



1401 H Street, NW, Washington, DC 20005-2148, USA  
202/326-5800 www.ici.org

February 25, 2016

Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549

Re: *Regulation of NMS Stock Alternative Trading Systems (File Number S7-23-15)*

Dear Mr. Fields:

The Investment Company Institute (“ICI”)<sup>1</sup> appreciates the opportunity to comment on the proposed rules of the Securities and Exchange Commission (“SEC” or “Commission”) on the regulation of alternative trading systems (“ATSs”) that offer trading in NMS stocks (“NMS Stock ATSs”).<sup>2</sup> As significant users of NMS Stock ATSs, our members have a compelling interest in ensuring that regulations governing these important trading venues promote competition, transparency, liquidity, and price discovery. Consistent with that goal, we strongly support the Commission’s proposal to require all NMS Stock ATSs to make standardized and comprehensive disclosures on new Form ATS-N. We commend the Commission for undertaking this initiative, which we believe will greatly improve the functioning of the U.S. equity markets and enhance funds’ ability to provide long-term benefits to their shareholders.

Part I of our letter provides background about the challenges that funds currently face when evaluating ATSs and expresses our support for the Commission’s proposal to reform Regulation ATS. Part II explains how proposed Form ATS-N would allow investors to assess the conflicts of interest that arise as a result of the relationship between an NMS Stock ATS and the broker-dealer that operates the ATS and its affiliates (collectively, “broker-dealer operators”). In this section, we recommend several

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<sup>1</sup> ICI is a leading, global association of regulated funds, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s U.S. fund members manage total assets of \$17.6 trillion and serve more than 90 million U.S. shareholders.

<sup>2</sup> *Regulation of NMS Stock Alternative Trading Systems*, Securities Exchange Act Release No. 76474 (November 18, 2015), 80 FR 80998 (December 28, 2015) (“Release”).

ways that the Commission could tailor these disclosures to provide more useful information to market participants. Part III focuses on the proposed disclosures on Form ATS-N that relate to the operations of an NMS Stock ATS. We believe these disclosures would greatly improve funds' access to critical information about these trading venues. Part IV lays out our views on other aspects of the Release and encourages the Commission to do more to increase transparency in the equity markets. We encourage the Commission to make public Form ATS filings for all ATSs and urge the Commission, following implementation of the ATS reforms, to monitor whether broker-dealers shift their order routing practices away from ATSs in favor of internalization to avoid the enhanced Regulation ATS disclosure regime.

## **I. Background and Need for Reform of Regulation ATS**

The proliferation of NMS Stock ATSs has greatly changed the landscape of the equity markets since the Commission adopted Regulation ATS in 1998.<sup>3</sup> Today, NMS Stock ATSs comprise a critical piece of equity market infrastructure. Approximately three dozen NMS Stock ATSs account for more than 15 percent of the total dollar volume in NMS stocks.<sup>4</sup> Although national securities exchanges still execute a large portion of NMS stock transactions, their market share has decreased measurably while the market share of NMS Stock ATSs has increased.<sup>5</sup>

NMS Stock ATSs compete with national securities exchanges by offering features not readily available on most exchanges. NMS Stock ATSs offer market participants a range of trading models that exchanges typically do not provide, such as auctions and block crossing mechanisms. Some of these trading models enable market participants to obtain executions on NMS Stock ATSs at prices better than the national best bid and offer displayed on the national securities exchanges. Certain NMS Stock ATSs allow funds some control over counterparty selection. All of these features of NMS Stock ATSs facilitate the trading of stocks in large volumes by enabling funds and other market participants to transact while keeping at least some of their trading interest confidential. This protects fund orders, to

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<sup>3</sup> See *Regulation of Exchanges and Alternative Trading Systems*, Securities Exchange Act Release No. 40760 (Dec. 8, 1998), 63 FR 70844 (December 22, 1998). Regulation ATS provides an exception from regulation as a national securities exchange for trading venues that operate pursuant to its terms. Absent this exception, a trading venue that satisfies the definition of "exchange" in Section 3(a)(1) of the Securities Exchange Act of 1934 generally must register with the SEC pursuant to Sections 5 and 6 of that statute. Under Regulation ATS, each ATS must register as a broker-dealer and notify the Commission of its intent to operate by filing Form ATS and disclosing to the SEC specified information about its subscribers, certain of its policies and procedures, and the operation of its trading system. Each ATS must update this information as required by SEC rules and must file a report summarizing its activity each quarter.

