



December 10, 2018

Via Electronic Mail (rule-comments@sec.gov)

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

Re: Rel. No. 34-84599, File No. SR-CboeEDGA-2018-017;  
Rel. No. 34-84661, File No. SR-CboeEDGX-2018-055;  
Rel. No. 34-84652, File No. SR-CboeBYX-2018-024; and  
Rel. No. 34-84653, File No. SR-CboeBZX-2018-083.

Dear Mr. Fields:

The Healthy Markets Association appreciates the opportunity to comment on the above-referenced immediately effective exchange filings,<sup>1</sup> which seek to revise fees across the Cboe exchange family.<sup>2</sup> In particular, the Cboe Filings dramatically alter the

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<sup>1</sup> Cboe EDGA Exchange, Inc., *Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Amend the Exchange's Fee Schedule Applicable to its Equities Trading Platform*, SEC, Exch. Act Rel. No. 34-84599, Nov. 15, 2018, available at <https://www.sec.gov/rules/sro/cboeedga/2018/34-84599.pdf> ("EDGA Filing"); Cboe EDGX Exchange, Inc., *Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Modify Certain Routing Fees*, SEC, Exch. Act Rel. No. 34-84661, Nov. 27, 2018, available at <https://www.sec.gov/rules/sro/cboeedgx/2018/34-84661.pdf> ("EDGX Filing"); Cboe BYX Exchange, Inc., *Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Modify Certain Routing Fees*, SEC, Exch. Act Rel. No. 34-84652, Nov. 26, 2018, available at <https://www.sec.gov/rules/sro/cboebyx/2018/34-84652.pdf> ("BYX Filing"); Cboe BZX Exchange, Inc., *Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Modify Certain Routing Fees*, SEC, Exch. Act Rel. No. 34-84653, Nov. 26, 2018, available at <https://www.sec.gov/rules/sro/cboebzx/2018/34-84653.pdf> ("BZX Filing"). Collectively, unless otherwise specified, we hereafter refer to these as the "Cboe Filings".

<sup>2</sup> On November 1, 2018, the EDGA, EDGX, BYX, and BZX exchanges each made remarkably similar filings to those implemented here. However, the initial filings for EDGX, BYX, and BZX were withdrawn and refiled on November 13th. See, EDGX Filing, at 2, n.3; *accord*, BYX Filing, at 2 and BZX Filing, at 2. None of the EDGA Filing, BYX Filing, or BZX Filing offers any discussion why the original filings were withdrawn and substantively similar filings were subsequently made.

pricing structure for orders routed to and executed on Cboe EDGA Exchange, Inc., which currently operates using an inverted pricing model.

The Cboe Filings do not provide sufficient information to support a finding by the Commission that the proposed changes:

- provide for an equitable allocation of reasonable dues, fees, and other charges;
- do not unfairly discriminate between different exchange participants;
- do not impose burdens on competition that are not necessary or appropriate; and
- do not impose impediments to the free and open market system.

As a result, the filings are insufficient to establish that the exchanges have met their obligations under the Exchange Act and Commission rules. Accordingly, we request that the Commission suspend the Cboe Filings and institute proceedings to disapprove them.

## About Healthy Markets and Our Interest in Exchange Pricing Fairness

The Healthy Markets Association is an investor-focused not-for-profit coalition working to educate market participants and promote data-driven reforms to market structure challenges. Our members, who range from a few billion to hundreds of billions of dollars in assets under management, have come together behind one basic principle: Informed investors and policymakers are essential for healthy capital markets.<sup>3</sup>

The conflicts of interest and costs associated with exchange pricing have been a longstanding concern for Healthy Markets.

## Background on SEC Review of Exchange Rule Proposals

The Commission is obligated to review SRO filings and determine that those filings are consistent with the Exchange Act,<sup>4</sup> including that an exchange's rules:

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<sup>3</sup> To learn more about Healthy Markets, please see our website at <http://www.healthymarkets.org>.

<sup>4</sup> See *Susquehanna Int'l Grp., LLP v. SEC*, 866 F.3d 442 (D.C. Cir. 2017). *Accord*, Remarks of Brett Redfearn, SEC, before the SEC Roundtable and Market Access and Market Data, Oct. 26, 2018, available at <https://www.sec.gov/news/public-statement/statement-redfearn-102518> (declaring that in order for the Commission to "meet our obligations under the Exchange Act, we also need to ensure that the fees that are being charged for such important market services are fair and reasonable, not unreasonably discriminatory, and do not impose an undue or inappropriate burden on competition."). We note that another exchange family has recently argued that "Section 19(b)(3) does not "require" the

- “provide for the equitable allocation of reasonable dues, fees, and other charges;”<sup>5</sup>
- not be “designed to permit unfair discrimination”;<sup>6</sup>
- “not impose any burden on competition not necessary or appropriate in furtherance of the purposes of” the Act;<sup>7</sup> and
- be designed “to protect investors and the public interest.”<sup>8</sup>

Making these findings is not an easy task. In 2017, the securities exchanges and FINRA made over 1500 filings with the Commission. Of those, about 200 were directly related to listings, another 350 related to fees, and about 100 related to order types. No less than 500 were “other” filings. Many of these filings were extremely complex. The vast majority received no public comments. Many were immediately effective upon filing, and many were approved without any public findings by the Commission. A significant portion of these filings do not contain sufficient information to make the determinations. Many include boilerplate language that has been recycled from filing to filing.

