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April 15, 2016

By Electronic Mail

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: *Regulation of NMS Stock Alternative Trading Systems; Proposed Rule*, Release No. 34-76474; File No. S7-23-15

Dear Mr. Fields,

Markit appreciates the opportunity to provide the Securities and Exchange Commission (“Commission”) with comments on its proposed rule regarding Regulation of NMS Stock Alternative Trading Systems (“ATS-N”).¹

Markit² is a leading global diversified provider of financial information services.³ Founded in 2003, we employ over 4,000 people in 11 countries, including over 1,600 in the U.S., and our shares are listed on Nasdaq (ticker: MRKT). Markit has been actively and constructively engaged in the debate about regulatory reform in financial markets, including topics such as the implementation of G20 commitments for OTC derivatives and the design of a regulatory regime for benchmarks. Over the past years, we have submitted more than 140 comment letters to regulatory authorities around the world and have participated in numerous roundtables.

Markit’s Information Services division⁴ is a leading provider of compliance, analysis, and reporting of best execution and related execution quality data for broker-dealers, Alternative Trading Systems (“ATs”), and stock exchanges. We believe our expertise in U.S. equity market structure and our experience in collecting, analysing and publishing execution statistics for retail, institutional and regulatory market participants gives us a unique perspective on transparency around the handling and routing of institutional customer orders by broker-dealers. This letter addresses the comments requested by the Commission on the execution quality statistics

¹ Release No. 34-76474, 80 FR 80998 (“ATS-N”).

² See www.Markit.com for more details.

³ We provide products and services that enhance transparency, reduce risk and improve operational efficiency of financial market activities. Our customers include banks, hedge funds, asset managers, central banks, regulators, auditors, fund administrators and insurance companies. By setting common standards and facilitating market participants’ compliance with various regulatory requirements, many of our services help level the playing field between small and large firms and foster a competitive marketplace.

⁴ See <http://www.markit.com/Product/BestEx-Reporting> for more details.

currently made public under Rules 605 and 606 of Regulation NMS⁵ and the market quality information available to the public about ATSS and other trading centers.

Markit is also a leading vendor for fixed income securities data. For example, Markit pricing data for bonds uses price inputs from a variety of sources that are either aggregated to calculate composite levels or fed into a dynamic model to produce a price validated against a number of parameters. The service also includes full transparency on the depth of price sources used, a liquidity score reflecting the frequency and breadth of pricing and comprehensive analytics.

1. Executive Summary

We are generally supportive of the goals of ATS-N but are concerned that its focus on ATS operational transparency is too narrow. In particular:

a. There is a need for greater transparency in the operation of registered stock Exchanges and their affiliated routing brokers. At a minimum, any increase in the regulatory burden on ATSS should be matched by the same burden on stock Exchanges, including external oversight despite their Self-Regulatory Organization (SRO) status.

b. While it is certainly helpful to the investing public to have greater transparency on the *operations* of all markets, such disclosures are essentially qualitative and do not inform specific routing decisions. What is needed is more data on the efficacy of each service or order type offered. Thus, we propose that the SEC require all regulated markets to provide clear and statistically verifiable data on each type of order and routing service that they offer.

c. One of the major benefits of the ATS structure is the flexibility for ownership by broker dealers and asset managers. While it is important to address conflicts of interest that can be created by such ownership, the definition of affiliates, and the scope of disclosures, as proposed, is too broad. We agree with SIFMA and other commenters that disclosures should be limited to the activities that have a direct bearing on the operations of the ATS.

d. We agree with ATS-N's exclusion of fixed income ATSS from the scope of ATS-N, although we do think that such ATSS should publicly file their Form ATS. We also believe that such markets could benefit from enhanced disclosures, but fixed income is sufficiently different from equities to warrant a separate regulation.

⁵ See Release No. 34-43590 (November 17, 2000), 65 FR 75414 (December 1, 2000) (Disclosure of Order Execution and Routing Practices - Rules 11Ac1-5 and 11Ac1-6); and Release No. 34-51808 (June 9, 2005), 70 FR 37469 (June 29, 2005) ("Regulation NMS") (among other things, re-designating Rules 11Ac1-5 and 11Ac1-6 as Rule 605 and 606 respectively).

2. Discussion

a. There is a need for greater transparency in the operation of registered stock Exchanges and their affiliated routing brokers. At a minimum, any increase in the regulatory burden on ATSS should be matched by the same burden on stock Exchanges, including external oversight despite their Self-Regulatory Organization (SRO) status.

