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

Re: Volume-Based Transaction Pricing for NMS Stocks, File No. S7-18-23, Release No. 34-98766

Dear Ms. Countryman:

Although Nasdaq, Inc. ("Nasdaq") embraces the prospect of change in the structure of the U.S. equity markets, we believe that change should be justifiable and prudent – particularly if it stands to upend practices that are woven deeply into the fabric of the markets. As a steward of the markets and all who depend upon them, we cannot support proposals, such as this one,[1] which would place the markets and investors at needless and significant risk. Our objections to the Proposal include the following:

- **The Proposal rests upon three false premises about volume-based pricing**:
    - First, the SEC's supposition is inaccurate that volume-based pricing inhibits small- and medium-sized brokers from competing with larger brokers for orders. In fact, volume-based pricing is not a meaningful factor in determining the competitive positions of brokers and banning it may actually harm small- and medium-sized brokers. Competition among broker depends principally upon factors that are extrinsic to exchanges and their fee model. Indeed, the SEC should address these extrinsic factors directly rather than doing so indirectly by upending established exchange business models.
    - Second, the SEC presents no evidence to support its premise that volume-based pricing unduly influences broker routing decisions. It also fails to account for its ability, both now and through other pending reform proposals, to effectively manage conflicts of interest by enforcing the duty of best execution.
    - Third, the SEC asserts that volume-based pricing inhibits small exchanges from competing with large ones, but inter-exchange competition is fierce and has never been more so – with 16 exchanges and counting. Exchanges also compete with dark pools, single-dealer platforms, and central risk books, which together consume over 40% of equities volume.
- **Notwithstanding the SEC's abrupt and unexplained reversal of position on volume-based pricing, it is a model that is rational, pro-consumer, and pro-competition.** Volume-based pricing is ubiquitous in this and countless other industries around the world. Moreover, it is a pricing model that the national securities exchanges have employed for decades, and which is reflected in hundreds

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[1] See Securities Exchange Act Release No. 34-98766 (October 18, 2023), 88 FR 76282 (Nov. 6, 2023) (the "Proposal").

of fee filings to which the SEC either expressly or tacitly assented, without controversy, until now. Exchange pricing practices are similar to how a shopping mall operator leases space to anchor tenants, like department stores, at a lower price per square foot than it does to smaller retailers. Such a discount is fair because anchor tenants do more to attract shoppers to a mall than do small retailers, while small retailers also benefit from the extra foot traffic that anchor tenants provide. Another apt analogy is that the Proposal is akin to banning a social media application from incenting its most prolific and trendy content creators to upload videos, even though it depends upon such content to become and remain popular. People are not apt to use an app en masse to view a smattering of amateur-produced first birthday party videos, but they will do so to view a library of videos produced by their favorite celebrities and influencers. Likewise, brokers are not apt to send orders to trading venues that have shallow pools of low-quality liquidity, but they will do so to venues with deep, broad, and high-quality liquidity. Volume-based discounts and rebates enhance exchanges by helping them to attract and sustain the types and levels of liquidity they need to be successful.

- **The SEC fails to demonstrate that the Proposal is rational.** The Proposal lacks analysis and weighting of the costs and benefits it identifies – steps that are needed to establish that the Proposal is reasonable. At best, the SEC projects only meager and speculative benefits from the Proposal, but it acknowledges that the Proposal would not be effective in solving its concerns and may leave brokers worse off than they are now. Indeed, it may force small- and medium-sized brokers that currently rely upon arrangements with larger brokers to access better pricing and technology infrastructure to pay higher exchange fees and to build this technology themselves. The Proposal also identifies a litany of serious harms, including the potential for it to accelerate the erosion of lit liquidity, thereby undermining the National Best Bid and Offer ("NBBO"), widening spreads, and raising investor costs. Given that the SEC itself has recognized an imperative to reverse existing trends that erode lit markets and the integrity of the NBBO, a proposal that would exacerbate these trends is irrational.
- **The Proposal is arbitrary and capricious under the Administrative Procedures Act.**[2] The Proposal fails to account for off-exchange markets, where volume-based pricing exists now and would continue unaffected by this Proposal. If adopted, the Proposal would thus unfairly discriminate against exchanges in favor of off-exchange markets. Moreover, the Proposal ignores its interplay with the SEC's other pending equity market structure proposals, several of which seek to address the same problems that the SEC identifies. Uncertainty about whether or in what form the SEC will adopt these other proposals makes it impossible to evaluate this Proposal properly.
- **The Exchange Act[3] does not authorize the SEC to make rules that proscribe exchange pricing models or fix their fees.** It only authorizes the SEC to make rules that do not burden competition. While the Proposal purports to promote competition among brokers and exchanges, it would do so by harming competition among exchanges and non-exchanges – a result that violates the Act.
- **Finally, the SEC's proposed alternatives to the Proposal would be no less problematic or any more effective.** Broadening the ban on volume-based pricing to include principal orders in addition to agency and riskless principal orders would only exacerbate the extent to which the ban would harm markets and investors. Even an alternative that requires only added transparency about volume-based pricing would offer nothing more than potentially misleading information about the design of tiers.

For these reasons and those that follow, Nasdaq opposes the Proposal and recommends that the Commission withdraw it from consideration.

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[2] Administrative Procedures Act, 5 U.S.C. § 551 et seq. (the "APA").

[3] Securities Exchange Act of 1934, 15 U.S.C. § 78a et seq. (the "Act").

I. The Premises of this Proposal are Fundamentally Flawed

Above all else, this Proposal is flawed because it is based upon three unfounded premises: (1) volume-based pricing inhibits the ability of small- and medium-sized brokers to compete for business with larger-sized brokers; (2) volume-based pricing exacerbates conflicts-of-interest inherent in exchange pricing models based upon the provision of fee discounts and rebates; and (3) volume-based pricing tied to participation in closing auctions inhibits competition among exchanges.

The Proposal is devoid of evidence to support these premises.[4] Its discussions of the problems it identifies with volume-based pricing are theoretical and speculative. It is replete with discussions of what harms "might" or "can" happen because of volume-based pricing,[5] but it fails to demonstrate that volume-based pricing is actually causing such harms today. It also fails to quantify such harms or assess their significance relative to other contributory and mitigating factors that it acknowledges exist.

Much of what the SEC posits about the competitive impacts of volume-based pricing is based, not on its own rigorous economic analysis, but rather upon bald assertions made in just two questionable documents – one, a letter from a trade association that supports its arguments mainly with the prior statements of its own CEO, and the other, a blog post from a mostly-dark exchange that has a strong commercial self-interest in attacking the business model of incumbent exchanges.[6] The APA demands

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[4] Another unsubstantiated premise is that concentration among brokers is harmful. Although Nasdaq agrees that the, all else equal, presence of more brokers in the markets would be desirable, we disagree that the mere fact of a decrease in the number of brokers over time is evidence of a problem – let alone a problem that is appropriate for the SEC to address by regulating the behavior of exchanges, rather than that of brokers themselves. Markets can be competitive even with a small number of participants; the competitiveness of a market is also a function of the nature of participants themselves, the context in which they operate, and their behavior. Even if a small number of brokers have become dominant, and a gulf has emerged between the capabilities of the largest and smallest brokers, why are those facts harmful to investors if the scale and resources of large brokers make them better able to serve investors' needs? Moreover, to the extent that disparities among broker do threaten investor welfare, why is it fair to place the burden on exchanges to solve this problem? The SEC fails to consider these questions, much less answer them.

[5] See Proposed Rule at 76284 ("… lower-volume members may find it difficult to compete for customer order flow ..."); id. at 76285 (stating concern that "exchanges' tiered transaction pricing may confer an inappropriate benefit on a small group of members to the detriment of other members ..."); id. at 76300 ("Volume-based pricing tiers thereby generate the potential for exchange members to concentrate customer order flow onto particular exchanges in order to increase the likelihood of tier qualification possibly contrary to the interests of individual customers."); id. at 76285 ("… [W]hen a primary listing exchange bases pricing in its closing auction on the volume that a member executes on the exchange during regular trading hours, members that prefer (or whose customers prefer) the primary listing exchange's closing auction are incentivized to route orders to the exchange during the regular hours trading session in order to obtain more favorable pricing in the closing auction, which could negatively affect the ability of other exchanges to compete for that volume during regular trading hours."); id. at 76314 ("When the dominance of high-volume brokers becomes sufficiently heightened, it is conceivable that dominant broker dealers may eventually choose to exercise market power more aggressively.") (emphasis added to all).

[6] See Proposal (citing Letter from T. Gellasch, President and CEO of Healthy Markets Association to G. Gensler, dated Nov. 22, 2022, available at https://healthymarkets.org/wp-content/uploads/2022/12/HMA-Ltr-re-Volume-Based-Pricing-11-16-22-1.pdf; John Ramsey, Chief Market Policy Officer, Investor Exchange, "Why Exchange Rebate Tiers are Anti-Competitive," June 27, 2023, at

that the SEC have a more substantial basis than this for engaging in rulemaking. At a minimum, it must act rationally, including by identifying the existence of a genuine problem that it intends the rule to solve.[7] Harms must be real, rather than merely speculative.[8]

> a. *Volume-based pricing is not a meaningful factor in determining the competitive positions of brokers and banning it may leave brokers worse off than they are now.*

Contrary to the SEC's assertion, brokers do not compete primarily based upon differences in their respective access to volume-based exchange transaction fee and rebate tiers. A review of broker advertising collateral reveals that large brokers do not publicly tout their access to better or the best volume-based exchange pricing tiers as a principal selling point to potential customers. Instead, these materials demonstrate that brokers compete for investor business primarily based on a wide array of other factors, including access to better technology (e.g., systems, algorithms, connectivity, routing), prime brokerage services, investment product access and selection, availability and quality of research, ancillary product offerings, accessibility, customer service, commission rates, brand reputation and prestige.