Nevertheless, the difficulty in wading through the massive volume of filings does not relieve the Commission of its legal obligation.<sup>9</sup> The Commission must review all

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Commission “to make a finding as a prerequisite to” the non-suspension of an immediately effective SRO rule filing.” Letter from Elizabeth King, NYSE, to Brent J. Fields, SEC, at 1, n. 2, Nov. 21, 2018, *available at* <https://www.sec.gov/comments/sr-nyse-2018-49/srnyse201849-4670738-176530.pdf>. NYSE inaccurately suggests that the statutory permission granted to the exchanges to have certain types of filings become immediately effective upon filing also separately relieves the Commission of the obligation of the requirement to ensure that those filings are consistent with the Exchange Act. No part of the Exchange Act, including the relevant amendments included pursuant to Section 916 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, so relieves the Commission of this obligation.

<sup>5</sup> 15 U.S.C. § 78f(b)(4).

<sup>6</sup> 15 U.S.C. § 78f(b)(5).

<sup>7</sup> 15 U.S.C. § 78f(b)(8).

<sup>8</sup> 15 U.S.C. § 78f(b)(5).

<sup>9</sup> *Susquehanna Int’l Grp., LLP v. SEC*, 866 F.3d 442 (D.C. Cir. 2017) (“We do not reach them because, as Petitioners also argue, the SEC’s Order approving the Plan fails in a more basic respect: the Commission did not itself “find[]” or “determin[e],” that the Plan met any of those requirements. Instead, the SEC effectively abdicated that responsibility...”)(citations omitted).

exchange filings, including those related to market data,<sup>10</sup> connectivity costs,<sup>11</sup> and trading fees (such as the Cboe Filings).<sup>12</sup>

## Background on Transaction Pricing

Exchanges' transaction prices serve as powerful incentives for brokers and market makers to route orders to particular venues,<sup>13</sup> and have become a powerful tool for exchanges to compete for order flow.<sup>14</sup> The competition based on different transaction

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<sup>10</sup> See, e.g., *Order of Summary Abrogation of the Twenty-Third Charges Amendment to the Second Restatement of the CTA Plan and the Fourteenth Charges Amendment to the Restated CQ Plan*, SEC, Rel. No. 34-83148, May 1, 2018, available at <https://www.sec.gov/rules/sro/nms/2018/34-83148.pdf>; see also *Order of Summary Abrogation of the Forty-Second Amendment to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis*, SEC, Rel. No. 34-83149, May 1, 2018, available at <https://www.sec.gov/rules/sro/nms/2018/34-83149.pdf>.

<sup>11</sup> See, e.g., *Suspension of and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend the Fee Schedule on the BOX Market LLC Options Facility to Establish BOX Connectivity Fees for Participants and Non-Participants Who Connect to the BOX Network*, SEC, Rel. No. 34-84168, Sept. 17, 2018, available at <https://www.sec.gov/rules/sro/box/2018/34-84168.pdf>; see also *Suspension of and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend the Fee Schedule Regarding Connectivity Fees for Members and Non-Members*, SEC, Rel. No. 34-84175, Sept. 17, 2018, available at <https://www.sec.gov/rules/sro/miax/2018/34-84175.pdf>.

<sup>12</sup> We previously objected to similarly unsupported pricing tier filings by the New York Stock Exchange. Letter from Tyler Gellasch, Healthy Markets Association, to Brent J. Fields, SEC, Oct. 12, 2018, available at <https://www.sec.gov/comments/sr-nyse-2018-40/srnyse201840-4510950-175996.pdf>; see also, Letter from Tyler Gellasch, Healthy Markets Association, to Brent J. Fields, SEC, Nov. 13, 2018, available at <https://www.sec.gov/comments/sr-nyse-2018-49/srnyse201849-4640899-176435.pdf>.

<sup>13</sup> We question how this competition based on order routing incentives squares with FINRA's clear statements that brokers should not allow payments for order flow or other incentives to unduly impact brokers' order routing decisions. See, e.g., *Best Execution Guidance on Best Execution Obligations in Equity, Options and Fixed Income Markets*, FINRA, Reg. Notice 15-46, at 6 (2015) ("[F]irms should not allow access fees charged by particular venues to inappropriately affect their routing decisions, and, in general, a firm's routing decisions should not be unduly influenced by a particular venue's fee or rebate structure."), available at [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Notice\\_Regulatory\\_15-46.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-46.pdf); *Accord, 2018 Report on FINRA Examination Findings*, FINRA, at 13, Dec. 2018, available at [https://www.finra.org/sites/default/files/2018\\_exam\\_findings.pdf](https://www.finra.org/sites/default/files/2018_exam_findings.pdf).

