On March 20, IEX Exchange (Investors' Exchange LLC) filed our response to the SEC's proposed changes to the reforms related to Regulation NMS, which include limiting maximum fees (and therefore rebates) exchanges can charge, trading increments, and "tick sizes" (units in which securities can be quoted). We believe the Commission's proposals are thoughtful, thorough, and appropriately identify aspects of the rules that require reform. We support reform in all the areas identified by the SEC, while suggesting modifications to certain aspects to ensure that regulatory reform meets the Commission's objectives.

Below is a summary of what we shared with the SEC.

General Points

The Market Has Changed Significantly

Regulation must keep pace with market changes to stay relevant and achieve policy goals. The SEC's proposed changes to Reg NMS are appropriately focused on huge changes in the market since the rule set was adopted in 2005. They include:

- An explosion in volume and speed of trading (volumes have tripled and execution time has gone from seconds to microseconds).
- Substantial fragmentation in market venues from a few dominant exchanges to 16 exchanges and 30-plus ATSs.
- A trend away from "lit" exchange trading to "dark" trading (dark venues now handle close to half of all volume).
- A decline in broker competition and an increase in concentration in handling retail orders.
- A handful of firms now handle almost all retail orders, and the proportion of these orders that are "internalized" is now one-fourth of all market volume.
- The costs to access exchange fees have stayed high, at the maximum rate allowed, while almost all fees collected are transferred to a small number of trading firms in the form of rebates.

The Proposals are Based on Reviews, Comments and Data

The proposals do not arise in a vacuum. The SEC has been reviewing these issues and collecting data and comments ever since Reg NMS was adopted. This includes the issuance of "concept" releases, public roundtables, conducting a pilot on tick sizes, and reviewing proposals for reduction in access fees, among others. The SEC's latest proposals grew out of this ongoing review. In addition, none of the proposals are offered on a "take-it-or-leave it" basis. The SEC lays out, in detail, multiple alternative approaches on each aspect of the proposals and asks for comment about those, as well.

Profound Changes to the Market Justify these Rule Changes

Given the dramatic market changes, the SEC is fully justified in acting on each of the topics covered. In fact, one reason that U.S. markets have been strong is the willingness to adopt regulatory changes that keep up with the market. Because the nature of the changes since 2005 are profound and not incremental, it is not sufficient to make incremental changes to the rules. Those who are arguing loudest for no or minimal change are the intermediaries who are best served by the current market structure.

Comments on the Individual Proposals

Reduction in Access Fees

IEX Position:

The SEC should reduce the cap on fees exchanges can charge to access their quotes by two-thirds, from $0.003 to $0.001 per share, or from “30 mils” to “10 mils.” This is closely aligned with the SEC’s proposal.

- The cap set in 2005 is outdated. It has come to be used by the large exchanges as the standard rate to access quotes, which is out of step with market and economic changes since 2005.
- Technology advances mean that costs to process and match trades have gone down substantially.
- Market forces have pushed commission rates charged by brokers down significantly and have reduced “spreads” between the best bid and offer prices, but access fees remained essentially unchanged.
- In 2005, the SEC said it was seeking to avoid a result where exchanges charge high access fees and pay most of those fees out in the form of “rebates” to firms that provide quotes. But this is exactly what has occurred. Of all the access fees exchanges collect, on a net basis, they pay out in rebates all but 2 mils (more than 90%).
- Further these rebates are not equally distributed to liquidity providers. Under the “tier” rebate schedule the maker-taker exchanges use, the lion’s share of all rebate payments is paid out to a handful of trading firms. (IEX has done extensive analysis of public data to prove this point.)
- Rebates also create conflicts of interest to the extent brokers route orders to receive a rebate, since the rebate is not returned to the client.
- A standard access fee cap of 10 mils is in line with other transaction prices and aligns with previous proposals.
- In general, fees charged by ATSs which are not subject to the cap are at about 10 mils.
- The NYSE has previously proposed testing a cap at that level. Goldman Sachs is among trading firms that have argued for it.
- The only respect in which the SEC proposal is different is that the SEC proposed a lower (5 mil) access fee cap only for stocks that would be subject to the lowest of its 4 tick size categories. If the SEC simplifies the tick size proposal as we recommend, there is no reason not to apply the same cap to all stocks.