<sup>4</sup> See Release at 81109 (citing data from the second quarter of 2015). We understand that there are as many as 93 ATSs—counting NMS Stock ATSs and other ATSs—registered with the SEC although not all of them are operational. John D'Antona Jr., *More ATS Fragmentation and Consolidation Seen in 2016 But How?* (Jan. 25, 2016).

<sup>5</sup> See James Angel, Lawrence Harris, and Chester Spatt, *Equity Trading in the 21<sup>st</sup> Century: An Update* (Jun. 21, 2013), available at <http://www.q-group.org/wp-content/uploads/2014/01/Equity-Trading-in-the-21st-Century-An-Update-FINAL.pdf>.

a certain extent, from market participants that would seek to profit from knowledge of a fund's trading intentions or strategies. Protecting confidential trading information reduces fund trading costs and provides greater returns to their investors.<sup>6</sup>

NMS Stock ATSs also pose unique challenges for funds because these important trading venues typically disclose little information to the public. Regulation ATS permits NMS Stock ATSs to operate in a far less transparent manner than national securities exchanges because it deems confidential all information reported on Form ATS, amendments to the form, and ATS quarterly reports. Consequently, many NMS Stock ATSs do not disclose even basic information about their operations, fee schedules, or the potential conflicts of interest that might arise as a result of the activities of their broker-dealer operators.

In contrast to Regulation ATS, the Commission's rules governing the registration and operation of national securities exchanges promote transparency by requiring all national securities exchanges to disclose extensive information about their activities to both the Commission and the public. The uneven regulatory landscape between NMS Stock ATSs and exchanges may have been appropriate when the Commission adopted Regulation ATS, but it now constrains funds' ability to assess fully the relative merits of these functionally similar trading venues.

We strongly support the SEC adopting the proposal, which would provide market participants with substantially more information about NMS Stock ATSs. The new rules would significantly enhance the understanding of funds and other market participants of the potential conflicts of interest that may arise as a result of the other business activities of the broker-dealer operators of these trading venues. The new rules also would provide funds basic information about how these venues operate, including the treatment of different subscribers and subscriber orders on an ATS. The transparency that would result from making Form ATS-N filings available publicly would provide a valuable tool for funds to use to assess NMS Stock ATSs, make informed routing decisions, and evaluate the performance of their brokers.<sup>7</sup> Absent regulatory action, market participants will continue to have difficulty obtaining this critical information and certain market participants, especially smaller funds, might not be able to obtain this information at all.

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<sup>6</sup> We have expressed related concerns about front running and disclosure about investment strategy in the context of holdings reports to the Commission. See Letter from David W. Blass, General Counsel, Investment Company Institute, to Brent J. Fields, Secretary, Securities and Exchange Commission, dated August 11, 2015, *available at* <http://www.sec.gov/comments/s7-08-15/s70815-315.pdf>.

<sup>7</sup> Proposed Rule 304(b). We similarly support the Commission's proposal to make public all filed amendments to a Form ATS-N. As the Commission observes in the Release, having access to current information regarding changes to the operation of an NMS Stock ATS and its relationship with its broker dealer operator would ensure that funds learn of these changes in a timely manner and assist funds in optimizing routing decisions and evaluating the NMS Stock ATS as a trading venue on an ongoing basis. See Release at 81035.