The Commission's adoption of Regulation ATS⁶ was a major milestone in the evolution of the U.S. equity market. The original concept was to foster innovation by establishing a structure whereby brokers could create and operate alternative trading systems ("ATSS") with less regulatory burdens and more flexible ownership restrictions than fully registered stock Exchanges while preserving the fundamental goals of a national market system of economically efficient executions, fair competition and broad dissemination of basic market information.⁷ By all accounts, Regulation ATS was a success, as the Commission lists 86 ATSS as of March 1, 2016.⁸ Over the past two decades, trading costs have declined, share and dollar volume have increased and spreads have narrowed, all due at least in part by the rise of ATSS.⁹ Over the same period of time, ATSS have evolved to address specific investor needs. Examples include ATSS that specialize in block trading (Liquidnet, BIDS, Luminex), and ATSS with new and innovative features such as on demand, high speed auctions (PDQ), and price protection for pegged orders (IEX). In addition, such robust markets as BATS (and Direct Edge, which has subsequently merged with BATS¹⁰) have evolved into Exchanges after starting as ATSS.¹¹

The flip side to this innovation is increased complexity, both in terms of the number of venues and the number and nuances of specific products offered.¹² Unfortunately, execution quality statistics currently made public by Rules 605 and 606 of Regulation NMS, and market quality statistics made available to the public by the Exchanges and ATSS are inadequate for a statistically valid comparison of the venues and their products. We discuss our specific recommendations for enhanced transparency in both execution quality reporting and routing practices below. But we

⁶ Release No. 34-40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) (Regulation of Exchanges and Alternative Trading Systems) ("Regulation ATS").

⁷ See id at 70847 ("This regulatory framework should encourage market innovation while ensuring basic investor protections.").

⁸ See "Alternative Trading Systems with Form ATS on File with the SEC as of March 1, 2016" located at: <https://www.sec.gov/foia/docs/atsslist.htm>.

⁹ See ATS-N at 81115.

¹⁰ See Release No. 34-71449 (January 30, 2014), 79 FR 6961 (February 5, 2014) (Self-Regulatory Organizations; EDGA Exchange, Inc.; EDGX Exchange, Inc.; Order Granting Approval of Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, in Connection With the Proposed Business Combination Involving BATS Global Markets, Inc. and Direct Edge Holdings LLC).

¹¹ See Release No. 34-58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) (In the Matter of the Application of BATS Exchange, Inc. for Registration as a National Securities Exchange; Findings, Opinion, and Order of the Commission).

¹² See "U.S. Equity Market Structure: An Investor Perspective," Blackrock, April 2014 at 6, available at: <http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-us-equity-market-structure-april-2014.pdf> ("Blackrock") ("The proliferation in new order types and resulting modifications to order prioritization and matching logic has dramatically increased complexity in the market."). See also ATS-N at 81115 ("Additionally, order types and their characteristics can also vary significantly across NMS Stock ATSS, including with respect to how particular order types interact with other order types, which could affect execution priorities.").

believe that enhanced transparency should apply to all market participants (not just ATSS) to forward the national market system goals of economically efficient executions, fair competition and broad dissemination of basic market information. Exchanges, like ATSS, support dark trading models that do not display any quotations in the consolidated quotation data, and offer a number of different and complex order types and routing strategies in direct competition with ATSS and other venues and outside of SRO status.¹³ Failing to extend enhanced transparency requirements to Exchanges for activities commensurate with those of ATSS would result in an incomplete picture of market quality, making it difficult for investors to conduct meaningful comparisons to inform their decisions and protect their own interests. It may also result in a competitive advantage to Exchanges, which is the very kind of competitive imbalance that the Commission wishes to address in ATS-N.¹⁴ Neither of those results would improve investor confidence or improve the integrity of the markets, and may stifle the innovation that has made Regulation ATS such a success. Thus, despite the fact that ATS-N is limited to ATSS, we believe it would be inappropriate to require more disclosures from ATSS than what is required of NMS stock Exchanges. We therefore respectfully submit that all improvements in disclosures be applicable to Exchanges as well as to ATSS.

b. While it is certainly helpful to the investing public to have greater transparency on the operations of all markets, such disclosures are essentially qualitative and do not inform specific routing decisions. What is needed is more data on the efficacy of each service or order type offered. Thus, we propose that the SEC require all regulated markets to provide clear and statistically verifiable data on each type of order that they offer.