<sup>14</sup> We do not believe that the Commission is generally well-equipped to act as a "price controller" in this competition. However, in adopting the 30 cents per 100 shares cap on fees to access a protected quote, the Commission appropriately recognized that it would be detrimental to the markets to, on the one hand, compel market participants to interact with the protected quote, and then not restrict the fees at the venue where that quote is offered. The government mandate to access that quote necessitates the further protections to ensure the reasonability of the fee to access it. Notably, there is no cap on the rebates that venues may pay—even though those rebates facially create conflicts of interest for routing brokers. Nor is there a cap on the fees charged to post liquidity, as the Cboe Filings propose. Further, we do not urge the

pricing has grown and increased dramatically in complexity over the last decade. By one firm estimate there are over 1,023 pricing paths which represent at least 3,762 pricing variables.<sup>15</sup>

But there is also an important side effect of this competition for order flow: the competition between customers of the exchanges. To the extent that different competitors fall into different pricing tiers, it will directly impact the competitive balance between those firms.<sup>16</sup> As a result, exchange pricing not only impacts the competition between venues for execution, but also the competition between brokers and other market participants.<sup>17</sup>

Various pricing tiers also create significant market distortions and complexities. For example, the process through which pricing tiers are assessed is purely retrospective. At the end of the month, all of the trading by a given broker is aggregated and matched against the then-applicable tiers. Rebates and fees are then determined, and checks or invoices sent. However, that pricing tier is not then used for the forward-looking month. Thus, unlike most other “rewards” programs, the benefits are only awarded on decisions previously made, and do not apply to future activity.

Because the determination of what fee or rebate will be assessed to any given trade is not determined until the end of the month, neither brokers nor their customers may know the fee that may be ultimately charged (or rebate paid) for any individual transaction at the times they are making the order routing decisions.

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Commission to simply mandate one pricing tier for each exchange. Rather, to the extent that the Commission permits different pricing models and tiers, we urge the Commission to ensure that the distinctions between customers be transparent, justified, and otherwise consistent with the exchanges’ Exchange Act obligations.

<sup>15</sup> Letter from Rich Steiner, RBC Capital Markets, to Brent J. Fields, SEC, Oct. 16, 2018, *available at* <https://www.sec.gov/comments/s7-05-18/s70518-4527261-176048.pdf>.

<sup>16</sup> Remarks of Joe Wald, Clearpool Group, before the SEC Roundtable on Market Access and Market Data, Oct. 25, 2018, Transcript at 198, *available at* <https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102518-transcript.pdf> (“First, is there a disproportionate impact of the current market data and market access regime on smaller broker-dealers and does this act as a barrier of entry to innovation? From what we have experienced, through the high costs for market data and the complex and opaque tiering structure established by the exchanges for transactional fees, smaller broker-dealers end up subsidizing many of the costs for larger firms.”). *Accord*, Remarks of Tyler Gellasch, Healthy Markets Association, before the SEC Roundtable and Market Access and Market Data, Oct. 26, 2018, Transcript at 280-281, *available at* <https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102618-transcript.pdf>.

<sup>17</sup> Remarks of Joe Wald, CEO of Clearpool, before the SEC Roundtable on Market Access and Market Data, Oct. 25, 2018, Transcript at 198.

This creates significant administrative complexities, but also exacerbates significant conflicts of interest. For example, a broker who is worried about hitting a particular tier level near the end of the month may preference that venue, even if the preferred venue is not likely to offer the best execution for the customer.

This conflicted preferencing behavior may be also more likely to impact smaller or less-sophisticated firms. A broker with a less-sophisticated customer may send orders to a venue so that the firm would reach a certain tier threshold, despite the broker’s awareness that executions on that venue may result in inferior execution outcomes to investors. However, the same broker, if faced with the same order from a more-sophisticated customer, may not. Put simply, the broker may be tempted to engage in more conflicted routing practices based on the perceived likelihood of discovery by its customer.

In recent years, there have been dozens of pricing changes every single month. Simply staying abreast of these changes and seeking to implement them on often less-than-a-day’s notice, poses non-trivial logistical challenges.<sup>18</sup> Despite many obvious questions regarding whether individual pricing tiers (or filings to effectuate them) may meet the Exchange Act’s requirements, the Commission has historically not generally objected.

## Cboe Filings

The Cboe Filings impose several changes, largely related to the fees and rebates that apply for executed orders that have been routed to EDGA.

### **EDGA Filing:**

Fee Code	Fee Per Share to Add	Required Criteria
B	<del>\$0.0008</del> -\$0.0030	Adds Liquidity to EDGA (Tape B)
V	<del>\$0.0008</del> -\$0.0030	Adds Liquidity to EDGA (Tape A)
Y	<del>\$0.0008</del> -\$0.0030	Adds Liquidity to EDGA (Tape C)

<sup>18</sup> That said because market participants are now very frequently asked to adjust their routing practices to reflect pricing tier changes that are immediately effective, we would not expect significant additional technical difficulties or costs associated with the implementation of a transaction fee pilot. Ideally, we would urge the Commission to consider requirements that exchanges and other venues make transparent their costs for a given execution prior to the time of order submission. In other economic circumstances, market participants are not typically asked to engage in a financial transaction but not told the cost until after the fact. Rebates, discounts, and other “incentives” for volume purchases are typically known on or before the time of the transaction. In fact, we can think of no other regular financial transactions in which rebates and discounts are exclusively applied on a retrospective basis.