Likewise, the SEC fails to demonstrate that volume-based pricing has a meaningful impact on other aspects of the competitiveness of small- and medium-sized brokers, such as their profitability or their ability to invest in new capabilities or in growing their businesses. If anything, the Proposal suggests that high back-office and technology costs are more significant barriers to broker competition, and that the equalization of exchange transaction pricing among brokers would do little if anything to overcome those barriers. Staff expressly acknowledged as much during questioning at the Open Meeting preceding the issuance of the Proposal.[9] Indeed, small- and medium-sized brokers enter into direct market access agreements ("DMAs") with larger brokers for the primary purpose of attaining access to back office, technology, and connectivity solutions that they cannot afford to create and operate themselves. Small and medium brokers will continue to depend upon DMAs to compete if the SEC adopts this Proposal.

Small- and medium-sized brokers also use DMAs to attain access to better pricing tiers, a benefit that the Proposal imperils. Indeed, the SEC itself acknowledges that they may end up worse off under the

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https://www.iex.io/article/why-exchange-rebate-tiers-are-anti-competitive) ("IEX Blog"). IEX volume is 68% non-displayed. See https://iextrading.com/stats/.

[7] See e.g. Chamber of Commerce v. SEC, 2023 U.S. App. LEXIS 28881 (5th Cir. Oct. 31, 2023) (agreeing with petitioner that rule was arbitrary and capricious because the SEC never substantiated the threshold proposition that there was problem to be solved by regulation).

[8] Cf. N.Y. Stock Exch. LLC v. SEC, 962 F.3d 554, 567 (D.C. Cir. 2021) ("Notably absent from the record is any assessment by the Commission of whether it believes the fee structure or its effects—including any uncertainty, confusion, or lack of market confidence the cap may have engendered—are actually harming investors.") (concurring).

[9] See SEC Open Meeting, Oct. 18, 2023, available at https://www.youtube.com/watch?v=iA279gQ0tMw (in response to a question from Commissioner Peirce as to whether the Staff anticipates that the Proposal will reverse an observed trend in broker concentration, Trading & Markets Director Haoxiang Zhu replied that "we don't want to say that this rulemaking by itself would reverse this meta-trend, but our hope is that it will slow down the concentration of broker-dealer services").

Proposal than they are now. [10] That is, even if the Proposal results in the elimination of relative differences among brokers in transaction fee rates, it may result in small- and medium-priced brokers facing a flat rate that is higher than it is now in absolute terms, or higher than what small- and medium-sized brokers are able to achieve now through DMAs. [11] Moreover, because the Proposal would make DMAs less lucrative for larger brokers, larger brokers may compensate for lost revenues by charging higher fees to their DMA customers, by limiting their investments in the technologies and other services that they provide to DMA customers, or by discontinuing such services altogether. [12]

b. Volume-based pricing does not unduly influence broker routing decisions.

Another underlying fallacy is that volume-based pricing exacerbates conflicts of interest facing brokers when they make order routing decisions, and that it unduly entices them to route orders to "maker-taker" exchanges that charge the lowest fees or pay the highest rebates.

As a threshold matter, the SEC fails to demonstrate that the maker-taker model itself creates harmful conflicts-of-interest,[13] that volume-based pricing exacerbates such conflicts, or that such conflicts – even as exacerbated – are significant enough to override other considerations. As Nasdaq noted in its letter commenting on the Commission's pending proposal to slash the exchange access fee cap[14] (which the Commission proposes on similar grounds), the Commission attempted to conduct a pilot program four years ago for the express purpose of determining whether access fees and rebates are distortive and require further regulation.[15] It did so because it acknowledged that it "currently lacks the data necessary to meaningfully analyze the impact that exchange transaction fee-and-rebate pricing models have on order

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[10] See Proposal at 76319 ("some sponsored traders may face higher net fees, compared to a setting where (1) the sponsored traders benefit from being the customers of top- tiered broker-dealers and (2) incorporating orders from sponsored traders reinforces the broker-dealers' ability to achieve higher rebates. The proposed ban on volume-based tiers may have a particularly adverse effect on the smaller traders that use these arrangements.").

[11] See id. ("To the extent that average exchange pricing on agency-related orders become more expensive than the previous top-tier pricing, investors and any intermediating broker-dealers who previously benefitted from the high- volume broker-dealers' passing through the volume-based exchange transaction pricing may be worse off.").

[12] As we explain below, even if the SEC were correct that exchanges' volume-based pricing model harms inter-broker competition, the Proposal is arbitrary and capricious in that it fails to account for the fact that this same pricing model is prevalent among off-exchange market centers that account for almost half of all trading and which would not be subject to this Proposal.

[13] The financial system is rife with conflicts. The mere fact that a conflict of interest exists does not mean that it is harmful, per se, or that it is harmful to such an extent that it is reasonable to ban it. Moreover, even if the Commission's concerns about this conflict were well-founded, such concerns are readily addressable through existing means, such as enforcement of best execution obligations, such that there is no need to resort to the extreme step of prohibiting an established business model.

[14] See Securities Exchange Act Release No. 34-96494 (Dec. 14, 2022), 87 FR 80266 (Dec. 29, 2022) (the "NMS Proposal").

[15] See Letter from J. Zecca to V. Countryman, dated March 30, 2023, available at https://www.sec.gov/comments/s7-31-22/s73122-20162299-331153.pdf.

routing behavior, market and execution quality, and our market structure generally."[16] The D.C. Circuit invalidated this proposal to regulate rebates because the Commission failed to establish them as problematic. Indeed, as the Court stated in its opinion: "unless an agency's authorizing statute says otherwise, an agency regulation must be designed to address identified problems."[17] Here, the SEC has not substantiated that rebates pose a problem that warrants a regulatory solution.

Even if the SEC had demonstrated that exchange fees and rebates present harmful conflicts of interest for brokers, it never even attempts to weigh the purported harmful effects of such purported conflicts against the benefits of rebates.[18] It takes an unreasonably narrow view of rebates that emphasizes only their potential negative effects,[19] while ignoring the market-wide benefits of rebates that, in Nasdaq's view and as explained below, more than offset such theoretical costs.[20] Because the SEC has failed to consider the benefits of rebates and the harm that would flow from eliminating, or drastically reducing, rebates, it has failed to satisfy its obligation under the Act as well as the APA.[21] Where the SEC "duck[s] [a] serious evaluation of the costs" imposed by a rule, it acts arbitrarily and capriciously.[22]

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16 See id. (quoting Securities Exchange Act Release No. 34-84875 (Dec. 19, 2018), 84 FR 5202, at 5203 (Feb. 20, 2019)).

17 See N.Y. Stock Exch., 962 F.3d at 546 ("Nothing in the Commission's rulemaking authority authorizes it to promulgate a "one-off" regulation like Rule 610T merely to secure information that might indicate to the SEC whether there is a problem worthy of regulation.").

18 Agency action is arbitrary and capricious if, for example, an agency "entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) (emphasis added). An agency is required to "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." Id. (quoting Burlington Truck Lines v. United States, 371 U.S. 156, 168 (1962)) (internal quotation marks omitted); Md. People's Counsel v. FERC, 761 F.2d 768, 779 (D.C. Cir. 1985) (an agency's failure to show that "more good than harm will come of its action" is arbitrary and capricious).

19 The SEC argues that rebates are harmful to the extent that they provide for lower-volume members to subsidize the activities of higher-volume members. See Proposal at 76284. However, rebates are not subsidies. Rather, they are payments that reflect the economic value of the contributions to market quality that high-volume members provide to an exchange.

20 In the NMS Proposal, the SEC acknowledges arguments that rebates are beneficial to the markets. See NMS Proposal at 80288 ("Conversely, others argue that the maker-taker model may have positive effects by enabling exchanges to compete with non-exchange trading centers and by narrowing quoted spreads by subsidizing posted prices. Specifically, maker-taker fees may narrow displayed spreads in some securities insofar as the liquidity rebate effectively subsidizes the prices of displayed liquidity by allowing a maker to post a more aggressive price than it may have in absence of a rebate. In turn, that displayed liquidity may establish the NBBO, which is often used as the benchmark for marketable order flow, including retail order flow, that is executed off-exchange by either matching or improving upon those prices.") (citations omitted). However, the SEC does little to grapple with these benefits.

21 Section 3(f) of the Act obligates the SEC to "apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation." 15 U.S.C. § 78c(f).

22 Bus. Roundtable v. SEC, 647 F.3d 1144, 1152 (D.C. Cir. 2011).

Just as the SEC assumed in the NMS Proposal, without basis, that exchange fees and rebates are harmful, and that their harms outweigh their benefits, so does it assume here that volume-based pricing exacerbates these same harms and that this effect outweighs the benefits of the practice. Indeed, the SEC merely speculates that volume-based pricing "may" incentivize members to route orders to certain exchanges to meet their tier qualification requirements, and that this incentive "may be particularly enticing" for members,[23] but it does nothing to demonstrate that these incentives are strong enough to – and actually do – override other factors that brokers consider when they determine where to route orders.