## **II. Proposed Form ATS-N would Allow Investors to Assess the Conflicts of Interests of NMS Stock ATSs and Their Broker-Dealer Operators**

The current lack of transparency regarding ATSs complicates funds' efforts to assess the conflicts of interest that may arise in connection with executing orders on a particular NMS Stock ATS. The broker-dealer operator of an NMS Stock ATS, for example, may conduct other brokerage or dealing activities that compete with the NMS Stock ATS for order flow. The NMS Stock ATS or its broker-dealer operator also might have business arrangements with other trading venues or broker-dealers that could result in the sharing of subscriber orders, or information about these orders, outside the ATS. These potential conflicts of interest have become increasingly common, as highlighted by recent SEC enforcement actions.<sup>8</sup>

Form ATS-N would assure disclosure of potential conflicts of interest by requiring each NMS Stock ATS to provide extensive information concerning its broker-dealer operator and the activities of the broker-dealer operator in connection with the NMS Stock ATS.<sup>9</sup> Disclosures regarding conflicts of interest will help funds determine, among other things, whether aspects of an NMS Stock ATS make fund orders or trading strategies vulnerable to information leakage. It also would require an NMS Stock ATS to explain the range of services offered by its broker-dealer operator and disclose to its subscribers whether these services are available on a non-discriminatory basis. Collectively, these disclosures would improve the ability of funds and their managers to determine whether a particular NMS Stock ATS provides a fair market for their orders and the information provided by these disclosures would empower funds to make more informed routing decisions and evaluate routing decisions made by their brokers. Accordingly, we urge the Commission to adopt these disclosures as proposed, subject to the minor changes described below.

### **A. NMS Stock ATSs Should Disclose Business Practices and Arrangements That Pose a High Risk of Information Leakage**

To establish or liquidate an equity position, a fund generally will either trade a single block or execute numerous smaller trades over a period of time. In either case, if another market participant learns that a fund plans to trade a particular stock, it can profit from this information at the expense of the fund. NMS Stock ATSs have helped funds shield their trading strategies from other market participants by providing a means for funds to transact without announcing the full extent of their intentions. In some cases, however, information about a fund's trading strategy can leak from an NMS Stock ATS to its broker-dealer operator, another trading venue, or other market participants.

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<sup>8</sup> See Release at 81042, n. 374.

<sup>9</sup> See Part III of proposed Form ATS-N.

Regulation ATS does not presently require NMS Stock ATSs to disclose potential sources of information leakage, leaving funds and other investors with few means to assess this risk or guard against it. Part III of proposed Form ATS-N would address this shortcoming in Regulation ATS. If adopted, NMS Stock ATSs would be required to disclose business arrangements and other key information that could lead to information leakage.<sup>10</sup>

ICI fully supports the proposed disclosures, which generally would provide funds with enough information to evaluate the potential for information leakage or, at a minimum, provide sufficient indications for funds to request further information from a particular ATS. To enhance the benefit of this type of disclosure to funds and other market participants, we suggest four modifications to the Commission's proposal.

First, we believe the Commission should narrow the scope of shared employees for whom information must be disclosed to those who may have access to or knowledge of confidential subscriber information or orders. The Commission generally should target the proposed disclosures to help investors understand the potential for information leakage, which would provide more meaningful information.<sup>11</sup> The disclosures contemplated by the proposal could encompass any shared employee, including those who do not have knowledge of or access to confidential information and therefore pose no risk of information leakage. If the Commission adopts Form ATS-N as proposed funds and other market participants will need to devote resources to determine which employees actually could pose risks of information leakage or raise conflict of interest concerns. Our recommended approach would improve the quality of information provided to the Commission and market participants by focusing on employees whose roles and responsibilities make them potential sources of information leakage or raise conflict of interest concerns.

Second, we recommend that the Commission ensure that the required disclosures regarding shared employees provide meaningful narrative information about the role and duties of each covered employee, both at the NMS Stock ATS and the other business unit or affiliate of the broker-dealer operator. The disclosure should allow a fund to assess the scope of the information that the employee might obtain and how the employee could obtain or use the information. This disclosure is critical to the ability of a fund to evaluate the possibility of information leakage. In addition, to better equip

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<sup>10</sup> See Proposed Items 1, 2, and 4 of Part III of Form ATS-N. Specifically, the form would require each NMS Stock ATS to disclose any relationship or arrangements between its broker-dealer operator and trading centers other than the NMS Stock ATS. The form would further require an NMS Stock ATS to disclose any trading activities of its broker-dealer operator, whether its broker-dealer operator uses a smart order router to send or receive subscriber orders to and from the NMS Stock ATS, whether the NMS Stock ATS shares employees with other business units or affiliates of the broker-dealer operator and whether any services or functions of the NMS Stock ATS are performed by vendors. See Proposed Items 5, 6, 7 and 8 of Part III of Form ATS-N. Responses to proposed Item 10 in Part III of Form ATS-N would allow funds to assess whether an NMS Stock ATS has taken adequate measures to ensure the confidentiality of their trading information.