3	<del>\$0.0008</del> -\$0.0030	Adds Liquidity to EDGA, pre and post market (Tapes A or C)
4	<del>\$0.0008</del> -\$0.0030	Adds Liquidity to EDGA, pre and post market (Tape B)
RP	<del>\$0.0008</del> -\$0.0030	Non-displayed order, adds liquidity using Supplemental Peg
HA	<del>\$0.0008</del> -\$0.0030	Non-displayed order, adds liquidity
DA	<del>\$0.0008</del> -\$0.0030	Adds Liquidity using MidPoint Discretionary order within discretionary range
DM	<del>\$0.0008</del> -\$0.0030	Removes Liquidity using MidPoint Discretionary order not within discretionary range

### EDGA Remove Fee Code Updates

Fee Code	Rebate Per Share to Remove	Required Criteria
N	<del>\$0.0004</del> -\$0.0024	Removes liquidity from EDGA (Tape C)
W	<del>\$0.0004</del> -\$0.0024	Removes liquidity from EDGA (Tape A)
6	<del>\$0.0004</del> -\$0.0024	Removes liquidity from EDGA, pre and post market (All Tapes)
VV	<del>\$0.0004</del> -\$0.0024	Removes Liquidity from EDGA (Tape B)
DR	<del>\$0.0004</del> -\$0.0024	Removes liquidity using MidPoint Discretionary order not within discretionary range

### EDGA Remove Sub Dollar Fee Code Updates

Fee Code	Rebate Per Share to Remove	Required Criteria
HR	<del>.05% of Dollar Value</del> FREE	Non-displayed order, removes liquidity
MT	<del>.05% of Dollar Value</del> FREE	Removes Mid-Point Peg liquidity from EDGA

### EDGA Add Volume Tier Addition

Tier	Rebate Per Share to Remove	Required Criteria
Add Volume Tier 1	\$0.0026	Member has an ADAV $\geq$ 0.10% of the TCV

### EDGA Remove Volume Tier Addition

Tier	Rebate Per Share to Remove	Required Criteria
Remove Volume Tier 1	(\$0.0026)	(1) Member has an ADAV $\geq$ 0.20% of the TCV; and (2) Member has a remove ADV $\geq$ 0.40% of the TCV

**EDGA Route Volume Tier Addition**

Tier	Rebate Per Share to Remove	Required Criteria
Route Tier 1	\$0.0026	Member routes an ADV $\geq$ 3,000,000 shares yielding fee codes RT and RX.

**EDGA RMPT/RMPL Tier Updates**

Tier	Rebate Per Share to Remove	Required Criteria
RMPT/RMPL Tier 1	\$0.0008	Member adds or removes an ADV $\geq$ 2,000,000 shares using routing strategy RMPT or RMPL (i.e., yielding fee codes PA, PL, PT and PX)

**EDGX Filing:**

Fee Code	(Rebate)/Fee per Share to Route	Required Criteria
AA	<del>\$0.0003</del> (\$0.0024)	Routed to EDGA using ALLB routing strategy
I	<del>\$0.0003</del> (\$0.0024)	Routed to EDGA
RA	<del>\$0.0003</del> \$0.0030	Routed to EDGA, adds liquidity
RR	<del>\$0.0003</del> (\$0.0024)	Routed to EDGA using DIRC routing strategy

**BYX Filing:**

Fee Code	(Rebate)/Fee per Share to Route	Required Criteria
AA	<del>\$0.0003</del> (\$0.0024)	Routed to EDGA using ALLB routing strategy
BJ	<del>\$0.0003</del> (\$0.0024)	Routed to EDGA using TRIM or TRIM2 routing strategy
RA	<del>\$0.0003</del> \$0.0030	Routed to EDGA, adds liquidity

**BZX Filing:**

Fee Code	(Rebate)/Fee per Share to Route	Required Criteria
AA	<del>\$0.0003</del> (\$0.0024)	Routed to EDGA using ALLB routing strategy



BJ	<del>\$0.0003</del> (\$0.0024)	Routed to EDGA using TRIM or TRIM2 routing strategy
RA	<del>\$0.0003</del> -\$0.0030	Routed to EDGA, adds liquidity

The Cboe Filings comprise no less than a comprehensive change to how EDGA operates, and the increases in fees and rebates is dramatic. For example, in some instances, the fees increased tenfold.

Because the exchanges filed the changes under Section 19(b)(3)(A) of the Exchange Act and Rule 19b-4(f)(2) thereunder, the proposed rule changes became effective upon filing with the Commission.<sup>19</sup> In the case of the EDGA Filing, these changes were filed with the Commission on November 1, 2018, and became effective that day.<sup>20</sup> In the case of the other three filings, initial filings were made on November 1, 2018 and were immediately effective. Thereafter, those filings were withdrawn and re-submitted to the Commission on November 13, 2018, again becoming effective that day.<sup>21</sup>

Notably, the Cboe Filings are not the first time Cboe has dramatically changed the pricing structure of EDGA. Prior to Cboe’s acquisition of Bats, the exchange had operated for more than a decade as an inverted venue. Then, approximately 18 months before these current filings, in May of 2017, Cboe announced that