Indeed, other factors weigh heavily on broker routing decisions, including the various measures of execution quality, such as fill rates, depth, time to execution, and time at the NBBO, among others.

The SEC also acknowledges that regulatory guardrails exist that can temper conflicts-of-interest,[24] including both the broker's duty to obtain best executions for their customers and Rule 611 of Regulation NMS,[25] which prohibits brokers from trading through protected quotations. Again, however, the SEC fails to analyze the impacts of these countervailing considerations and guardrails on its thesis. It fails to demonstrate that volume-based pricing incentives are so irresistible to brokers that these guardrails are inadequate and result in broker actions that are inconsistent with the best interests of investors.

This analytical deficiency in the Proposal is egregious in light of the fact that the Commission separately proposes to adopt a new Rule Best Execution.[26] Among other things, the Best Ex Proposal would require market participants that accept fee discounts and rebates provided by exchanges to establish and implement "heightened" policies and procedures to ensure that investors receive best executions notwithstanding their receipt of fee discounts and rebates.[27] The Commission should explain why its Best Ex Proposal would be insufficient to address the purportedly harmful conflicts that maker-taker and volume-based pricing present, such that this Proposal is warranted.

Likewise, the Commission should account for the impact of its other proposal to reduce the access fee cap to levels that are intended to render rebates and fee discounts insignificant (and the harmful conflicts that they purportedly cause).[28] Furthermore, it should account for its pending proposal to

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[23] See Proposal at 76288 ("Specifically, volume-based pricing may incentivize members to route customer order flow to certain exchanges for the purpose of meeting tier qualification, which has the potential to be costly to customers if it comes at the expense of execution quality. Moreover, this incentive may be particularly enticing for members …."). The SEC again relies solely on the Healthy Markets Association letter to support this concern, but that letter, in turn, is itself entirely speculative on this point. See id.

[24] See id. at 76311 ("There are forces in the market for equity brokerage services that serve to limit the extent to which this conflict of interest can alter behavior. For example, because of the Order Protection Rule, a broker-dealer looking to concentrate order flow on a particular exchange could not do so if doing so resulted in trading through the NBBO.").

[25] See 17 C.F.R. § 242.611.

[26] See Securities Exchange Act Release No. 34-96496 (Dec. 14, 2022), 88 FR 5440 (Jan. 27, 2023) (the "Best Execution Proposal" or "Best Ex Proposal").

[27] See id.

[28] See NMS Proposal at 80303 (stating that one of the Commission's aims in reducing the access fee cap is to "lower the total amount of access fees collected and rebates distributed, reducing, though not eliminating, any distortionary effects of exchange rebates on order routing and likely improving market efficiency.").

enhance the transparency of exchange fee schedules by requiring fees and rebates to be determinable at the time of order execution, rather than at the end of each month – a proposal which the SEC intends to facilitate the pass-through of fees and rebates to customers as a means of mitigating conflicts-of-interest.[29]

Of course, the Commission cannot account for the impacts of any of these other pending proposals because it has yet to determine whether or in what form to adopt them. Thus, this Proposal is premature as its issuance prior to adoption of the other proposals deprives the public of an opportunity to provide meaningful comments. It also renders inadequate the SEC's baseline for its economic analysis of the Proposal. At the very least, logic dictates that the SEC should wait to see whether an enhanced duty of best execution, or other proposals the SEC has put forth, will address the Commission's concerns before taking the additional steps that this Proposal contemplates.

c. Volume-based pricing does not inhibit inter-exchange competition.

The third faulty premise upon which this Proposal is based is that primary listing exchanges like Nasdaq engage in anti-competitive behavior when tying qualifications for certain volume-based pricing tiers to participation in closing auctions.

The SEC's own analysis once again undercuts its assertion that auction-based pricing inhibits competition among exchanges. The SEC acknowledge that "there is a lack of consensus within the economic literature on the anti-competitive potential of offering price discounts for allocating a target purchasing level in a bundled goods context."[30] In particular, the research the SEC cites finds that the "use of [full-line forcing] in this context is unlikely to have large anticompetitive effects."[31] Furthermore, the research states that "even focusing solely on foreclosure can yield ambiguous results on how tying affects social welfare"[32] and that "the impact of this exclusion on welfare is uncertain."[33] Some of the research even shows that such price discounts "can increase total surplus and the buyer's surplus,"[34] meaning it enhances consumer welfare.

The SEC's premise also is belied by the fact that the equity markets now include 16 exchanges – a number that has grown by 4 venues just since 2016 (IEX, MEMX, MIAX Pearl, and LTSE) and which stands to continue growing in the future. If the competitive environment for non-listing exchanges was as

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[29] See NMS Proposal at 80329-30 ("Access fees create potential conflicts of interest. Passing on fees and rebates to end customers could eliminate such distortions and lead to improved overall order execution for end customers."). In the NMS Proposal, the SEC solicited public comment on the question of whether volume-based discounts and tiered fee structures affect routing decisions, present conflicts of interest, or burden competition. See id. at 80293. If this Proposal is an outgrowth of those comments, then the SEC should account for the comments that led it to reach a conclusion on this question.

[30] See Proposal at 76305.

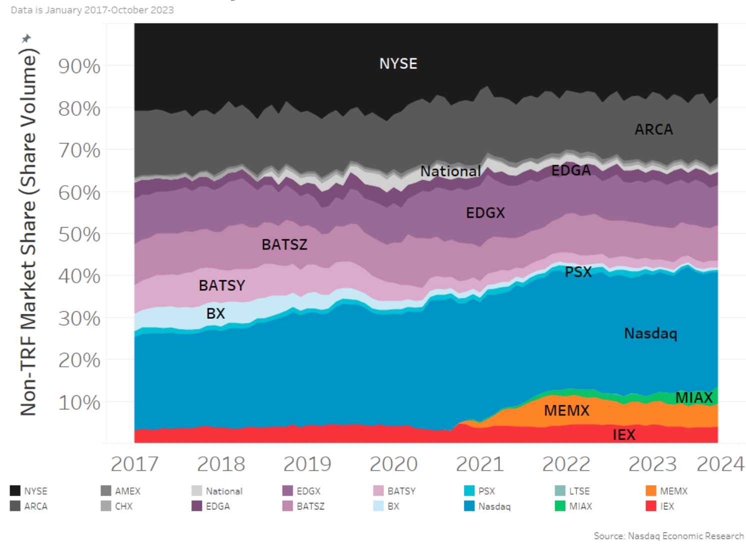
[31] See Katherine Ho, Justin Ho, & Julie Holland Mortimer, "The Use of Full-Line Forcing Contracts in the Video Rental Industry," 102 AM. ECON. REV. 686 (2012).

[32] See Dennis W. Carlton and Michael Waldman, "The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries," 33 RAND J. ECON. 194 (Summer 2002).

[33] See Michael D. Whinston, "Tying, Foreclosure, and Exclusion," 80 AM. ECON. REV. 837 (Sept. 1990).

[34] See Yong Chao, Guofu Tan, and Adam Chi Leung Wong, "All-Units Discounts as a Partial Foreclosure Device," 49 RAND J. ECON. 155 (2018).

prohibitive as the SEC suggests, then it would not see this steady drumbeat of new entrants – especially when firms can choose to organize themselves in other ways.[35] Indeed, since 2016, new exchange entrants have won 13.5% of non-TRF market share (based on share volumes) from incumbent exchanges – including from exchanges like NYSE, BATSY, and BX, all of which offer volume-based pricing.[36]



Not only have new exchange entrants been able to win market share – despite the existence of volume-based pricing – but they have been able to do so at a profit. If the incumbent exchanges had the market power the SEC asserts, new entrants would be unable to profitably take market share. However, IEX's net income has always been positive and has quintupled since 2017.

Moreover, the courts recognize that competition among exchanges is robust. In 2010, the D.C. Circuit stated that "[n] one disputes that competition for order flow is 'fierce.' … As the SEC explained, '[i]n the U.S. national market system, buyers and sellers of securities, and the broker-dealers that act as their order-routing agents, have a wide range of choices of where to route orders for execution'; [and] 'no exchange can afford to take its market share percentages for granted' because 'no exchange possesses a monopoly, regulatory or otherwise, in the execution of order flow from broker dealers'. . . .''[37]

As to auction-based pricing itself, many factors are far more important than auction-based pricing in determining exchange competitiveness. These factors include technological capabilities and

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[35] U.S. exchanges also compete with other markets around the world in both equities and other asset classes where regulatory disparities impact such competition.

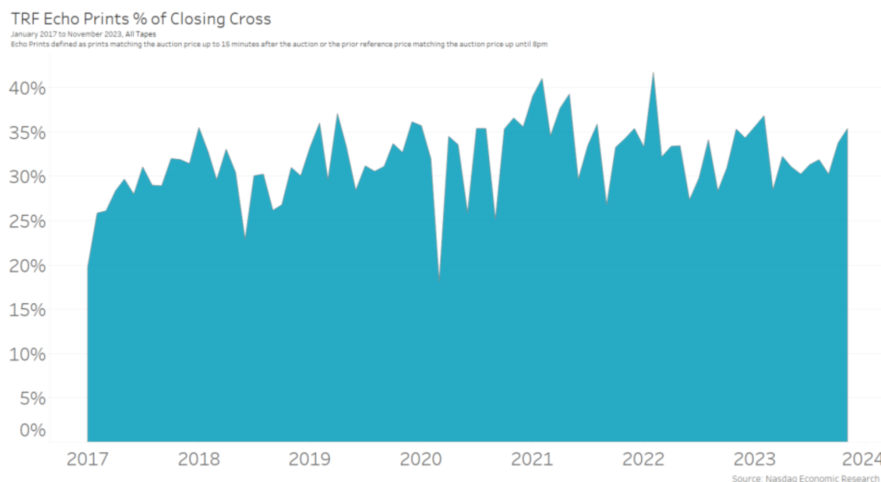
[36] The SEC asserts that a correlation exists between the number of exchange pricing tiers and market share. However, NYSE, which has the most pricing tiers of any exchange, lost 3% of market share since 2017, while BX, which has the fifth most tiers, lost 4% of market share. Meanwhile, IEX, which does not employ volume tiers, accumulated more market share during this period than 9 of the other exchanges.

