As we have previously stated[3] and summarized below, there are many reasons the SEC should not interfere with access fees, especially for securities priced less than $1.00 for which the negative impact of the proposed access fee caps would be even more pronounced. Among other reasons, we find it most concerning

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1 See Securities Exchange Act Release No. 34-96494, 87 FR 80266 (December 29, 2022).

2 The proposed amendments to Rule 610 would reduce the level of the access fee caps. For quotations in NMS stocks priced at $1.00 or more and that have a minimum pricing increment of $0.001, the access fee cap would be $.0005 per share. For NMS stocks with a minimum pricing increment greater than $0.001, the access fee cap would be $0.001 per share. For quotations in NMS stocks priced less than $1.00, the access fee cap would be 0.05 percent of the quotation price.

3 See Cboe Comment Letter dated August 23, 2023 Re: File No. S7-29-22, Release No. 34-96493 (Disclosure of Order Execution Information); File No. S7-30-22, Release No. 34-96494 (Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders); File No. S7-31-22, Release No. 34-96495 (Order Competition Rule); File No. S7-32-22, Release No. 34-96496 (Regulation Best Execution) available at: https://cdn.cboe.com/resources/government_relations/Cboe-s-Supplemental-Response-to-SEC-Equity-Market-Structure-Proposals-S7-30-22-Filed-8-23-23.pdf. See also Cboe Comment Letter dated March 31, 2023 Re: File No. S7-29-22, Release No. 34-96493 (Disclosure of Order Execution Information); File No. S7-30-22, Release No. 34-96494 (Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders); File No. S7-31-22, Release No. 34-96495 (Order Competition Rule); File No. S7-32-22, Release No. 34-96496 (Regulation Best Execution) available at: https://cdn.cboe.com/resources/government_relations/Cboe-Response-to-SEC-Market-Structure-Proposals-3-31-23.pdf.

that the proposed mandated reduction in access fee caps has been entirely divorced from the original justification for their existence, which centered around ensuring that transaction fees did not unduly distort the price of a quote that the Commission was protecting by rule. That original justification for access fee caps had nothing to do with tick sizes. Further, we expect a mandated reduction in access fee caps will have a negative impact on market quality and investors, as access fees fund liquidity provision rebates, and rebates directly result in narrower spreads and better executions for investors.

In the following letter, we share new information regarding the impact of access fee compression on liquidity provision. We find that if the access fee cap is reduced to $.001 (”10 mils”) from the current access fee cap of $.003 mils (“30 mils”), liquidity providers will see a significant reduction in the rebates they receive. In turn, we expect bid-ask spreads will likely widen as acknowledged in the Proposal, making it more expensive for investors to enter and exit positions.

<u>**Changing Access Fee Caps Would be Inappropriate, Unjustified, and Disruptive**</u>

- **Access fee caps are tantamount to government-imposed price controls** of markets and have been controversial from their very inception. It is not the role of government to set prices in competitive markets. Our securities markets are highly competitive and beneficial to retail investors who typically pay no commissions to trade. Fees should continue to be determined by competition.
- **Access fee caps were originally adopted with a clear and limited purpose that market observers either do not realize or entirely disregard in current discussions:** to ensure that market centers displaying the best price did not impose access fees that compromised the value of the better price. Linking access fee caps to commenter sentiment and/or modest tick reductions not only ignores their original justification but also represents a significant paradigm shift in terms of when and how governments intervene in markets. Modifications to access fee caps should only be discussed in the context under which they were conceived.
- **Exchange fees are highly regulated and consistently undergo SEC review rendering further compression of access fee caps unnecessary**. When the SEC has reason to believe exchange fees have the potential to create a policy concern, it can use its authority to reject such fees under Section 19(b) of the Securities Exchange Act of 1934 (the “Act”),[4] rather than impose arbitrary and sweeping price controls.
- **Compressing the caps further would negatively impact competition in equities markets** to the detriment of market quality and investors. Exchange access fees are an integral component of exchange pricing schedules, enabling exchanges to develop pricing schedules and mechanisms (including rebates) that allow exchanges to compete. Lower access fee caps would negatively impact exchanges’ ability to compete with other exchanges and with off-exchange market centers, where an increasingly larger percentage of equity transactions are executed, for reasons we have consistently discussed.[5] Reducing the ability of exchanges

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[4] Section 19(b) of the Act, and its rules thereunder, requires every SRO to file with the Commission any proposed rule change of the rules of the SRO, including fee changes. All proposals must be submitted to the Commission for review on Form 19b-4. <u>See</u> 17 CFR § 240.19b-4 19b-4.