Beginning June 1, 2017, a single standard rate of \$0.0003 applies to orders adding displayed liquidity or removing liquidity. Non-displayed orders adding liquidity are free while non-displayed orders removing liquidity are assessed a low fee of \$0.0005. All EDGA participants qualify for these rates, and there are no pricing tiers.<sup>22</sup>

<sup>19</sup> As we have stated before: This truncated process, wherein rules are immediately effective, was enacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act. As one of a very small number of organizations that reads every filing of every exchange each month, we believe that this process has enabled the proliferation of fees and complexity with little SEC oversight. With upwards of 200 SRO filings each month, and remarkably limited SEC staff resources, we have significant questions regarding the staff’s ability to review the filings, identify concerns, and take appropriate action to protect investors and promote fair and efficient markets on a consistent basis. Letter from Tyler Gellasch, Healthy Markets Association, to Brett J. Fields, SEC, at 4 n.15, Sept. 4, 2018, available at <https://www.sec.gov/comments/sr-miax-2018-19/srmiac201819-4300775-173209.pdf>.

<sup>20</sup> EDGA Filing, at 1.

<sup>21</sup> See, e.g., EDGX Filing, at 1.

<sup>22</sup> Press Release, Bats Announces Fee Overhaul of EDGA Equities Exchange, Bats, May 30, 2017, available at [https://cdn.cboe.com/resources/press\\_releases/Bats-EDGA-Reprice-FINAL.pdf](https://cdn.cboe.com/resources/press_releases/Bats-EDGA-Reprice-FINAL.pdf) (“2017 EDGA Press Release”).

In that press release, Cboe stated that it was making the change to “move this discussion closer to a market practice of reduced transaction costs for our clients.”<sup>23</sup> The press release also explicitly acknowledged that the change was driven by customer and regulatory discussions related to fee structures and a potential “access fee pilot.”<sup>24</sup>

Put simply, the exchange converted from an inverted venue with significant pricing tiers to a simple, relatively low-cost venue with dramatically lower conflicts of interest. Despite these changes, EDGA’s years-long decline in market share continued.<sup>25</sup> That said, the decline in market share has very recently reversed itself.<sup>26</sup>

The CBOE Filings effectively abandon this exchange’s attempts to implement a less-conflicted business model. The Cboe Filings do not offer any specific details regarding this significant change in orientation.<sup>27</sup> Interestingly, under the section titled “*Self-Regulatory Organization’s Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change*”, the Cboe Filings offer no actual “statement of purpose.”<sup>28</sup> Instead, they simply state the substance of the changes.

In fact, there is no statement regarding the intention for any of the changes articulated in the filing, other than to say that the new, higher fees are reasonable because they are being used to offset new rebates.<sup>29</sup> The filings never clearly articulate any issues sought to be addressed by any of the proposed changes. It is particularly interesting that EDGA would so dramatically increase fees and rebates now, given that (1) the exchange has recently been gaining market share, and (2) the Commission is widely expected to implement in the very near future a pilot that would go in the opposite direction.

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<sup>23</sup> 2017 EDGA Press Release.

<sup>24</sup> 2017 EDGA Press Release.

<sup>25</sup> Cboe, Market Share Charts, available at [https://markets.cboe.com/us/equities/market\\_statistics/venue/cboeedgausagequitiesexchange/](https://markets.cboe.com/us/equities/market_statistics/venue/cboeedgausagequitiesexchange/) (offering breakdowns by Tape A, Tape B, and Tape C) (last viewed Dec. 4, 2018). Interestingly, the day the change became effective, the exchange enjoyed an increase in market share—overnight. Again, we do not question whether order routing incentives may be effective in attracting order flow. Rather, we question whether these incentives create conflicts of interest that lead to violations of brokers’ best execution obligations. See generally, FINRA Reg. Notice 15-46.

<sup>26</sup> Cboe Market Share Charges.

<sup>27</sup> Notably, in its comment letter on the Transaction Fee Pilot, Cboe argued that reducing rebates to provide liquidity would widen spreads. Letter from Edward Tilly, Cboe to Brent J. Fields, SEC, at 3, May 25, 2018, available at <https://www.sec.gov/comments/s7-05-18/s70518-3718531-162484.pdf>. Was that assessment based on their real-life experiment with EDGA after the 2017 fee changes?

<sup>28</sup> See, e.g., EDGA Filing, at 2.

<sup>29</sup> EDGA Filing, at 7.

## The Cboe Filings Are Inconsistent with the Exchange Act

As described above, the Exchange Act requires, among other items, that an exchange's rules:

- “provide for the equitable allocation of reasonable dues, fees, and other charges;”<sup>30</sup>
- not be “designed to permit unfair discrimination”;<sup>31</sup>
- “not impose any burden on competition not necessary or appropriate in furtherance of the purposes of” the Act;<sup>32</sup> and
- be designed “to protect investors and the public interest.”<sup>33</sup>

Further, as the Commission has recently explained:

Under the Commission's Rules of Practice, the “burden to demonstrate that a proposed rule change is consistent with the [Act] and the rules and regulations issued thereunder . . . is on the [SRO] that proposed the rule change.” The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding, and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Act and the applicable rules and regulations.<sup>34</sup>

The Cboe Filings fails to meet this burden.