[37] NetCoalition v. SEC, 615 F.3d 525, 539 (D.C. Cir. 2010) (quoting Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770, 74782–83 (December 9, 2008) (SR–NYSEArca–2006–21)).

performance, the matching engine algorithm, the availability of novel or innovative order types, as well as the relative costs of the exchange's overall platform of products and services (of which transaction fees is but one component). Within the context of platform competition, the relative prices of the full platform of goods and services an exchange offers, rather than the relative prices of any constituent good or service, are determinative of inter-exchange competition.

The SEC also ignores the reality that exchanges not only compete with each other, but also with off-exchange market centers and their features, offerings, and prices – and they do so at a regulatory disadvantage that would only grow more acute with this Proposal. Indeed, through this Proposal, the SEC would irrationally seek to bolster inter-exchange competition at the expense of harming competition among exchanges and off-exchange market centers.

Meanwhile, the notion that auction-based pricing inhibits the ability of non-listing markets to compete for closing orders is demonstrably false. As the SEC acknowledges, alternatives exist to trading in the auctions of listing exchanges, like "broker-dealers [offering] to internalize customer orders at the closing auction price," or "the pre-match close offered by one exchange for market-on-close orders."[38] Recently, the SEC approved Cboe's proposal to adopt a market-on-close order type, which matches the closing price a security gets from its primary listing exchange. Off-exchange venues also issue so-called "echo prints." Together, these alternatives have siphoned almost 30% of market on close orders.



Moreover, auction-based pricing does not unduly coerce members to trade intraday on primary listing exchanges for the same reasons discussed in the prior section.[39] We note that market participants trade on primary listing exchanges based on the value these exchanges provide to market participants – including trading firms, investors, and issuers. Positive externalities associated with trading on primary listing exchanges include better quoting on listed securities, more time at the NBBO, and greater depth of

[38] Proposal at 76304.

[39] Echoing a point we make elsewhere in this letter, 6 of 7 of the agency participants that qualify for Nasdaq's best auction-linked pricing tier otherwise qualify for the same pricing through other means. This belies the notion that auction-linked pricing is unduly influencing participant behavior on Nasdaq.

liquidity. Where such value is absent in a market, moreover, market participants will not necessarily trade there even if that market offers listings.[40]

Once again, even if the SEC is correct that auction-based pricing harms exchange competition, it fails to quantify and analyze this harm to demonstrate that the Proposal is reasonable.

II. Volume-Based Pricing is Rational, Fair, Pro-Competitive, and Ubiquitous

The SEC ignores the reality that this pricing model is widely utilized and recognized to be rational, fair, pro-competitive, and beneficial for consumers. It exists, without controversy, in a wide array of industries throughout the economy, including elsewhere in the securities industry, both in the U.S. and abroad. It is a standard feature of everything from wholesale product distribution to retail sales. It exists even in regulated industries like consumer banking, where customers who deposit more money in their checking accounts, and thus contribute more to the pool of capital that banks utilize to make loans, may qualify for better account "tiers," entitling them to receive higher interest rates, lower fees, and other perks. Nasdaq is unaware of any other pertinent context in which regulators have banned or proposed to ban firms from engaging in volume-based pricing due to concerns like those that the Commission raises – nor does the Commission cite an example where this is the case.

This model is an economically rational and efficient means for firms to increase sales. It rewards a firm's best customers for their patronage and contributions to the firm's business. It incents those customers to continue to do so, and to an increasing extent. It recognizes economies of scale associated with elevated levels of customer activity; marginal costs associated with a customer's purchases or usage fall as the volume of the customer's purchases or activity increases. In other words, it makes economic sense in such circumstances to treat customers differently because the costs of serving them and their contributions to the firm differ based upon their volume of purchases or activity with the firm. To charge a flat fee to all customers would ignore these facts and create inefficiency in the market by causing the participants who contribute most to the market to subsidize the fees of its less committed customers.

For a multi-sided platform like an exchange, whose value as a market is a function of its popularity with and utility to buyers and sellers, this pricing model is efficient as it incents buyers and sellers to transact on the platform and provides the largest incentives to those who are most active on it and therefore contribute most to its value. Media content platforms like Instagram or TikTok also employ this same model by rewarding those who contribute the most popular, "buzz-worthy" videos; doing so recognizes that such content drives viewership and incents others to contribute content to those platforms.

This pricing model is recognized to be pro-competitive and pro-consumer, leading firms to provide better products to consumers at lower prices.[41] This is exactly what occurs in the exchange

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[40] For example, NYSE AMEX has listing capabilities and opening and closing auctions, but still struggles to gain more than de minimis market share.

[41] See e.g., Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 243 (1993) (holding that defendant's "unprecedented volume rebates" were not anti-competitive as a matter of law); Eisai, Inc. v. Sanofi Aventis U.S., LLC, 821 F.3d 394, 407 (3d Cir. 2016) (noting that "the threat of a lost discount is a far cry" from unlawful anticompetitive conduct); Concord Boat Corp. v. Brunswick Corp., 207 F.3d 1039, 1062 (8th Cir. 2000) (holding that volume-based discounts were not anti-competitive as a matter of law, in part because "[c]utting prices is the very essence of competition"); W. Parcel Exp. v. United Parcel Serv. of

context, as it incents market participants to provide lit liquidity and to do so aggressively, aiding the price discovery process and market efficiency. Moreover, the aggregation of liquidity, and particularly high-value liquidity, on an exchange tends to improve quoting, increase depth, tighten spreads, and thereby increase the quality of executions at lower prices for investors. The SEC itself acknowledges the beneficial effects of this pricing model for exchanges, market participants, and investors.[42]

Nevertheless, the SEC seems to believe that volume-based pricing is problematic, per se, because it involves so-called "price discrimination" among exchange members. However, the Act does not prohibit exchanges from engaging in all forms of price discrimination; rather, it prohibits only "unfair" discrimination.[43] As discussed above, however, it is fair for exchanges to provide discounts and rebates to those customers that contribute most to the quality of their markets.[44]

We note again that even the SEC admits that, at worst, the theoretical support for the "welfare consequence of price discrimination is ambiguous."[45] It asserts that "a number of empirical papers have found that when restricting to a constant price, customers previously enjoying the lower prices are worse off and those enjoying higher prices are better off, relative to a world where firms can vary prices with the customers' price-sensitivity."[46] However, the research that the SEC cites in support of this assertion concludes that consumer welfare increases under "intertemporal price discrimination."[47] It also concludes "that market segmentation is welfare enhancing" because "profits and average customer welfare would decrease… if the refillable products were removed from the market."[48] Beyond the research cited by the

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Am., Inc., 190 F.3d 974, 976 (9th Cir. 1999) ("The district court properly concluded that [defendant's] contracts are volume discount contracts, not exclusive dealings contracts. Such volume discount contracts are legal under antitrust law."); cf. Cascade Health Sols. v. PeaceHealth, 515 F.3d 883, 903 (9th Cir. 2008) ("[W]e think the course safer for consumers and our competitive economy to hold that bundled discounts may not be considered exclusionary conduct within the meaning of § 2 of the Sherman Act … unless the discounts result in prices that are below an appropriate measure of the defendant's costs.").

42 See e.g, Proposal at 76325 (noting that "volume-based discounts may expand overall liquidity across exchanges" and "increase broker-dealers' and their customers' total surplus."); id. (observing that volume-based price discrimination may benefit low-volume members because "additional order flow from high-volume exchange members may ultimately be beneficial to lower-volume broker-dealers" and because high-volume members "contribute substantially more to the depth of book on an exchange," which in turn "reduces the cost of searching for the best execution and benefits the lower-volume broker-dealers.").

43 See Act, Section 6(b)(5); 15 U.S.C. § 78f(b)(5) (stating that exchange rules may not be "designed to permit unfair discrimination between customers, issuers, brokers, or dealers.").

44 The SEC fails to establish that it would be any fairer for exchanges to charge all members a flat transaction fee. Equal is not necessarily fair. See Phil Mackintosh, "Equal Is Not Fair," Market Makers, November 30, 2023, at https://www.nasdaq.com/articles/equal-is-not-fair. In this case, it would mean that larger-volume brokers would effectively subsidize smaller-volume brokers' participation on exchanges.

45 Proposal at 76316, n.194.

46 Id.

47 See Igal Hendel and Aviv Nevo, "Intertemporal Price Discrimination in Storable Goods Markets", 103 AM. ECON. REV. 2722 (2013).