The goal of enhanced disclosures is to inform investor decisions that would benefit from transparency regarding the relative value of individual routing and order placement strategies.¹⁵ While it would be helpful to understand how the matching engines of ATSS and Exchanges operate with regard to the interaction of each type of order from each type of subscriber, the real goal of this reporting should be to provide data on the likely *outcomes* of utilizing each type of order or service offered by these firms. For example, learning about specific ATS or Exchange features designed to prevent adverse selection is interesting, but verified data demonstrating the amount of adverse selection¹⁶ (as well as fill rates and execution quality metrics) would be much more valuable. Such data, if made available to trading firms, could be used to develop routing and order placement strategies. To underscore this point, we recommend the following general principles be applied to the disclosure rules:

¹³ See Blackrock at 6.

¹⁴ See ATS-N at 81001 (“The Commission is concerned that the differences between ATSS that trade NMS stocks and registered national securities Exchanges with regard to operational transparency may be creating a competitive imbalance between two functionally similar trading centers that may trade the same security but are subject to different regulatory requirements.”).

¹⁵ See ATS-N at 81001 (“Transparency is the hallmark of the U.S. securities markets and a primary tool by which investors protect their own interests”).

¹⁶ Adverse selection is defined as market movement after the order is filled that indicates that a better price would have been achieved if the fill had not occurred. Realized spread is the metric used to show if adverse selection tends to occur.

- 1) All trading systems and Exchanges should be required to report the execution quality of each order type they offer. This information should be made accessible to the public on a delayed and aggregated basis to avoid disclosing sensitive data and include information from firms that route orders, match orders, or execute orders as principal.
- 2) All statistical disclosures pursuant to either SEC rules or voluntarily provided should either be validated by a third party or be labelled "unverified." This would help investors know whether the statistics being presented could be exposed to potential conflicts of interests. This is similar to the rules governing listed companies disclosures of financial results since they are required to specify if the results they are presenting are audited and compliant with generally accepted accounting standards.¹⁷ It is also similar to the way that registered investment companies publish returns.¹⁸

ATS-N asks many questions in the release about improving disclosures of execution quality data. Rather than answer those questions individually, we believe that the best approach would be to amend both Rules 605 and 606 of Regulation NMS as follows:

- 1) Execution quality statistics of market centers, currently made public under Rule 605 should be enhanced to:
 - a. Expand the rule to cover the term "trading centers"¹⁹ in order to include all firms that report trades that are included in the "consolidated tape;"
 - b. Broaden the definition of "covered orders"²⁰ for reporting purposes to include all orders submitted by a client to a trading center, regardless of order size or trading conditions (and add new "covered order" size buckets 1-99, 10,000 – 24,999, 25,000+);
 - c. Reclassify the reporting categories into order type and trading characteristic combinations that are statistically comparable. This should include, at a minimum, the following categories:
 - i. Not Held (with and without limit prices);

¹⁷Section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m) sets forth the periodic and other reports required of every issuer of a registered security. Regulation S-X (17 CFR 210.1-01 and 02) sets forth the requirements for financial statements required to be filed with the Commission, including: "Representations as to the audit: The accountant's report: (1) Shall state whether the audit was made in accordance with generally accepted auditing standards." Section 103(a) of the Sarbanes-Oxley Act of 2002 (Pub. L. 107-204, 116 Stat. 745 (2002)) authorizes the Public Company Accounting Oversight Board ("PCAOB") to establish standards for accounting firms, which includes a requirement that issuer financial statements audited by a public accounting firm that is not registered with the PCAOB are considered to be non-audited and deficient, and any 10-K, proxy statement or registration statement containing or incorporating by reference such financial statements should be amended to, among other things, label the columns of the financial statements as "not audited." (See PCAOB Rule 4110.4 (Qualification of Accountants) dated June 30, 2009, located at: <https://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.pdf#topic4>).

¹⁸Section 13(f) of the Securities Exchange Act of 1934 (15 U.S.C. 80a-29(g)) requires financial statements contained in annual reports required of registered investment companies by the Commission be accompanied by a certificate of independent public accountants.

¹⁹ Rule 600(b)(78) of Regulation NMS.

²⁰ Rule 600(b)(15) of Regulation NMS.