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<sup>30</sup> 15 U.S.C. § 78f(b)(4).

<sup>31</sup> 15 U.S.C. § 78f(b)(5).

<sup>32</sup> 15 U.S.C. § 78f(b)(8).

<sup>33</sup> 15 U.S.C. § 78f(b)(5).

<sup>34</sup> *Suspension of and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend the Fee Schedule Regarding Connectivity Fees for Members and Non-Members*, SEC, Rel. No. 34-84175, at 6, Sept. 17, 2018, available at <https://www.sec.gov/rules/sro/miax/2018/34-84175.pdf> (citations omitted).

## Cboe Filings Fail to Offer Sufficient Evidence to Support a Commission Finding That it Provides for an Equitable Allocation of Reasonable Fees, Costs, and Charges or That it is Not Unfairly Discriminatory

By law, the proposed fees must be both (1) reasonable and (2) equitably allocated.<sup>35</sup> The Cboe Filings make little attempt to demonstrate compliance with either mandate. Further, despite the fact that the Cboe Filings expressly discriminate between exchange customers, they make no significant effort to explain why that discrimination is not unfair (much less in the public interest).

### *The Cboe Filings Do Not Establish the Fees Are Reasonable*

We do not know if the changes are reasonable or not, because the Cboe Filings do not contain any information necessary for us to engage in that analysis. The Cboe Filings offer almost no discussion regarding the “reasonability” of the pricing changes or why such a dramatic pricing shift is being implemented.

With respect to its dramatically higher fees for adding displayed and non-displayed liquidity, the EDGA Filing simply argues that the fees are

reasonable because the Exchange must balance the cost of rebates for orders that remove liquidity (and as described above, the Exchange is increasing the rebates provided for orders that remove liquidity).<sup>36</sup>

The exchange then further argues that “the proposed fee is similar to, and in line with, transaction fees assessed on other Exchanges ... and that ... the proposed fee increase applies uniformly to members.”<sup>37</sup>

These conclusory and vague statements are inadequate to establish that the fees and rebates are, in fact, reasonable.

The Cboe Filings raise fees several hundred percent to post liquidity, while offering significant rebates for taking liquidity--with a notice of less than 24 hours. Setting aside the natural discussion of whether a competitive marketplace would normally institute such changes on such short notice, the filings do not offer any discussion as to why these changes are being made.

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<sup>35</sup> 5 U.S.C. § 78f.

<sup>36</sup> EDGA Filing, at 7.

<sup>37</sup> EDGA Filing, at 7.

In fact, the EDGA Filing doesn't argue that the fee increases -- or even the overall changes -- will likely result in increased liquidity on the exchange. Instead, it only notes that:

- The “higher rebate to members [for removing liquidity] ... is designed to further incentivize members to bring additional liquidity to the Exchange, thereby promoting price discovery and enhancing order execution opportunities for members.”<sup>38</sup>
- some proposed exceptions to the new, dramatically higher costs to post liquidity may encourage members to increase their liquidity on the Exchange.<sup>39</sup>

For example, the EDGA Filing conclusorily declares that

the increased rebate for Displayed orders that remove liquidity is reasonable, equitable and not unfairly discriminatory because it provides a higher rebate to members and is designed to further incentivize members to bring additional liquidity to the Exchange.<sup>40</sup>

Similarly, the EDGA Filing asserts that the EDGA Route Add and Remove Volume Tier changes are

reasonable because it provides members an opportunity to receive a reduced fee or enhanced rebate, depending on the Tier. The Exchange additionally notes that volume-based discounts have been widely adopted by exchanges and are equitable and nondiscriminatory because they are open to all members on an equal basis and provide additional benefits or discounts that are reasonably related to (i) the value of an exchange's market quality; (ii) associated with higher levels of market activity, such as higher levels of liquidity provision and/or growth patterns; and (iii) introduction of higher volumes of orders into the price and volume discovery processes.<sup>41</sup>

We have several concerns.

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<sup>38</sup> EDGA Filing, at 7.

<sup>39</sup> EDGA Filing, at 5.

<sup>40</sup> EDGA Filing, at 7.

<sup>41</sup> EDGA Filing, at 8-9.

First, the Cboe Filings suggest that other exchanges have similar volume tiers with similar requirements.<sup>42</sup> We disagree. In fact, as a result of the changes implemented by the CBOE Filings, EDGA now pays the highest rebate of any exchange to remove liquidity.<sup>43</sup>

Second, we disagree with the unstated assumption that any incentive (or disincentive) is “reasonable” or “equitable” if it applies to all members. Offering new disincentives and incentives are not *de facto* -- regardless of size or form -- reasonable. If the exchange were to offer \$100 million cash payments each month to its top 5 customers, the “incentive” would be present, but the payments would clearly not be “reasonable.”<sup>44</sup> Even more so if the \$100 million came at the expense of the smallest firms. In such a case, it would be unreasonable, inequitable, unfairly discriminatory, and a burden on competition--any one of which would be disqualifying.

Third, we disagree with the unstated assumption that any incentive (or disincentive) is “reasonable” if the issue it intends to address is a laudable one. We agree with efforts to promote liquidity. But that does not justify any means with which to do that. The goal must be reasonable, and the means through which that goal is achieved must be reasonable. At a minimum, the exchange should be able to establish that the means selected could reasonably be expected to achieve that goal. None of that is provided in the Cboe Filings.