<sup>11</sup> In addition to the disclosure about shared employees, the Commission could consider further tailoring the disclosures concerning "affiliates" of the broker-dealer operator.

funds and other market participants to assess the role and expertise of covered shared employees, we recommend that an NMS Stock ATS also disclose whether any shared employees are registered with the SEC or the Financial Industry Regulatory Authority and whether they hold one or more securities licenses. Other information, such as the title or position of a shared employee, would provide little benefit to funds because titles change frequently, lack standard meaning across firms and generally convey insufficient information to assess thoroughly the risk of information leakage.

Third, the Commission should clarify that the proposed disclosures about service providers to NMS Stock ATSs do not encompass information about vendors that provide administrative services to the ATS.<sup>12</sup> The Release states that the Commission does not intend that the proposed disclosures would extend to operations, services, or functions that are “administrative in nature and do not pose a significant risk of information leakage of confidential trading information, such as payroll functions servicing employees of the NMS Stock ATS or email services provided by an outside provider,” because the Commission believes these disclosures would not be relevant to market participants’ evaluation of an NMS Stock ATS as a trading venue and would not be necessary for the Commission’s oversight functions.<sup>13</sup> We agree. We therefore recommend that the Commission amend the language of Item 8 in Part III of Form ATS-N to make this intent clear.

Fourth, we request that the Commission add an item to Part III of proposed Form ATS-N to require disclosure of any proceeding within the last 10 years against the NMS Stock ATS, the broker-dealer operator or officers or employees of the broker-dealer operator that relates to the handling of equity orders or the operation of the NMS Stock ATS.<sup>14</sup> The Release details numerous occurrences where broker-dealer operators of NMS Stock ATSs admitted to engaging in unlawful conduct relating to the handling of subscriber orders or the operation of the NMS Stock ATS.<sup>15</sup> Subscribers and potential subscribers to an NMS Stock ATS could find past or pending proceedings material in determining whether or not to transact on a trading venue and these matters should be disclosed on Form ATS-N along with other material information about the NMS Stock ATS and its broker-dealer operator.

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<sup>12</sup> See Proposed Item 8 of Part III of Form ATS-N.

<sup>13</sup> See *id.* at 81056.

<sup>14</sup> We believe the Commission could, for purposes of Form ATS-N, use the same definition of “proceeding” as on Form BD. This form defines “proceeding to include “a formal administrative or civil action initiated by a governmental agency, self-regulatory organization or a foreign financial regulatory authority; a felony criminal indictment or information (or equivalent formal charge); or a misdemeanor criminal information (or equivalent formal charge).” A “proceeding” does not include “other civil litigation, investigations, or arrests or similar charges effected in the absence of a formal criminal indictment or information (or equivalent formal charge).”

<sup>15</sup> See Release at 81042, n. 374.

**B. NMS Stock ATs Should Disclose Information About the Products and Services Offered by Their Broker-Dealer Operators and Whether They Are Provided on a Non-Discriminatory Basis**

Proposed Form ATS-N also would improve funds' ability to understand all functionality offered by a broker-dealer operator and evaluate whether the broker-dealer operator makes its services available in a fair and impartial manner.<sup>16</sup> These disclosures could, for example, reveal that a broker-dealer operator makes certain functionality available only to non-fund subscribers. The disclosures also could assist funds in understanding any algorithmic trading strategies offered by the broker-dealer operator and assess whether certain subscribers can receive favorable treatment within the ATS if they purchase other services or products from the broker-dealer operator. All of these factors would affect funds' assessment of an NMS Stock ATS as a potential execution venue, and we urge the Commission to adopt the disclosures as proposed.