48 See "Hassel Costs and Price Discrimination: An Empirical Welfare Analysis," 7 AM. ECON. J.: APPLIED ECON. 123 (2015).

SEC, other academic research finds that price discrimination increases competition because "if [a company] can price discriminate…, [they are] competing with [their] rival for every single customer…. It also makes collusion much more difficult because now [they] have to coordinate… on prices to every single customer."[49] Furthermore, restrictions on pricing strategies would reduce welfare because "in competitive markets firms can attract consumers only by delivering utility that is close to the maximum possible; restricting the ways in which firms can deliver utility reduces this maximum utility."[50]

In a blog that the SEC relies upon for its position, IEX argues that volume-based pricing is unfairly discriminatory because it concentrates benefits among a handful of brokers. It likens this practice to the Met Gala offering free tickets only to celebrities like Kim Kardashian, while everyone else must pay to attend.[51] This analogy only makes Nasdaq's case. Offering celebrities free invitations to attend parties is a rational in that it increases paid attendance by creating excitement around an event. People may not normally pay $50,000 to attend a gala, but they may do so to mingle with Kim Kardashian.[52] Similarly, one of the key ways in which events like the Met Gala compete against one another is in their ability to attract celebrities and attention. So too here, exchanges compete against one another and against off-exchange markets in their ability to attract order flow. Removing a price-discounting mechanism that some exchanges use to compete would not only dampen competition overall, but it would unreasonably and unfairly put a thumb on the scale in favor of those markets that would not be subject to the Proposal and/or primarily use different strategies to compete. And where, as here, the SEC would be putting a thumb on the scale in favor of dark markets, an agency rule that distorts competition among exchanges would have far-reaching adverse consequences on the marketplace.

Until the advent of this rulemaking, the SEC agreed that volume-based pricing was consistent with the Act. Over decades, the SEC had countless opportunities to review exchange fee filings based upon volume-based pricing.[53] It had every opportunity raise concerns and suspend or disapprove these filings, but by and large it did not do so.[54] It fails to explain why it has suddenly changed its position on

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[49] See Summary of Remarks of Professor Dennis W. Carlton at the OECD Roundtable on Price Discrimination, at 6 (Apr. 4, 2018), available at https://one.oecd.org/document/DAF/COMP/M(2016)2/ANN3/FINAL/en/pdf.

[50] See Mark Armstrong and John Vickers, "Competitive Price Discrimination," RAND Journal of Economics, at 6 (Winter 2001) available at https://users.econ.umn.edu/~holmes/class/2003f8601/papers/rje_Winter%2701_Armstrong.pdf.

[51] See IEX Blog, supra.

[52] In its blog, IEX also argues that volume-based pricing is problematic in the exchange context because pricing tiers there tend to be linked to a percentage of total consolidated volume across all markets, rather than to absolute volume on a particular exchange. See IEX Blog, supra. However, the use of relative volume thresholds is reasonable as it cushions exchanges and brokers against the effects of changes to absolute volumes that occur each month.

[53] Examples of volume-based fee changes to which the SEC has assented are too numerous to list. A few recent examples, just from Nasdaq, include the following: Securities Exchange Act Release No. 34-98128 (Aug. 14, 2023), 88 FR 56667 (Aug. 18, 2023) (2023) (SR-NASDAQ-2023-028); Securities Exchange Act Release No. 34-97466 (May 9, 2023), 88 FR 31083 (May 15, 2023) (2023) (SR-NASDAQ-2023-013).

[54] To the extent that the SEC has suspended volume-based tiers in recent years, it has done so due to concerns other than those it identifies in the Proposal, including whether exchanges appropriately designed certain

volume-based pricing and concluded that it is now problematic – and so much so that it must be banned. Once again, this failure to explain its change of position renders the Proposal arbitrary and capricious, especially as the industry has invested heavily in and relies upon the operation of this pricing model.[55]

III. The SEC Fails to Demonstrate that this Proposal is Rational in Terms of Costs and Benefits

As part of an agency's duty to conduct a reasoned decision-making process, the APA requires it to consider the costs and benefits of its actions. Such "consideration" must be more than a mere compilation of potential costs and benefits; instead, an agency must demonstrate that the rulemaking is rational insofar as the benefits outweigh the costs.[56] As noted by the D.C. Circuit, "reasoned decision-making requires assessing whether a proposed action would do more good than harm."[57] In this instance, the SEC conducted no such assessment.[58] Had it performed the required analysis, that analysis would have revealed the irrationality of the Proposal; its benefits are meager and speculative at best, while the potential costs are likely to be substantial.

By the SEC's own admission, the potential costs of the Proposal are myriad. It states that the Proposal "would risk exchanges losing market share to off-exchange venues"[59] – which would erode lit liquidity and harm the NBBO. In this regard, the SEC explains that exchanges use volume-based pricing to compete for order flow with off-exchange market centers (which would not be subject to the Proposal),

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tiers to continually incentivize volume growth over time. See e.g., Securities Exchange Act Release No. 34-97437 (May 4, 2023, 88 FR 30181 (May 10, 2023) (Suspension of and Order Instituting Proceedings To Determine Whether To Approve or Disapprove Proposed Rule Change To Amend the BZX Equities Fee Schedule To Add and Modify Certain Step-Up Tiers, Add a Non-Displayed Step-Up Tier and Modify Certain Fee Codes) (suspending step-up tiers due to concerns about the fairness of such tiers requiring that members demonstrate growth in volumes relative to fixed baseline months that do not update).

[55] See FCC v. Fox TV Stations, Inc., 556 U.S. 502, 515 (2008) (an agency must justify changing its prior position on a matter when "its new policy rests upon factual findings that contradict those which underlay its prior policy; or when its prior policy has engendered serious reliance interests that must be taken into account. It would be arbitrary or capricious to ignore such matters.") (internal quotation omitted); see Mingo Logan Coal Co. v. EPA, 829 F.3d 710, 736 (D.C. Cir. 2016).

[56] Michigan v. EPA, 576 U.S. 743, 750 (2015) (internal quotations and citations omitted) (agency's action violated the APA because it did not consider whether the costs outweighed the benefits); id. ("the process by which [an agency] reaches [a] result must be logical and rational. It follows that an agency action is lawful only if it rests on a consideration of the relevant factors."); see also Chamber of Commerce, 2023 U.S. App. LEXIS 28881, at *6 ("Arbitrary-and-capricious review requires this court to scrutinize the record to determine whether the agency has 'examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choice made.'") (quoting Motor Vehicle Mfrs. Ass'n of U.S., 463 U.S. at 43); Inv. Co. Inst. v. United States CFTC, 891 F. Supp. 2d 162, 216 (D.C. Cir. 2012) (agency did not act arbitrarily and capriciously, in part, because it "made a reasoned, informed decision that the benefits of the Final Rule outweighed these costs.").

[57] Mingo Logan Coal Co., 829 F.3d at 732.

[58] See N.Y. Stock Exch., 962 F.3d at 559 (quoting Bus. Roundtable v. SEC, 647 F.3d at 1150) ("[b]ecause the [SEC] failed to 'make tough choices about which of the competing estimates is most plausible, [or] to hazard a guess as to which is correct,' . . . it neglected its statutory obligation to assess the economic consequences of its rule").

[59] Proposal at 76320.

and that a ban on volume-based pricing would make exchanges less attractive venues to which to send agency orders relative to off-exchange market centers.[60]

The SEC also admits that the Proposal could disperse agency order flow,[61] "harm on-exchange liquidity and increase trading costs,"[62] and reduce the allocative efficiency of trade executions.[63] It states that "as off-exchange market centers such as wholesalers often benchmark trades (and price improvement) to the NBBO, the withdrawal of a portion of on-exchange order flow may potentially result in wider (NBBO) spreads thereby harming execution quality in the market as a whole."[64]

As to brokers, which are the main intended beneficiaries of the Proposal, the SEC even admits that the Proposal may leave them worse off in numerous respects – as well as their investor customers. This is the case, moreover, both for large and small brokers. The SEC states the following:

> To the extent that average exchange per unit trading fees become more expensive than the lowest per unit (i.e., top tier) fees currently offered, the proposed banning of volume-based exchange transaction pricing for agency-related volume would result in costs for the high-volume exchange members and possibly the smaller non-members routing through them if they receive pass-through exchange transaction pricing. This increase in costs may in turn cause the commissions charged by such broker-dealers to increase, resulting in costs for their customers as well.[65]

Similarly, the SEC states as follows:

> … market participants that send exchange orders through large exchange members, which currently likely benefit from the volume-based transaction tiers of their sponsors, may experience costs in the form of higher fees from their executing brokers under the proposed rule. In the absence of the ability of exchanges to use volume-based transaction pricing for agency-related flow, investors which rely on high-volume exchange members for market access may be left with relatively more expensive exchange transaction fee options.[66]

As such, the SEC acknowledges that its Proposal "could harm investor welfare."[67]

The SEC does little to assess the magnitude or collective impacts of the costs it identifies. Instead, it minimizes them by speculating that exchanges would find ways to adapt their businesses to accommodate a new regulatory reality. It is clear, however, that these costs would be substantial and

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60 Id. at 76321.

61 Id. at 76326. We note that much of the orders dispersed would likely flow to off-exchange market centers owned and operated by many of the same market participants that currently achieve the best pricing tiers on exchanges.