Lastly, while not articulated in the Cboe Filings, we note that representatives from some exchanges have recently urged the Commission and market participants to focus on firms’ “all-in” trading costs as a way to assess the appropriateness and reasonability of the various exchanges’ fees.<sup>45</sup> At the same time, the exchanges have declined to

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<sup>42</sup> Notably, EDGA claims the proposed fees are similar and inline with transaction fees assessed on other exchanges citing to NYSE ARCA equities. EDGA Filing, at 7, n. 14. We are puzzled by this comparison, given that NYSE ARCA is not an inverted venue, and so the incentives offered are the opposite of the incentives discussed here.

<sup>43</sup> It appears as though the changes to EDGA pricing are a response to the pricing model of NYSE National, which has generally paid a rebate of 0.0020 per share since earlier this year.

<sup>44</sup> See generally, Remarks of Chris Concannon, Cboe Global Markets, before the SEC Roundtable on Market Access and Market Data, Oct. 25, 2018, Transcript at 74-75, *available at* <https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102518-transcript.pdf>.

<sup>45</sup> See, e.g., Remarks of Stacey Cunningham, New York Stock Exchange Group, before the SEC Roundtable on Market Access and Market Data, Oct. 25, 2018, Transcript at 34, *available at* <https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102518-transcript.pdf> (“The value and importance of market data and connectivity has evolved and it has increased, based on the competition that was introduced with regulations, namely Reg NMS. That competition has benefitted investors and brought costs down, as Chris just detailed, but it’s introduced fragmentation, dramatic fragmentation. It is unsurprising that, in a fragmented world, that variable costs come down and fixed costs have gone up. But the overall, all-in cost to trade on the New York Stock Exchange has come down. When I say the all-in cost to trade, that includes transaction fees, market data

provide the information with which to engage in the analysis needed to determine if that “all-in” cost is reasonable, equitably allocated, not an undue burden on competition, or unfairly discriminatory. For example, to engage in that analysis, we would think the Commission and market participants would need to see from the exchanges sufficient information to perform an analysis of cost per shares traded (both inclusive and exclusive of market data and connectivity fees), based on volumes of orders sent, shares executed, firm size, and firm type. Currently, we are not aware of either the Commission or the public having any of that information. The Cboe Filings offer none of that information.

The exchange is dramatically increasing the costs of firms who provide liquidity on less than a full day’s notice. There may be some very persuasive arguments for why such a structure may attract order flow, including studies that suggest overall execution quality may be better for some customers on inverted pricing venues than on traditional maker/taker venues. But the exchange declines to show why it has determined that taxing the provision of liquidity and paying those who take liquidity will lead to increased liquidity. Nor has it made any arguments regarding the levels it has chosen. Unfortunately, the Cboe Filings offer no discussion of why Cboe believes that increasing fees to post liquidity by several hundred percent will attract more liquidity.<sup>46</sup>

The Cboe Filings don’t offer any information with which the Commission could conclude that the fees are reasonable. Accordingly, because the Cboe Filings fail to establish that the changes provide for an equitable allocation of reasonable fees, costs, and charges, the Commission should suspend the filing and initiate proceedings to disapprove them.

### *The Cboe Filings Do Not Establish That the Fees are Equitably Allocated Or That Discrimination Is Fair*

The Cboe Filings that “the proposed changes are equitable and not unfairly discriminatory because they apply equally to all members.”<sup>47</sup> We are puzzled as to how adding an incentive that may benefit one firm or a small subset of firms<sup>48</sup> is somehow “equitable” for all firms and not unfairly discriminatory. While the fee schedule may apply to all members, the actual impact of those fees is facially inequitable. Under the exchange’s logic, it would be “equitable” and “non-discriminatory” for the exchanges to provide free trading for its largest three volume customers, if the volume thresholds

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fees, colocation fees, port fees and all of the connectivity fees. That all-in cost to trade, while it’s a different mix of revenues than it was before, it has come down.”).

<sup>46</sup> Ultimately, we question whether the new pricing schedule (which is nearly the opposite of EDGA’s May 2017 price changes) is being instituted now as little more than an attempt to front-run a potential moratorium on pricing changes in the likely upcoming pilot.

<sup>47</sup> EDGA Filing, at 7.

<sup>48</sup> Again, we have to assume this, because the Cboe Filings do not provide the Commission or public with sufficient information regarding to the nature or number of firms to which the pricing is likely to apply.

applied for all members. Of course, smaller firms would be forced to continue paying to trade, while larger firms would not. And so the smaller firms would be effectively subsidizing the largest firms. Further, this would effectively exclude smaller firms from the opportunity to effectively compete on price, leading to greater market consolidation and weaker markets. Such a fee would be facially inequitable, discriminatory, an unnecessary barrier to competition, and contrary to fair and open markets. It would be unquestionably contrary to the Exchange Act.