**III. Proposed Disclosures Relating to the Operations of NMS Stock ATs Are Critical to Funds to Assess Trading Venues**

Funds consider a range of information when determining whether and how to use a trading venue, including the types of subscribers who participate in the venue, the types of orders permitted and how these order types interact, the services provided by the venue, and the fees charged to subscribers. Unfortunately, this information is not widely available for NMS Stock ATs because Regulation ATS does not require its disclosure. As a result, funds typically receive only information they request from broker-dealer operators—who may or may not supply the requested information—and have difficulty assessing the accuracy or completeness of the information provided. The disclosures in Part IV of Form ATS-N would ensure that all market participants, including funds and brokers that route orders on behalf of funds, have access to fundamental information regarding the order interaction and matching and execution methodology of each NMS Stock ATS. The proposal also would end the practice, followed by some ATs, of disclosing select functionality—including the existence of certain order types—only to favored subscribers.<sup>17</sup> Funds could use these disclosures to provide long term benefits to their shareholders by optimizing order routing practices.

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<sup>16</sup> Specifically, proposed Item 3 of Part III of Form ATS-N would require an NMS Stock ATS to disclose information about the products or services offered to subscribers by its broker-dealer operator. The item also would require identification of the type of subscribers (e.g., retail, institutional, professional) to which the products and services are offered. If the broker-dealer operator makes its products or services available to different subscribers on different terms, the form would require a description of the differences. Proposed Item 9 would require disclosure of whether the NMS Stock ATS makes services or functionality available to its broker-dealer operator but not to any subscriber of the NMS Stock ATS.

<sup>17</sup> See *In the Matter of UBS Securities LLC*, Securities Exchange Act Release No. 74060 (January 15, 2015), available at <http://www.sec.gov/litigation/admin/2015/33-9697.pdf> (finding that the owner and operator of an ATS made selective and misleading disclosures to market participants, particularly institutional investors, regarding order types offered by the ATS).

We therefore fully support the disclosures in Part IV of proposed Form ATS-N, subject to four enhancements. First, the Commission should require disclosure of whether a single ATS subscriber, or an affiliated group of ATS subscribers, accounts for more than a specified percentage of the order flow or trading volume in the NMS Stock ATS. Second, the Commission should specify in Form ATS-N that an NMS Stock ATS must disclose whether it identifies customer orders of broker dealers as customer orders. Third, the Commission should require disclosure of any anti-gaming technology employed by an NMS Stock ATS. Fourth, the Commission should require disclosure of all sources of revenue generated by an NMS Stock ATS. We elaborate on each suggestion below and explain the benefit of this additional information to funds and their shareholders.

#### **A. NMS Stock ATSs Should Disclose the Existence of Any High-Volume Subscribers**

The Commission should require disclosure of information concerning the types of participants that use an NMS Stock ATS to enable funds to assess more fully the quality of the order flow on that ATS and determine whether and how to participate in the venue. Proposed Form ATS-N would require an NMS Stock ATS to disclose information concerning its subscribers, including the criteria used to determine subscriber eligibility, terms and conditions of use, types of subscribers, arrangements with liquidity providers and the circumstances under which the NMS Stock ATS can limit or deny access to its services.<sup>18</sup> Funds and other market participants would find this information valuable because it would facilitate the efficient comparison of eligibility processes and requirements across all NMS Stock ATSs and describe the types of participants that may dominate order flow on a particular NMS Stock ATS.

The Commission could further enhance the utility of this disclosure by requiring an NMS Stock ATS also to disclose whether any single subscriber (or group of affiliated subscribers) participates in a significant percentage of the transactions on the NMS Stock ATS, either by number or volume.<sup>19</sup> The presence of one or more subscribers that participates in a large portion of the transactions on an NMS Stock ATS could raise concerns for other subscribers and also could reveal material information regarding the quality of order flow to the NMS Stock ATS. A disclosure apprising market participants of the existence of such subscribers would enable funds to conduct further diligence about the nature of the high-volume subscribers and the policies and procedures the NMS Stock ATS has adopted to assure a fair market. Funds could use this information to inform their decisions about how to trade on a particular NMS Stock ATS or to avoid executing on the ATS entirely if it deemed the risks posed by these subscribers to be too substantial.

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<sup>18</sup> Proposed Item 1 of Part IV of Form ATS-N.