[5] Most recently, we noted “Off-exchange venues also offer features today that exchanges cannot offer, such as capital commitment to customer orders, targeted indications of interest, order segmentation designed to increase fill rates and improve parent order level performance, and greater anonymity – not to mention a regulatory framework that enables off-exchange venues to more quickly introduce new innovations. This competitive dynamic has left registered exchanges with an increasingly smaller share of the overall equities

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to compete could directly result in more volumes migrating to off-exchange market centers and could have negative price discovery implications.

- **Lower access fee caps for equities could disrupt business practices and have significant revenue consequences**. At the time the $.0003 ("30 mils") (i.e., 30 cents per 100 shares) access fee cap for equities was adopted by the Commission, it was deemed appropriate for equities because exchanges "[had] very few fees on their books of more than $.003 per share." In other words, with the original fee cap amount the Commission was not disrupting existing competitive and demand-based pricing. Reducing the current access fee cap any further could, however, greatly disrupt current business practices and such pricing.
- **Ultimately, lower access fee caps would negatively impact market quality and investors as access fee caps fund rebates, and rebates directly result in narrower spreads and more liquidity for investors**. We detail below the expected negative impact on liquidity provision.

Estimated Negative Impact on Liquidity from Further Compression of Access Fee Caps

In proposing its variable access fee cap structure, the Commission acknowledges that a reduction in the access fee cap is likely to materially impact the amount of rebates earned by exchange liquidity providers. The Commission further concedes that as rebates decline, exchange liquidity provision is likely to diminish. Concerningly, rather than squarely addressing this liquidity gap, the Commission attempts to offset its impact by theorizing that as rebates decrease, so-called price distortions will be removed from the markets, thereby decreasing the cost of demanding liquidity. By reducing trading costs for some, the Commission further posits that other market participants (e.g., institutional investors) will seek to trade more often, thereby generating more trading volume.

This analysis is speculative, at best, and fails to consider the deleterious impact the proposed access fee cap reductions will likely have on exchange liquidity provision. Cboe notes that it is highly unlikely that any liquidity gap will be met by other market participants (e.g., institutional investors), as these market participants have no incentive to step in to serve the market, particularly during times of market stress. More importantly, it is also highly unlikely that liquidity providers will be able to sufficiently support exchange liquidity provision at current levels, given the proposed fee caps will materially diminish the revenue that liquidity providers receive for providing on-exchange liquidity, and significantly impair the protection rebates offer liquidity providers to the risks inherent to liquidity provision, such as volatility, market risk, and even regulatory risk. Consequently, the quality of displayed quotes on exchanges, upon which the entire marketplace depends, will also deteriorate.

Below is a simple example that shows the potential loss of liquidity that is likely to result from a reduction in the rebates exchanges will be able to offer if the access fee cap is reduced to 10 mils.

market and limited tools with which to compete. One important tool that exchanges rely on to be able to compete with other trading venues are volume-based rebates, which allow exchanges to attract orders and in turn directly result in lower costs, narrower spreads, and more liquidity for investors." See Cboe Comment Letter dated January 5, 2024, Re: File No. S7-18-23, Release No. 34- 98766 (Volume-Based Exchange Transaction Pricing for NMS Stocks), available at: https://www.sec.gov/comments/s7-18-23/s71823-365659-884582.pdf.

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Table 1. Impact of Compression on Access Fee Caps on Rebates Paid to All Liquidity Providers and Retail Orders

LIQUIDITY PROVIDERS

	Access Fee (per 100 Shares)	Rebate (per 100 shares)	Rebate as % of Min Tick Size $0.01 Tick
Liquidity Providers	$0.30	$0.28	28%
	$0.10	$0.08	8%
Loss in Rebates ($/%)		($0.20)	(71%)

RESTING RETAIL ORDERS

	Access Fee (per 100 Shares)	Rebate (per 100 shares)	Rebate as % of Min Tick Size $0.01 Tick
Resting Retail Orders	$0.30	$0.32	32%
	$0.10	$0.12	12%
Loss in Rebates ($/%)		($0.20)	(63%)

- Assume, as the Commission notes, that even with the proposed access fee cap reduction, exchanges can manage to retain their $.0002 ("2 mils") capture. There are two perspectives worth noting that demonstrate the potential loss of on-exchange liquidity due to a 10 mils access fee cap's impact on rebates: (1) the liquidity providers' perspective, and (2) the resting retail order perspective.