By definition, the pricing changes proposed (and implemented) by the Cboe Filings discriminate between customers who meet the articulated criteria and those who do not. Unfortunately, the filings do not offer any explanation for making the distinctions. We do not know whether this distinction between customers is appropriate or not. We do know, however, that favored firms will receive more beneficial pricing than disfavored firms. There is also no information or disclosed logic on how they arrived at the requirements for the various tiers. The filing does not explain which, how many, or the nature of the firms that meet the qualifications. The Cboe Filings do not explain why those firms selected as “deserving” the preferential treatment. Other than saying the changes will serve as incentives for qualifying firms, the Cboe Filings do not explain what impact, if any, the changes will have on quote behavior by market participants, trading activity on the exchange, execution quality, or overall market quality. This is particularly troubling given the significance of the changes.

For example, what is the justification for the ADAV requirement of at least .10% of TCV for the EDGA Add Volume Tier 1 and a .20% ADAV of the TCV coupled with a remove ADV of .40% of the TCV? Why were those numbers selected? What will be the impact on qualifying market participants? What is the impact on the firms that do not qualify? What will be the impact on the order and trading activity on the exchange?

We struggle to understand how the Commission could reasonably find that the changes provide for “reasonable” fees that are “equitably” allocated when the Commission has not been provided with any information about the magnitude of the fees, the impacted parties, or the allocation of the fees across the different customers of the exchange. Further, while the fees are facially discriminatory, the Cboe Filings offer no details as to who receives them and who doesn’t, what the impact is on each group, or why the favored firms are given the preferential pricing.

How can the Commission conclude a fee is not unfairly discriminatory when it has no understanding of who is impacted, what the impact is, or why the discrimination is being made? Accordingly, because the Cboe Filings fail to establish that the changes provide for an equitable allocation of reasonable fees, costs, and charges, and that the discrimination provided by is not unfair, the Commission should suspend the filing and initiate proceedings to disapprove them.



## The Cboe Filings Impose a Burden on Competition That is Not Necessary or Appropriate, and Impose Impediments to the Free and Open Market System

The Cboe Filings correctly note that Cboe competes with other trading venues for order flow, but offers no clear explanation of how its changes impact that competition.

But perhaps more importantly, the Cboe Filing entirely ignores the impact of its pricing changes on the competition between its customers. The Exchange Act's mandate is not just limited to protecting against undue burdens on competition for order flow. The Exchange Act also protects against exchanges' rules acting as undue burdens on competition between brokers, data providers, investment advisers, proprietary trading firms, and other market participants. The EDGA Filing conclusively explains

[T]he Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. Particularly, the proposed rates and rebates would apply uniformly to all members, and members may opt to disfavor the Exchange's pricing if they believe that alternatives offer them better value.<sup>49</sup>

This blanket statement is little more than an unsupported assertion that it doesn't "believe" the filing will impose any burden on competition. Unfortunately, the Cboe Filings offer no details relevant to assessing the burden on competition posed by the changes on market participants, such as:

- the number and types of firms impacted by each change;
- the dollars involved in each change;
- how each change is expected to impact order routing behavior in qualitative or quantitative terms;
- how each change is expected to impact trading (including execution quality) in qualitative or quantitative terms;
- How each change may impact the competition between exchange customers; and
- Overall market quality.

Cboe would have the Commission ignore its responsibility to ensure that the exchange's rules do not unfairly discriminate or burden competition between member firms.

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<sup>49</sup> EDGA Filing, at 10.

The filings appear to offer no particular boundary regarding what is permitted, versus impermissible, fee discrimination or burden on competition. For example, what if one broker was able to negotiate an outrageous subsidy of 1 penny per share for all trades? Or perhaps more realistically, what if an exchange granted a proprietary trading firm with a senior executive that was personally close to an exchange executive a unique, highly-beneficial set of rates? This arrangement would plainly fail to meet the Exchange Act's requirements. It would clearly pose an undue burden on competition between the proprietary trading firm with the pricing advantage and all of its competitors. It would be facially unfair discrimination against all but the favored firm. And it would be facially inequitable. In another example, suppose Cboe were to propose a pricing tier schedule whereby it would offer free trading to each of its top 10 volume traders. Wouldn't this be "unfair discrimination" against smaller firms, who would still have to pay the fees? Wouldn't this be an "undue burden" on competition against the member firms?

Rather than simply stating its belief that the proposed fee changes won't impact competition, the exchange offers no analysis or data with which to assess the impact of any of the proposed changes on the competition between its customers--much less conclude that the changes are not an undue burden on competition. Yet, it must. That is what the Exchange Act requires. Because the Cboe Filings have not established that the fees and limits they impose do not unduly burden competition and unfairly discriminate between different exchange participants, they should be disapproved.

## Conclusion

The Cboe Filings are just another example of the recent proliferation of massive fee filing changes--almost none of which provide sufficient details to permit the Commission to find that the proposals are consistent with the Exchange Act. Accordingly, we urge the Commission to, for this and all similar filings, take any appropriate actions to pause and carefully review the filings for their compliance with the law. In particular, we urge the Commission to consider allowing for modifications that are only prospective in nature. Thank you for the opportunity to highlight our concerns contained within the NYSE Filing. Should you have any questions or seek further information please contact Chris Nagy at [REDACTED] or me at [REDACTED].

Sincerely,



Tyler Gellasch  
Executive Director