- ii. Held Market orders without trading restrictions;
 - iii. Held Market orders with trading restrictions (AON, FOK, SS, etc);
 - iv. Held Marketable Limit orders without trading restrictions in 3 categories:
 - 1. IOC;
 - 2. At the Market Day orders (Limit price = NBBO); and
 - 3. Thru the Market Day orders (Limit price > NBO or < NBB);
 - v. Held Marketable Limit orders with trading restrictions (AON, FOK, SS, etc):
 - 1. IOC;
 - 2. At the Market Day orders (Limit price = NBBO); and
 - 3. Thru the Market Day orders (Limit price > NBO or < NBB);
 - vi. Held Non-Marketable Limit orders (Inside the spread, at the spread, near the spread and away from the spread);
 - vii. Pegged Orders (classified separately as “Displayed” and “Non-Displayed”):
 - 1. Inside the spread;
 - 2. Passive (buy on bid, sell on offer); and
 - 3. Aggressive (buy on offer, sell on bid);²¹
 - viii. Auction orders including Open, Close and periodic auctions;
 - ix. Require new order types that gain approval to either be statistically comparable to one of the above categories or add a new one to the requirements.
- d. Standardize the NBBO benchmark for orders received to be the last quote of the prior time interval provided by the trading center; and
 - e. Add the percentage of all non-marketable orders that are displayed as a statistic. This should be for all orders as well as for all executed orders.

2) Order Routing statistics, currently made public under Rule 606 should be enhanced to:

- a. Apply to all routing firms (including those of Exchanges and ATSS);
- b. Include basic metrics of execution quality to all categories of executed orders, in line with the above;
- c. Categorize the reporting for routed and executed orders in separate reports, broken out by marketability (including at the market and through the market);
- d. Add a new report of unexecuted routed orders (including IOC, dark and visible limit orders);
- e. Quantify net fees paid and rebates received from each routed venue where executions occurred, per new marketability category;

²¹ Aggressive pegged orders have limit prices that potentially allow them immediate execution at current market prices, and, for this reason, are classified as marketable limit orders that are currently disclosed under Rule 605 of Regulation NMS. See Staff Legal Bulletin No. 12R (Revised) “Frequently Asked Questions about Rule 11Ac1-5” dated June 22, 2001, Question 5, available at: <https://www.sec.gov/interps/legal/slbim12a.htm#g5>.

- f. Eliminate or significantly reduce the 5% threshold to capture all relevant venues; and
- g. Standardize interpretation of “directed order”²² and require disclosure of the routed destinations when a firm acts in a “riskless principal” capacity.

We believe that these disclosures would meet the SEC’s policy goal of improving transparency and facilitating data driven decision-making by firms that route customer orders. The data that is proposed in this letter is quite similar to the market quality data being collected to validate the Tick Pilot,²³ which means that it should not be difficult to collect. It will, however, provide a standardized method for routing firms to compare market centers and will almost certainly lead firms to upgrade their best execution policies and to do even more detailed analysis.

c. One of the major benefits of the ATS structure is the flexibility for ownership by broker dealers and asset managers. While it is important to address conflicts of interest that can be created by such ownership, the definition of affiliates, and the scope of disclosures, as proposed, is too broad. We agree with SIFMA and other commenters that disclosures should be limited to the activities that have a direct bearing on the operations of the ATS.

The stated goal of the proposal is to improve transparency in order to help investors make more informed decisions about the utilization of each ATS.²⁴ As a result, we agree that it is important for all rules and operational processes that govern the prioritization and categorization of participants to be transparent and for all subscriber information to be treated equally with respect to confidentiality.

We do not agree, however, that imposing significant burdens on investment manager or broker affiliates of ATSs is an appropriate response to perceived conflicts of interest. We believe the most effective and efficient way to address conflicts of interest is to limit disclosures to the way in which ATS affiliates and non-affiliated subscribers of the ATS interact with the ATS and any differences in treatment between these two groups. Thus, while we support more transparency into the operations of ATSs that are highly integrated within a particular broker dealer, there is no reason to require substantial disclosures about trading operations that are run separately from an ATS that happen to be an affiliate of the ATS. In addition to the significant administrative burdens the current proposal would create,²⁵ it would also run the risk of precluding firms from utilizing an

²² Rule 600(b)(19) of Regulation NMS.

²³ See Release No. 34-74892 (May 6, 2015), 92 FR 27514 (May 11, 2015) (Joint Industry Plans; Order Approving the National Market System Plan to Implement a Tick Size Pilot Program by BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, The Nasdaq Stock Market LLC, New York Stock Exchange LLC, NYSE MKT LLC, and NYSE Arca, Inc., as Modified by the Commission, for a Two-Year Period) (the “Tick Pilot”) and The Plan to Implement A Tick Size Pilot Program Submitted To The Securities and Exchange Commission Pursuant to Rule 608 of Regulation NMS Under the Securities Exchange Act of 1934 (the “Tick Pilot Plan”) at page 27 (Appendix B – Data Collected by Participants and Trading Centers) available at: <https://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-final.pdf>.