Tick Size

IEX Position:

Reduce the tick size to one half-cent for all stocks that have an average spread of up to 2 cents, while keeping the existing one cent tick size for all others. The SEC proposal would apply 4 different tick sizes, at levels of one-tenth cent, one-fifth cent, one-half cent, and one cent to different categories of stocks. Our recommendation differs from some industry proposals that favor a half-cent tick for stocks with a narrow spread, in that we would apply that tick to a somewhat larger set of securities.

- A lower tick size is warranted for many stocks because data shows that there is a demand to trade at a smaller increment than the current one cent.

- We favor a less aggressive reduction in tick sizes than the SEC proposed because we think very narrow tick sizes (at one-tenth cent and one-fifth cent) could harm investors, and there is not a demonstrated demand for trading at these very narrow ticks.
- With vary narrow tick sizes, much less liquidity is available at each price point, which means that quotes become less stable, i.e., more likely to "flicker" in and out. Fast electronic trading firms have a much better ability to use speed tools to adjust to this instability than institutional investors, who can never react as fast to changing prices.
- As a result, we think with overly narrow tick sizes, institutional investors will find it harder to trade on exchanges, which is contrary to the SEC's purpose.

We think the half-cent tick reflects the right balance between giving firms enough flexibility to trade at narrower prices without these negative consequences.

Retail Investor Orders

IEX Position:

The SEC should set a minimum trading increment of $0.001 per share (one-tenth cent) for all retail execution systems. It should also allow exchanges offering retail execution programs (which exist today) the ability to display the price and size of orders willing to give price improvement to retail investors. The proposal for this minimum trading increment is very similar to an alternative floated by the SEC.

- Retail execution systems as defined in our position include exchange programs to trade with retail investors (retail execution programs), as well as wholesaler retail systems.
- This alternative would put all venues executing retail orders on a level playing field by requiring that all trades occur at the same increments. Today, wholesalers can execute at 100 different prices within one cent, while exchanges are limited by the one-cent standard.
- It would also establish a minimum level of price improvement for retail orders. Today, because there is no minimum trading increment, a significant portion of orders that are internalized receive less than this minimum level of price improvement.
- Exchange retail liquidity systems would have the ability to display and advertise the size and specific price of orders willing to trade with retail orders sent by brokers at these same $0.001 increments.
- Because exchanges are now limited to displaying orders at one-cent increments, they are prevented from showing how much price improvement firms are willing to offer retail investors. This change would help to direct brokers to markets that offer the best possible prices for retail investors.
- This can also help institutional investors because it would increase chances for those investors to match up against retail orders at prices that are mutually beneficial.

Disclosing Better Prices

IEX Position:

We support the SEC proposal to fast-track implementation of changes to how securities display the best prices. This includes the use of new "round lot" sizes and disclosing odd-lot quotes in consolidated market data.

- The SEC already adopted changes to the 100-share round lot standard, which now applies to almost all stocks. Because there are many stocks with a high per share price, much more trading and quoting often happens in units of less than 100 shares. The change the SEC adopted in 2020 updates the rules with new round lot sizes that are based on share price.

- The SEC also required the public data feeds to include odd-lot quotes and to carry a measure of the best odd-lot bid and offer prices, which are often better than the NBBO prices retail investors see today. Adding this additional information will give ordinary investors a better chance to identify the best prices that may be available in the market. Today those prices can only be seen by firms that subscribe to expensive proprietary data feeds.

We look forward to continuing to participate in conversations around the SEC's proposals.