62 Id. at 76321.

63 Id. at 76326.

64 Id. at 76321.

65 Id. at 76318.

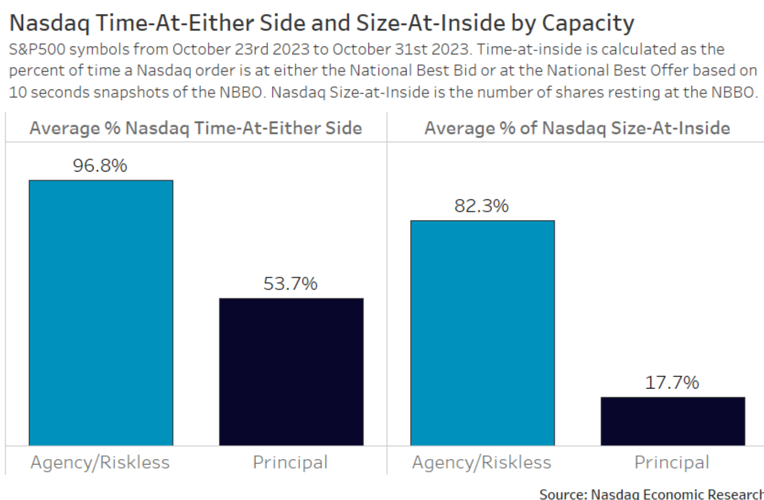
66 Id. at 76319.

67 Id. at 76319-20.

serious, and that the SEC should not gamble on exchanges to be able to minimize them, particularly when the SEC is also acting in other ways that limit exchanges' ability to innovate and compete.

The SEC itself previously identified the erosion of lit markets to be a serious threat to market quality, the integrity of the NBBO, and to spreads.[68] The NBBO is the product of liquidity on lit markets, and it is the North Star for investors in understanding the best prevailing price for stocks in U.S. markets. Forces that siphon this liquidity away from lit markets drain the remaining liquidity pool available to form the NBBO, leaving it less robust and representative of true market prices. The Proposal will only exacerbate this phenomenon, which has already led to almost half of all trading occurring in the dark. We therefore find it perplexing that the SEC would recognize this problem and propose to address it in one set of rules,[69] only to then issue another Proposal that would undermine its efforts. At a minimum, the SEC must acknowledge and explain its change in position.

The Proposal does little to mitigate its potential costs. The SEC seems to believe that limiting its ban to agency and riskless principal orders will limit damage to liquidity provision and to the NBBO, as it assumes that market makers and proprietary firms are primarily responsible for providing liquidity to lit markets. While market makers and proprietary firms do provide significant liquidity, agency orders account for 66% of liquidity on Nasdaq, with a sizable proportion of those orders being at the NBBO.



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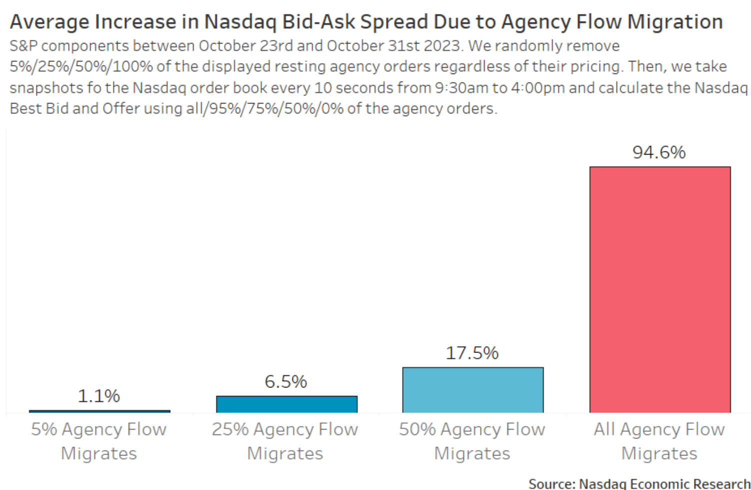
[68] See Gary Gensler, Prepared Remarks at the Global Exchange and Fintech Conference (June 9, 2021), https://www.sec.gov/news/speech/gensler-global-exchange-fintech-2021-06-09 ("Dark pools and wholesalers are not reflected in the NBBO. Moreover, the NBBO is also only as good as the market itself. Thus, … nearly half of trading along with a significant portion of retail market orders happens away from the lit markets. I believe this may affect the width of the bid-ask spread.").

[69] See, e.g. NMS Proposal at 80274 (stating that regulatory disparities between on- and off-exchange venues lead to market complexity and inefficiencies, and that harmonizing minimum trading increments across the market would address such problems by "level[ing] the competitive playing field."); id. at 80336.

If only agency and riskless principal orders migrate to off-exchange markets, depth at the NBBO would still decrease and spreads would still widen.[70] Even a 5% reduction in agency and riskless principal order flow would increase Nasdaq's spread by 1%. If all agency and riskless principal orders left Nasdaq, then the spread would widen by 85%. In fact, Nasdaq expects a substantial portion (but not all) of such orders to leave, especially if off-exchange venues remain advantaged in competing for them.[71]



Given these bright red flags, one would expect the Commission to have presented clear and compelling benefits that justify proceeding with the Proposal. Instead, the Commission presents only a few potential benefits, which are speculative and meager at best. The Commission asserts, unconvincingly, that the Proposal "may result in an increase in agency order flow to medium-sized exchange members,"[72] that it would "lessen the pricing advantage between the high-volume members

[70] For this estimate, Nasdaq created a synthetic quote separating agency and riskless principal flow on Nasdaq into one quote and principal activity into another. The quote comprised of only principal orders experienced reduced time at the NBBO compared to the agency and riskless principal quote (and Nasdaq's current quote, comprised of all types of activity). This implies a quote of just principal quotes would be wider than the quote today. As a thought experiment, we can extrapolate these results to the whole market and estimate that reduced agency order flow on exchanges would cause spreads to widen overall. Similarly, a substantial portion of depth on Nasdaq is comprised of agency and riskless resting orders. If this order flow were to leave Nasdaq, the accessible displayed depth would decrease.

[71] While quantifying the impact of the Proposal is difficult, we estimate that narrowing spreads by as little as 1 basis point could save $2.2 billion in mutual fund shortfall. Furthermore, reduced spreads would lower the cost of capital for issuers by $3.6 billion per basis point, which adds to market valuations and returns. See Phil Mackintosh, "How Much Does Trading Cost the Buy Side?" dated Feb. 17, 2022, available at https://www.nasdaq.com/articles/how-much-does-trading-cost-the-buy-side. If this Proposal were to increase spreads, one could reasonably expect opposite impacts.

[72] Proposal at 76316 (emphasis added).

when competing for DMA customers,"[73] and that it "may yield some benefits to lower-volume exchange members, some of which would be passed on to investors who are their customers."[74]

Indeed, the SEC's only confident assertion is that "the proposed volume-based ban would result in benefits to lower-volume exchange members in the form of lower transaction fees and higher rebates"[75] – but the Commission contradicts even this assertion elsewhere in the Proposal when it acknowledges that transaction fees may end up higher under the Proposal and leave exchange members worse off.[76]

Additionally, the SEC fails to make key contentions that the benefits it identified would outweigh the costs of its action. For example, to what extent will any cost savings associated with the Proposal (if cost savings actually occur) have a meaningful effect on the ability of small- and medium-sized brokers to compete for business with larger-sized brokers? To what extent will the Proposal actually result in more medium-sized brokers offering DMA service to small brokers? And to what extent would any cost savings or additional service benefit investors, if at all? The SEC answers none of these questions.

To the contrary, the SEC's statements, both in the Proposal and otherwise, only undermine the validity and significance of its unsubstantiated claims of net benefits. For example, during the SEC's Open Meeting preceding the Commission's vote to issue the Proposal, SEC Staff acknowledged that the Proposal would not solve the problem of broker concentration, and at best might slow it down.[77] The Proposal also acknowledges that "[h]ow much the customers of exchange members would tend to benefit from reducing the conflict of interest is uncertain" and that "the proposed prohibition of volume-based pricing for agency-related order flow will not resolve all potential conflicts of interest between exchange members and their customers."[78] Furthermore, the Proposal states that "the overall welfare effects of banning price discrimination are ambiguous and can vary across market settings."[79]

In sum, the Commission fails to make a case that the benefits of the Proposal outweigh its costs. If anything, the Commission's analysis supports our view that the costs would far outweigh the benefits.

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73 Id.

74 Id.

75 Id.

76 See id. at 76319 ("To the extent that average exchange pricing on agency-related orders become more expensive than the previous top-tier pricing, investors and any intermediating broker-dealers who previously benefitted from the high- volume broker-dealers' passing through the volume-based exchange transaction pricing may be worse off.").