<sup>19</sup> We urge the Commission to set the threshold for high-volume subscribers between 5 and 10 percent. Subscribers that participate in less than 5 percent of transactions on an NMS Stock ATS may not be engaged in significant enough amount of transactions to affect the quality of order flow the trading venue, and funds and other investors may find information about these subscribers less useful. In contrast, subscribers that participate in 10 percent or more of the transactions would be meaningful and failing to identify such subscribers would certainly deprive funds and other investors of critical information regarding about the market quality of the relevant venue.



## **B. NMS Stock ATs Should Disclose the Marking of Customer Orders**

The Commission should require NMS Stock ATs that engage in order segmentation—i.e., the classification of orders according to the type of subscriber that submits the order—to disclose this information. NMS Stock ATs that segment order flow may allow subscribers to choose whether or not to interact with orders submitted by particular “segments” of subscribers. This practice enables some market participants to elect to interact with buy-side order flow for the purpose of discovering fund trading strategies to attempt to trade ahead of the fund. When successful, these trading techniques harm fund shareholders by causing funds to receive worse executions on their orders.

The Commission proposes to require NMS Stock ATs to alert subscribers to any segmentation of orders or other trading interest on the NMS Stock ATS.<sup>20</sup> We support this proposal because it would inform funds of the possibility of order segmentation and allow funds to determine whether to avoid trading with certain types of market participants. We understand that certain NMS Stock ATs indicate whether an order submitted by a broker-dealer represents a proprietary order or a customer order and believe that this designation would constitute a form of segmentation addressed by the proposal. We request that the Commission specifically require the disclosure of this type of segmentation in Form ATS-N.<sup>21</sup> Funds and other buy-side market participants should know whether an NMS Stock ATS identifies customer orders that are submitted by a broker-dealer because trading systems that disclose the origin of a particular order can contribute to information leakage and adverse selection of fund orders.

## **C. NMS Stock ATs Should Disclose the Use of Anti-Gaming Technology**

The Commission should require an NMS Stock ATS to disclose whether it employs technology designed to detect and deter price manipulation and other disruptive trading practices. The existence of this anti-gaming technology can increase market confidence, particularly for market participants that transact in large volumes, such as funds, because it shows that a trading venue is committed to providing a fair and competitive market. Nevertheless, funds currently have no mechanism to receive standardized information regarding anti-gaming technology or to compare anti-gaming technologies across different ATs. We believe the Commission should modify proposed Form

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<sup>20</sup> See Proposed Item 5 of Part IV of Form ATS-N. An NMS Stock ATS that engages in order flow segmentation would be required to describe the segmentation categories, the criteria used to segment these categories and the procedures for determining, evaluating and changing segmented categories. The NMS Stock ATS further would be required to state whether it notifies subscribers or persons about the segmentation category to which a subscriber or person is assigned and describe any means and the circumstances by which a subscriber or the broker-dealer operator may designate an order or trading interest submitted to the NMS Stock ATS to interact or not to interact with specific orders, trading interest or persons on the NMS Stock ATS.

<sup>21</sup> We note that the Release acknowledges that some NMS Stock ATs segment order flow by source, including looking to “the underlying source of...trading interest in the case of trading interest that is intermediated.” See Release at 81070.

ATS-N to require an NMS Stock ATS to disclose whether or not it employs anti-gaming technology and, if so, to include a description of this technology in the form.

#### **D. NMS Stock ATSs Should Disclose All Sources of Revenue**

The Commission should require NMS Stock ATSs to provide complete information about their sources of revenue. The proposed rules would require disclosure of an NMS Stock ATS's fees, rebates and other charges, but NMS Stock ATSs may generate revenue in other ways, including through arrangements the ATS may have with other trading centers.<sup>22</sup> Funds and other market participants would use these disclosures to evaluate the potential for information leakage attendant to routing orders to a particular NMS Stock ATS or whether these arrangements may disadvantage subscribers of the ATS, including funds.