- Liquidity Providers

  - ***30 mils Access Fee Cap***: using the current access fee cap $.003 ("30 mils") (i.e., 30 cents per 100 shares), an exchange's $.0002 ("2 mils") capture sets a liquidity provider's average rebate at $.0028 ("28 mils") (i.e. 28 cents per 100 shares)

  - ***10 mils Access Fee Cap***: if the access fee cap were to decrease to $.001 ("10 mils") (i.e., 10 cents per 100 shares), a liquidity provider's rebate decreases 20 cents to an average of $.008 ("8 mils") (i.e., 8 cents per 100 shares), which equates to a 71% decrease in the liquidity provider's rebate.

- Resting Retail Orders

  - ***30 mils Access Fee Cap***: using the current access fee cap of $.003 ("30 mils") (i.e., 30 cents per 100 shares), an exchange's $.0002 ("2 mils") loss provides an average rebate to retail liquidity providers of $.0032 ("32 mils") (i.e., 32 cents per 100 shares).

  - ***10 mils Access Fee Cap***: if the access fee cap were to decrease to $.001 ("10 mils") (i.e., 10 cents per 100 shares), the retail liquidity provider's average rebate decreases 20 cents to $.0012 ("12 mils") (i.e., 12 cents per 100 shares), which equates to a 63% decrease in the retail liquidity provider's rebate.

A reduction of 71% or 63% of earned rebate revenues is undeniably such a significant percentage that liquidity providers currently providing on-exchange liquidity will be forced to reconsider their entire approach to on-exchange liquidity provision. In our view, a rebate reduction of this magnitude is so significant that it will all but guarantee liquidity providers are dissuaded from providing robust on-exchange liquidity. Consider a simple example, where under today's assumed 2 mil exchange capture and a 30 mils access fee cap, a liquidity provider earns $100,000 in rebates. Now, assume that as proposed, the Commission institutes a 10 mils access fee cap. Here, the liquidity provider would now earn $29,000 in rebates, which is a ***loss*** of $71,000. It stands to reason then, that liquidity providers are likely to reduce or even stop providing liquidity to exchanges, and instead migrate to off-exchange market making further contributing to the growing trend of off-exchange trading activity.

Moreover, as liquidity providers' rebate revenue is drastically reduced, liquidity providers will lack an important incentive that facilitates liquidity provision and tighter spreads. The resulting wider spreads will have negative implications for investors and will nullify the potential benefits of a finer trading increment. Indeed, even the Commission acknowledges that a reduction in access fees, and its impact on rebates and liquidity provision, is likely to lead to wider spreads but seeks to mitigate this consequence by noting that the corresponding tick-size reductions will result in net savings to investors. The speculative nature of this theory hardly justifies the risk. Rather, as spreads further widen, any cost savings non-retail investor participants realize from a reduction in the access fee cap are likely to be more than consumed by the rising frictional costs (the costs of trading in and out of a position) associated with wider spreads (which will also impact retail investors). What's more, given that retail investors trade in a commission-free environment, they would not be the beneficiaries of any hypothetical savings that might occur as a result of further access fee compression. Finally, spreads are likely to widen most acutely during times of market stress and price dislocations when economic incentives to provide on-exchange liquidity are needed the most.

The Commission must also consider that as liquidity moves off-exchange, the National Best Bid ("NBB") and National Best Offer ("NBO") (together, the "NBBO") will worsen, as the NBB and NBO deteriorate due to a likely decrease of displayed liquidity in the marketplace. In this regard, the Commission's proposal overlooks the critical importance and reliance of the entire marketplace on the displayed quotes provided by exchanges. For instance, the NBBO is utilized by many market participants as a reference price for benchmark pricing and other risk functions. In addition, if on-exchange liquidity moves to off-exchange venues such as alternative trading systems, these trading centers commonly use the NBBO as a reference price for executing transactions, which will make transactions in off-exchange venues more expensive as well. Wider spreads are likely to most benefit wholesale broker-dealers, that may be able to offer more levels of price improvement, but at the expense of increased frictional costs for investors.