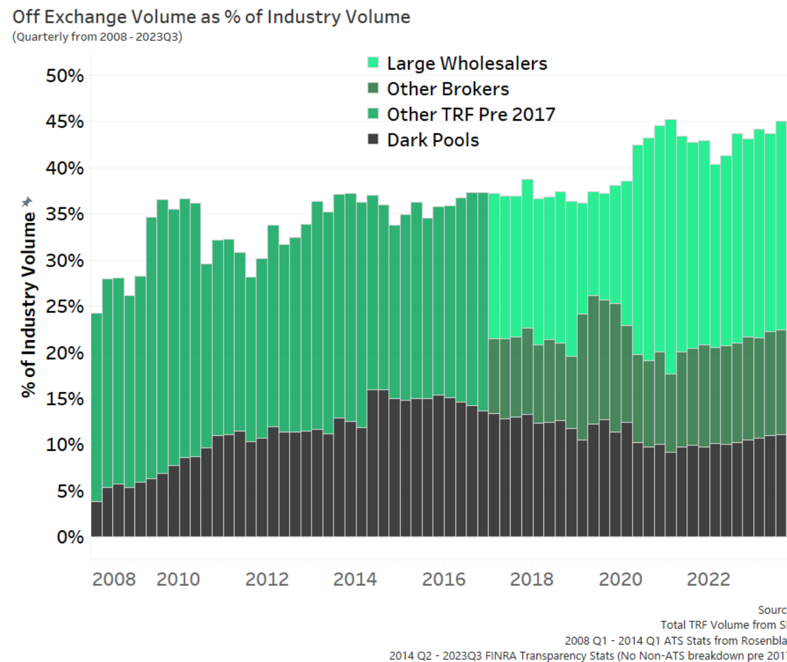
77 See SEC Open Meeting, supra. The SEC's Herfindahl-Hirschman Index ("HHI") data supports the conclusion that volume-based pricing has a limited relationship to broker-dealer concentration, such that the Proposal is likely to be ineffective in addressing such concentration. Overall, the SEC's HHI analysis shows that "individual members appear to be more concentrated (0.20) than would be expected by the relative market shares of the exchanges (0.18)" – a modest two basis point difference. To the degree volume-based discounts incentivize concentration, the impact is minor. See Proposal at 76310.

78 See e.g., Proposal at 76317.

79 See e.g., id. at 76325.

IV. The Proposal is Arbitrary and Capricious in Failing to Account for Similar Pricing Practices that Occur Off-Exchange

The Proposal also is arbitrary and capricious for its failure to consider a key aspect of the problems it identifies[80] – which is that the same volume-based pricing practices the SEC perceives to be harmful are prevalent among the non-exchange market centers – where almost half of trading on U.S. equities markets occurs.[81]



Off-exchange market centers, including Alternative Trading Systems ("ATSes"), wholesalers, and single-dealer platforms, employ volume-based pricing discounts and incentives, and the Proposal would have no impact on their ability to continue doing so. To the extent that legitimate concerns exist about volume-based pricing, such concerns are more acute for off-exchange market centers than they are for exchanges.

Exchange pricing is already highly-transparent to market participants and investors – and uniquely so compared to off-exchange market centers. As the Commission notes, "[n]ational securities exchanges establish and amend their fee schedules by filing proposed fee rule changes, pursuant to section 19(b) of the Exchange Act and rule 19b–4 thereunder, for Commission review."[82] Exchanges are

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[80] "[A] regulation is arbitrary and capricious if the agency 'failed to consider an important aspect of the problem.'" Mexican Gulf Fishing Co. v. United States DOC, 60 F.4th 956, at 973 (5th Cir. 2023) (quoting Motor Vehicle Mfrs. Ass'n, 463 U.S. at 43).

[81] See, e.g., Intelligent Cross, Form ATS-N, Exhibit 3, as amended Jan. 27, 2023, available at https://www.sec.gov/Archives/edgar/data/1708826/000170882623000005/0001708826-23-000005-index.html.

[82] NMS Proposal at 80292, n.321.

required to demonstrate that each such proposed fee is consistent with the Act by being reasonable, an equitable allocation, not unfairly discriminatory, and not unduly burdensome to competition.[83] Even though exchange fees are immediately effective upon filing, they remain subject to public comment and Commission scrutiny after filing. Indeed, they are subject to suspension within 60 days of filing if the SEC determines that the suspension is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.[84] Exchange fees, like all exchange rules, also are required by law to be published on their websites within two business days after filing them, and the Commission also publishes them in the Federal Register and on its own website.[85] On its own accord, Nasdaq publishes alerts to market participants, in advance of filing any proposed rule changes, to help educate them about fees and rebates and how they are calculated.[86]

Very few of these transparency or statutory approval requirements apply to off-exchange market centers. Even with recent proposed Commission enhancements to ATS pricing transparency,[87] Regulation ATS does not and would not require ATSes to provide the same level of transparency to the market as it requires for exchanges. For example, ATSes would not be required to demonstrate that their fees are consistent with Exchange Act standards. Rather than requiring ATSes to publish their full fee schedules on their websites, Form ATS-N requires ATSes to describe the types of fees, fee structures, variables that impact fees, differentiation in fees among customer types, and provide a range of potential fees. Meanwhile, no price transparency or approval requirements whatsoever apply to non-ATS market centers, wholesale market makers, or single-dealer platforms.

Whereas exchange pricing is subject to fair access requirements and anti-discrimination and competition standards, off-exchange market centers have no such requirements or standards. Thus, they can and do routinely provide, not only differential pricing based on firms' sizes, volumes, and the nature of their order flow, but also completely bespoke pricing deals that are specific to each individual customer.[88] The SEC fails to explain how, given this reality, it can solve the problems it identifies by banning volume-based pricing only for exchanges, and not also for off-exchange market centers.

This is not the first time the SEC has acted arbitrarily in this manner. In the transaction fee pilot litigation, the D.C. Circuit admonished the SEC for a similar attempt to regulate only half of the market for practices prevalent throughout it, noting that if implemented, the pilot program would have had "significant, costly, and disparate effects on the market and on regulated parties."[89] The SEC must not

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83 See 15 U.S.C. § 78f(b)(5).

84 See id. § 78s(b)(3)(A)(ii).

85 See 17 C.F.R. § 240.19b-4(l), (m).

86 Nasdaq's Equity Trader Alerts, https://www.nasdaqtrader.com/Trader.aspx?id=archiveheadlines&cat_id=2/.

87 See Securities Exchange Act Release No. 34-94062 (Jan. 26, 2022), 87 FR 15496 (Mar. 18, 2022).

88 Nasdaq does not object to such pricing practices, per se, but rather we object to the fact that such pricing practices are permissible for off-exchange market centers while they are impermissible for exchanges.

89 N.Y. Stock Exch., 962 F.3d at 551 (emphasis added); id. at 557 (critiquing the SEC's rule as imposing "significant, costly, and disparate regulatory requirements on only a subset of the securities market.").

make the same mistake again. Doing so would unfairly discriminate against exchanges, and in favor of off-exchange venues, in violation of the APA and the Act.[90]

V. The Act Does Not Authorize the SEC to Promulgate Rules that Proscribe Exchange Pricing Models or Fix Exchange Fees

In the Proposal, the SEC mistakes its statutory authority to oversee the world's largest capital markets as an invitation to micromanage and dictate the very nature of competition within them. Congress granted no such authority in the Act. Indeed, "[m]erely because an agency has rulemaking power does not mean that it has delegated authority to adopt a particular regulation."[91]

Although Congress did grant the SEC broad discretion in the Act,[92] it was clear that this discretion has limits. Notably among these limits, SEC rules must further the objective of assuring "fair competition," not only among brokers and dealers and among exchanges, but also "between exchange markets and markets other than exchange markets"[93] Similarly, Section 3(f) of the Act states that when the SEC determines whether a rule would be "necessary or appropriate in the public interest," it must consider "whether the action will promote efficiency, competition, and capital formation."[94] And Section 23 states that in making rules, the SEC "shall consider the impact of any such rule or regulation would have on competition," and "shall not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of [the Act]."[95]

The Proposal's statement of its projected impacts on efficiency, competition, and capital formation[96] lacks any consideration whatsoever of the impact of the Proposal on competition among exchanges and non-exchange markets. The Proposal would in fact harm the ability of exchanges to compete for agency order flow with off-exchange market centers to the detriment, not only of the exchanges themselves, but also to the quality of the markets, the NBBO, and investors. [97] The

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90 See Etelson v. Office of Pers. Mgmt., 684 F.2d 918, 926 (D.C. Cir. 1982) ("Government is at its most arbitrary when it treats similarly situated people differently."); see also Steger v. Def. Investigative Serv. Dep't of Def., 717 F.2d 1402, 1406 (D.C. Cir. 1983) ("The [agency] cannot, despite its considerable discretion, treat similar situations dissimilarly and, indeed, can be said to be at its most arbitrary when it does so.").

91 N.Y. Stock Exch., 962 F.3d at 546.

92 See Act, Section 11A; 15 U.S.C. § 78k-1 (directing the Commission to facilitate the establishment of a national market system with due regard for the public interest, the protection of investors and the maintenance of fair and orderly markets, and in accordance with stated Congressional objectives); id. Section 23(a)(1); 15 U.S.C. § 78w(a)(1) (granting general authority to promulgate rules "necessary or appropriate" to implement provisions of the Act).

93 See id., Section 11A; 15 U.S.C. § 78k-1(a). Moreover, in establishing the national market system, Congress noted that the Commission neither has the power nor the responsibility to act as an "economic czar" that lords over the markets. See S. Rep. No. 94-75, at 12 (Apr. 14, 1975).

94 Act, Section 3(f), 15 U.S.C. § 78c(f).

95 Id., Section 23(a)(2); 15 U.S.C. § 78w(a)(2).

96 See Proposal at 76325-28.

97 See infra.

Commission is already on record as having expressed concern about the current ability of exchanges to compete with off-exchange market centers.[98] Thus, it defies not only the Act but also common sense that the Commission would put forth a Proposal that would only exacerbate its stated concerns. Moreover, even if the Commission is correct that its Proposal would enhance competition among brokers and among exchanges,[99] nothing in these statutory provisions suggest that such competitive benefits are sufficient if they come at the expense of competition among exchanges and off-exchange market centers.