The proposal also would require an NMS Stock ATS to provide the range (e.g., high and low) of any fees, rebates or other charges levied by the ATS. If the fees, rebates or other charges of the NMS Stock ATS are not the same for all subscribers and persons, the NMS Stock ATS would be required to describe any differences.<sup>23</sup> We support this proposed disclosure and recommend that the Commission further require that any description of a differential fee structure contain enough information for a market participant to understand exactly which fees/rebates/charges—or level of fees/rebates/charges—apply to each type of subscriber or other person and the criteria that the NMS Stock ATS uses to sort subscribers into different fee categories. The description should include information sufficient to allow market participants to assess eligibility requirements for different fee tiers. The Commission also should require an NMS Stock ATS to explain whether it discriminates among different types of subscribers in establishing fees, rebates or other charges.

#### **IV. The Commission Should Do More to Promote Transparency**

Although we agree with the Commission's proposal to limit the application of Form ATS-N to NMS Stock ATSs, we believe the Commission can and should require additional transparency for all ATSs. We also support the proposal to require all ATSs to adopt written safeguards and written procedures to protect confidential trading information. Finally, should the Commission adopt the rule changes contemplated by the Release, we urge the Commission to surveil equity markets for any unintended consequences of the proposal, including increased internalization by broker-dealers. The

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<sup>22</sup> Part III of proposed Form ATS would require disclosure of the existence of arrangements between an NMS Stock ATS or its broker-dealer operator and a competing trading venue. *See* note 10 *supra*. NMS Stock ATSs also could earn revenue in a variety of other means, including by selling data generated by their operations, offering colocation services and charging market participants to use certain protocols to connect to the ATS. The Commission should clarify that the proposed disclosures would encompass these and other charges of the NMS Stock ATS.

<sup>23</sup> Proposed Item 12 of Part IV of Form ATS-N.

Commission should commit to address promptly unintended consequences to prevent any deterioration in market transparency.

#### **A. Only NMS Stock ATSs Should File Form ATS-N**

ICI supports the Commission's proposal to require only NMS Stock ATSs to file Form ATS-N at this time and to permit other types of ATSs to continue to operate pursuant to their current Forms ATS. As the Commission notes in its Release, a high level of automation characterizes U.S. equity markets. Routing networks generally connect equity trading centers to one another, orders execute at rapid speeds, and market participants use myriad order types to affect their trading strategies. Other securities markets, such as the corporate fixed income markets, have a very different market structure with a lower level of interconnectivity and automation. The extensive disclosures required by Form ATS-N might not be appropriate for other securities markets at this point in their development, and we believe that the Commission should carefully study these other markets before proceeding with an enhanced disclosure regime for ATSs that offer trading exclusively in securities other than NMS stocks.

We believe, however, that the Commission should improve transparency into the operations of non-NMS Stock ATSs by providing for public disclosure on the Commission's website of all effective Forms ATS, amendments to Forms ATS, and cessation of operations reports for all ATSs.<sup>24</sup> Providing public disclosure in this manner would impose little or no additional direct cost on non-NMS Stock ATSs while providing funds and other market participants with certain basic information that they could use to evaluate non-NMS Stock ATSs as potential trading venues. For example, the disclosures on Form ATS would provide funds with important information regarding the methods used by an ATS to match buyers and sellers of fixed income securities and whether these methods disadvantage funds or other market participants. The information on amendments to Forms ATS would keep funds and other market participants apprised of changes to the functionality of a non-NMS Stock ATS. Consistent with the Commission's rationale for proposing to make public all amendments to Forms ATS-N, funds and other market participants would use current information regarding changes to the operation of a non-NMS Stock to optimize routing decisions and evaluate the ATS as a trading venue on an ongoing basis.

#### **B. ATSs Should Implement Written Safeguards and Written Procedures to Protect Confidential Trading Information**

We support the Commission's proposal to require every ATS to have in place written safeguards and procedures to protect subscribers' confidential trading information and to separate ATS functions from other broker-dealer functions. As the Commission notes in the Release, Regulation ATS currently requires each ATS to have safeguards and procedures addressing these important

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<sup>24</sup>To apply the transparency requirements of the rule to all ATSs, the Commission should modify proposed Rule 304(b).

matters.<sup>25</sup> The proposed rule would merely require ATs to reduce to writing these existing safeguards and procedures. Requiring all ATs to document in writing these safeguards and procedures will strengthen their effectiveness and enhance the ability of funds, other market participants, and the Commission to evaluate how ATs treat confidential trading information.