More importantly, the proposed reduction in access fee caps, and its adverse impact on rebates and liquidity provision will hurt the quality of the displayed market. While some contend that exchange fees somehow negatively impact investors, the reality is that investors today, particularly Main Street investors, enjoy tighter spreads, higher and faster fill rates, and pay lower costs to trade than ever before. In fact, most individual investors do not pay any commissions on their self-directed stock trades. Rebates directly contribute to fostering such a marketplace, and exchanges' ability to offer economically adequate rebates is contingent upon today's access fees. Given that equities market competition continues to be vibrant, government-imposed price controls are ill-advised and counterproductive to investors.

Cboe understands that many commenters express support for the Commission lowering exchange fee caps – who would not mind if the government stepped in to seemingly reduce costs? However, this support is not accompanied

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by meaningful analysis and ignores the associated negative market structure implications. Moreover, while the Commission, as well as certain commenters and academic studies, claim that access fees and rebates create conflicts of interest for broker-dealers, these assertions remain speculative. If there is a concern that rebates drive brokers' routing decisions,[6] there exist other mechanisms for the Commission to discourage such behavior such as closer examination of a broker's routing practices, and indeed, through the proposed Best Execution Rule.[7] The well-functioning equities markets do not need major surgery. Cboe continues to support a do-no-harm approach to market reform - we welcome the opportunity for further discussion.

Sincerely,

s/Patrick Sexton

Patrick Sexton
EVP, General Counsel & Corporate Secretary

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[6] See Cboe Comment Letter dated August 23, 2023, available at: https://www.sec.gov/comments/s7-30-22/s73022-249719-570262.pdf ("Myth #3: Exchange rebates lead to conflicts of interest for broker-dealers so exchange rebates should be banned. First, approximately half of the rebates on Cboe accrue to nonagency market-making activity – thus, there is no real or perceived conflict of interest. Second, even for order flow where brokers do act in an agency capacity, some of that client flow is "directed" meaning the clients give specific instructions for the order to be routed to a particular venue for execution –again there can be no conflict of interest provided brokers are routing to market centers that are consistent with the client's order handling instructions. Third, brokers have a duty of best execution regardless of the pricing model used by exchanges.10 If there is evidence that brokers are violating their best execution obligations because of rebates paid by exchanges, then any such concern should be addressed directly by enforcing those brokers' best execution obligations. Addressing such a problem, if any, indirectly—by diminishing rebates—likely would lead to unintended consequences, such as reducing the exchanges' ability to compete with each other and with off-exchange trading venues. Further transparency between brokers and their clients regarding broker practices and policies also would help avoid potential problems arising out of any purported conflicts of interest. For instance, requiring broker-dealers to make publicly available their routing strategies, and best execution metrics would help to hold broker-dealers accountable for their order routing decisions, as market participants would be able to compare their execution quality metrics versus publicly available routing disclosures. By contrast, it is entirely inappropriate to experiment with exchange pricing models for fear of broker failings. Importantly, access fees enable exchanges to offer rebates to liquidity providers, which in turn results in enhanced liquidity and narrower spreads, thereby benefiting investors.")

[7] See Securities Exchange Act Release No. 96496, 88 FR 5440 (January 27, 2023) ("Best Execution Proposal"). The Best Execution Proposal, amongst other things, would require more robust policies and procedures for broker-dealers that engage in certain conflicted transactions for or with a retail customer, as well as require broker-dealers to review their best execution policies and procedures at least annually and present a report detailing the results of such review to their boards of directors or equivalent governing bodies.

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Cc: The Honorable Gary Gensler, Chairman, SEC
The Honorable Caroline A. Crenshaw, Commissioner, SEC
The Honorable Hester M. Peirce, Commissioner, SEC
The Honorable Jaime Lizárraga, Commissioner, SEC
The Honorable Mark T. Uyeda, Commissioner, SEC
Director Haoxiang Zhu, Division of Trading and Markets