The SEC improperly relies upon its statutory mandate conferred under Section 6 of the Act to assess whether national securities exchange have reasonable fees that are an equitable allocation, do not unfairly discriminate, and do not impose an undue burden on competition.[100] Section 6 of the Act governs SRO filings, not SEC rulemakings. Within the context of exchange fees, the Commission's opportunity to effectuate Section 6 is in the fee filing process prescribed by Section 19 of the Act.[101] Section 19 authorizes the SEC to analyze exchange fee filings for consistency with the Act on an individualized basis.[102] If the Commission determines that a fee is inconsistent with the Act, Section 19(b) only authorizes the SEC to proceed by suspending and disapproving the filing, again on an individualized basis and within defined time limits.[103] The provision nowhere references authority to promulgate a categorical rule proscribing fee models or setting fee or rebate rates.

Had Congress wanted to delegate power to the SEC to impose flat rate exchange pricing, it knew how to do so. In 1975, Congress did just that when it amended the Act to state that the SEC may permit national securities exchanges to continue to fix broker commission rates under specified conditions.[104]

The U.S. Supreme Court has held repeatedly that absent clear Congressional direction, federal agencies lack authority to invoke vague or ambiguous statutory provisions to address major policy questions that Congress left unanswered, particularly when the manner of doing would re-write statutes.[105] In this case, Sections 6, 11A and 19 of the Act do not contemplate, and do not specifically

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98 See infra.

99 The SEC is required to consider whether the Proposal would impose an unnecessary burden on competition. The Proposal fails to do this. The SEC's primary attempt to evaluate the potential impact of the rule on competition is to speculate about the extent that flattening of the fee structure might alter the relative costs facing large, medium, and small brokers. This relates to the question of how the Proposal would affect the competitors in the market, not whether the rule would affect competition.

100 See infra.

101 See Act, Section 19(b)(3)(A); 15 U.S.C. § 78s(b)(3)(A).

102 See id.

103 See id. The SEC may only suspend exchange fees retrospectively, and for a limited time, if "such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this chapter." Id.

104 See id., Section 6(e); 15 U.S.C. § 78f; Pub. L. No. 94-29, 89 Stat. 108 (June 4, 1975) (stating that the SEC may "permit a national securities exchange, by rule, to impose a schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members for effecting transactions on such exchange after November 1, 1976" if it finds doing so meets certain prescribed statutory standards).

105 See Biden v. Nebraska, 600 U.S. 477, 143 S. Ct. 2355, at 2375 (June 30, 2023) ("our precedent—old and new—requires that Congress speak clearly before a Department Secretary can unilaterally alter large

authorize the SEC to act as it proposes here. Doing so would involve re-writing the statutory scheme to provide for the SEC to become a utility regulator, rather than an overseer of competitive markets.

VI. Proposed Alternatives to the Proposal would be No Less Problematic or More Effective

Finally, although Nasdaq appreciates the fact that the Commission identifies alternatives to its Proposal, none of the alternatives would be any less problematic or more effective than the Proposal itself. Indeed, the fact that the Commission identifies so many alternatives and spends so much time pondering them only adds to the sense that the Commission itself lacks conviction in this Proposal.[106]

The alternative proposal to ban both principal- and agency-based orders, or to carve-out from that broader ban only orders from market makers providing displayed liquidity, would harm exchange market quality and the NBBO. An even broader ban on volume-based pricing would simply gut market-making on exchange, and with it, the integrity of the NBBO. Even if the ban were to exempt market makers providing liquidity, it still would potentially deprive exchanges of substantial liquidity, with similar negative effects for the NBBO. Said otherwise, if the Commission truly desires a robust NBBO and transparent, well-regulated trading, then it should avoid pursuing either of these alternatives.

Likewise, banning volume-based pricing on the options markets would be unwarranted and imprudent. The introduction of restrictions on volume-based pricing could impact marketable order flow and disincentivize execution quality on the markets. Volume-based incentives reduce costs for large market makers, thereby allowing them to offer price improvement for exchange orders and driving liquidity in options markets. Options exchanges are also quote driven, and market makers drive most of the quoting on options markets. Volume-based exchange transaction pricing incentivizes market makers to provide liquid, quality markets. Finally, we note that a ban on volume-based pricing would put established efficiencies at risk. Banks outsource the trading of certain options products (complex and stock-tied products) to a limited number of consolidators. This model reduces overall lower costs of trading certain options products by leveraging the scale of these consolidators. Economies of scale have enabled smaller firms to leverage technologies and other infrastructure benefits of certain service providers to grow their business without the need to carry certain fixed costs to develop their own systems/technologies. A ban on volume-based pricing would render these consolidation services less lucrative and would disincentivize investment in them. Similar to how a ban would harm many smaller equities brokers if DMAs became more expensive or offer fewer services, smaller options participants would be worse off if a ban negatively impacted the price of or their access to consolidation services.

Also problematic would be an alternative proposal to ban exchanges from engaging in auction-based pricing or in basing volume-based pricing for intraday transactions upon other unrelated activities. As we discussed earlier, the Commission's concerns about the competitive impacts of auction-tied pricing are unsubstantiated. Fear that primary listing exchanges might, one day in an uncertain future, attain and

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sections of the American economy"); see also West Virginia v. EPA, 142 S. Ct. 2587, 2609-13 (2022) ("[e]xtraordinary grants of regulatory authority are rarely accomplished through 'modest words,' 'vague terms,' or 'subtle device[s]. Nor does Congress typically use oblique or elliptical language to empower an agency to make a radical or fundamental change to a statutory regime"); Util. Air Regul. Grp. (UARG) v. EPA, 573 U.S. 302, 324 (2014); FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120 (2000).

[106] If the Commission to pursue one of these alternatives, it must re-issue the Proposal and provide a fresh opportunity for public comment before proceeding.

then abuse market power by employing volume-based pricing to reinforce their dominance[107] is fantasy. This fear certainly is not a reasonable basis for the Commission to act now to ban volume-based pricing.

Least harmful among the alternatives would be to permit exchanges to continue to engage in volume-based pricing but require increased transparency about the number of firms that qualify for each pricing tier each month. Nasdaq does not object in principle to additional transparency, provided that that same standard is applicable to all market centers, including off-exchange market centers. Nevertheless, we believe that the added transparency proposed in this instance would do little to achieve the SEC's objectives. Mere disclosure of the number of firms that qualify for a tier each month would not indicate how many firms actually received a rate because they qualified for that tier. Firms often attain the same rate via multiple pricing paths. Firm 1 may receive rate x based upon its qualification for Tier A and Tier B, both of which offer the same discounted rate x. One should not extrapolate from the mere fact that Firm 1 is the only firm to qualify for Tier A during a given month that tier A is unfairly discriminatory; it may be the case that Firm 1 also qualifies for Tier B and is one of several firms to do so. Even if Firm 1 is the only firm to qualify for Tier A during a particular month and it receives rate x solely because of its qualification for Tier A, such facts alone provide no reasonable indication that Tier A is unfairly discriminatory. There are many plausible explanations for this scenario that have nothing to do with unfairness. Perhaps when an exchange designed Tier A, it expected multiple firms to qualify for it, but only one actually did so during the measurement month or more than one firm qualified at a prior point in time. Maybe only one firm historically qualified for Tier A each month, but the identity of that one firm changed over time. And what if two firms or three firms or four firms qualified for Tier A – where does the SEC draw the line between what is fair and unfair in the design of a tier? The added transparency that the SEC proposes would not answer these questions. Instead, it would impose an undue burden on exchanges,[108] while providing unhelpful and misleading information to the public.[109]

VII. Conclusion

Nasdaq respectfully urges the SEC to withdraw this Proposal. The SEC presents no evidence beyond mere supposition that volume-based pricing in any meaningful way harms competition, among either brokers or exchanges, or that it distorts broker routing decisions in ways that existing or proposed regulatory guardrails do not otherwise address. It also fails to account for the substantial costs of the Proposal as compared to its paltry benefits, including harm to the ability of exchanges to compete with off-exchange market centers for agency orders, and corresponding harm to the NBBO and to investors.

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[107] See Proposed Rule at 76314 ("When the dominance of high-volume broker-dealers becomes sufficiently heightened, it is conceivable that dominant broker dealers may eventually choose to exercise market power more aggressively. As a manifestation of the more general principle that a monopoly (or players with market power) tends to charge prices higher than what is socially optimal, large broker-dealers may raise commission fees. Doing so may result in a decline of trading volume facilitated by broker-dealers and a shrinkage of total surplus across investors.").

[108] Commission proposals to require exchanges to affirmatively disclose this information every month through EDGAR, and potentially in XBRL format, would only add to this undue burden.

[109] The SEC may also want to look at its own fee practices and their effects on small brokers. The SEC should explore providing small brokers with discounts on Section 31 fees.

Finally, it fails to consider whether this Proposal is necessary now, if at all, as it ponders whether and in what form to adopt other pending market structure proposals that address many of the same concerns.

Nasdaq urges the SEC to work with the industry to study broker competition, determine factors that are meaningful in inhibiting it, and then develop prudent and effective solutions. We have a shared interest in ensuring that membership in our markets is robust, diverse, and growing. We would be happy to work with the SEC and with small- and medium-sized brokers to find ways to enhance their ability to participate and compete effectively in the market. We have already shared several such ideas with the SEC prior to the release of this Proposal. A rash and radical rulemaking that would impair exchange competitiveness is neither necessary nor appropriate to address these concerns.

Sincerely,

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John A. Zecca

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