### **C. The Commission Should Commit to Addressing Unintended Consequences of the Proposal to Ensure that Funds Benefit from Increased Transparency**

We commend the Commission for recognizing that funds and other investors might not recognize the full benefits of the proposed rules if broker-dealers avoid providing the additional disclosure contemplated by the proposal by closing NMS Stock ATs.<sup>26</sup> We urge the Commission not to allow broker-dealers to circumvent market transparency by internalizing more investor orders. To ensure that funds and other investors benefit from the proposal, as intended, we recommend that the Commission commit to monitor the equity markets and to take further action as necessary to address any diminution in transparency or market quality that may arise if broker-dealers alter their order routing practices to internalize orders in lieu of complying with the amendments to Regulation ATs.<sup>27</sup>

One way to mitigate harms associated with internalization would be to require broker-dealers to provide more information about their internalization practices. In that regard, ICI, together with other trade associations for the securities industry, has recommended that the Commission adopt a rule that would require broker-dealers to provide to institutional investors at regular intervals certain standardized disclosure regarding order routing and execution quality information.<sup>28</sup> We continue to

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<sup>25</sup> See Rule 301(b)(10) of Regulation ATs.

<sup>26</sup> See Release at 81127. The costs imposed by the proposed disclosure requirements could make operating an NMS Stock ATs less attractive than internalizing customer order flow. In addition to providing a disincentive for broker-dealers to continue operating existing ATs, the disclosure requirements in the proposal may be more of a hurdle for creating new ATs.

<sup>27</sup> Internalization also may raise conflicts between broker-dealers and their customers by incenting broker-dealers to execute customer orders at displayed quotations rather than routing orders to another trading center. This practice may maximize the profits of the broker-dealer but harms customers by assuring their orders receive no price improvement. Other characteristics of poor market quality, such as wider spreads (quoted, effective and realized), higher price impact per trade, and increased volatility of trades on registered national securities exchanges also can accompany internalization. See Release at 81117 (citing a working paper by Daniel G. Weaver).

<sup>28</sup> See Letter from Dorothy M. Donhue, Deputy General Counsel, ICI, Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, and Randy Snook, Executive Vice President, Securities Industry and Financial Markets Association, to Mary Jo White, Chair, SEC, dated October 23, 2014, *available at* <https://www.ici.org/pdf/28480.pdf>. Funds presently receive a range of information from their brokers regarding the routing of their equity market orders, the potential conflicts of interest brokers face and the execution quality provided by different brokers and trading venues. These reports, however, are not presented in a uniform manner that allows for easy comparison across different brokers.

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believe that such a rule would improve funds' ability to assess execution quality and urge the Commission to propose the rule as quickly as possible. The Commission could provide greater transparency of internalization practices in a rule on order handling by requiring broker-dealers to make various qualitative disclosures about their use of internalization with respect to fund orders. These disclosures should include, at a minimum, information concerning the policies and procedures that a broker-dealer has implemented with respect to internalization and the mechanisms that the broker dealer uses to provide best execution to institutional investor orders.

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ICI appreciates the opportunity to provide our views on the Commission's proposed regulation of NMS Stock ATs. Given the role that NMS Stock ATs now play in the equity markets, the time has come for these ATs to assume responsibilities commensurate with their position in these markets and provide funds and other investors with meaningful transparency about their venues. We believe the proposal would increase transparency in the equity markets and provide funds and other investors with important tools to assess trading venues and evaluate the quality of the executions they receive. If you have any questions on our comment letter, please feel free to contact the undersigned at (202) 326-5815 or david.blass@ici.org, Jennifer Choi, Associate General Counsel, at (202) 326-5876 or jennifer.choi@ici.org, or George Gilbert, Counsel, at (202) 326-5810 or george.gilbert@ici.org.

Sincerely,

/s/ David W. Blass

David W. Blass  
General Counsel

cc: The Honorable Mary Jo White  
The Honorable Kara M. Stein  
The Honorable Michael S. Piwowar

Stephen Luparello, Director, Division of Trading and Markets  
Gary Goldsholle, Deputy Director, Division of Trading and Markets  
David Shillman, Associate Director, Division of Trading and Markets