²⁴ See supra note 14.

²⁵ See Letter to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission, from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA, dated March 7, 2016 (“SIFMA Letter”), pgs 4, 8-17.

ATS which would otherwise be considered integral to their best execution policy. This is due to the fact that some firms, particularly investment manager owners of ATSs, might well determine that the proposed disclosure regime is either too expensive or runs counter to their policies for them to take on the burden it creates when trading with its affiliate.²⁶

We also believe that it is important to note that, in the recent settlements cited by ATS-N, there were conflicts of interest related to commercial relationships that had nothing to do with affiliates.²⁷ As a result, we believe that all differential treatment of subscribers should be disclosed, including volume discounts or access to trading data that is not generally available to all subscribers upon request. Thus, we propose that disclosures of affiliate relationships be limited to the following:

1. All ATS rules or operations that differ in respect to affiliates as compared to other subscribers must be disclosed. This includes, but is not limited to smart order routing that is offered on a packaged basis to clients along with access to the ATS or Exchange. If affiliates are treated identically to other subscribers, no additional disclosure should be required beyond the fact that the ATS has affiliated subscribers.
2. All ATSs that allow non-ATS personnel access to the confidential trading data of other ATS subscribers should disclose the uses for which that data is allowed. If such data is shared with an affiliated broker dealer for the purpose of supporting its router or to improve the liquidity provision of its market making operation, the details of that use and the data access must be disclosed to all subscribers.

In conclusion, Markit believes that the goals of ATS-N of requiring market centers to provide better information to subscribers is laudable and deserves support. Such information should, however, also be required of all markets including ATSs and Exchanges to allow for a complete and comparable picture of market quality, and should be focused upon the actual outcomes of trading with these venues to allow investors to make meaningful trading decisions. To accomplish these goals, we propose that all market centers be required to provide execution quality data on each type of order and service offered in addition to disclosing the operations of those services. We further propose to focus ATS disclosures upon all operational differences and data utilization policies that vary between subscribers as a better method of highlighting potential conflicts of interest.

²⁶ See Letter to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission, from Marc R. Bryant, Senior Vice President, Deputy General Counsel, Fidelity Investments, dated February 26, 2016 (“Fidelity Letter”), pg 5.

²⁷ See ATS-N at 81042 fn 374 (e.g., UBS ATS violated sub-penny pricing rules, failed to disclose in its Form ATS that it made available certain features on behalf of users of UBS’s trading algorithms only, and granted access to subscriber confidential trading information to non-ATS employees; LiquidNet granted access to subscriber confidential member trading information to non-ATS employees as a part of the employees’ marketing initiatives towards other clients; INET ATS violated fair access requirements of Regulation ATS for certain covered orders; Brut ECN failed to disclose in its Form ATS that it executed non-subscriber orders against rounded (inferior) prices).

d. We agree with the exclusion of fixed income ATSS from the scope of ATS-N.

We agree with ATS-N's exclusion of fixed income ATSS. We agree with the Commission when it observed the key differences between equity and fixed income markets: in fixed income markets, trading is largely bilateral; there is less reliance on speed or automation to accomplish trades; trades generally do not involve order types or strategies of the same complexity as in the equity markets; and subscribers may have different reasons for using fixed income ATSS and for comparing them to one another than is the case in the equity markets.²⁸ In addition, fixed income ATSS are currently not as evolved as equity ATSS, and the success and innovation experienced by ATSS under Regulation ATS might be thwarted if fixed income ATSS were made subject to excessive regulatory burdens and other restrictions at this stage of their development.

While fixed income markets might benefit from some transparency enhancements, we recommend the Commission address those separately and in a manner tailored to the structure of the fixed income markets. For example, we would support SIFMA's suggestion that the Commission could enhance transparency among the fixed income ATSS by requiring that firms publish their current Form ATS filings while the Commission considers alternative forms of disclosure.²⁹

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Markit thanks the Commission for the opportunity to submit these comments. If the Commission has any questions or would like additional information, please do not hesitate to contact us.

Respectfully submitted,



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Cc:

The Honorable Mary Jo White, Chair
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner
Stephen Luparello, Director, Division of Trading and Markets
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²⁸ See ATS-N at 81017.

²⁹ See SIFMA Comment Letter on File No. S7-23-15, at 34.