February 26, 2015

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Regulation of NMS Stock Alternative Trading Systems; Proposed Rule (File No. S7-23-15)

Dear Secretary Fields:

Better Markets[1] appreciates the opportunity to comment on the above-captioned proposed rule ("Proposal") issued by the Securities and Exchange Commission ("SEC" or "Commission").[2]

The Proposal represents an important enhancement in the oversight of alternative trading systems ("ATSs"), but a great deal more is required in this area to protect investors and reduce systemic risks. For example, the Proposal does not solve the underlying disparity in the regulation of functionally similar entities: Even with the adoption of the Proposal, registered exchanges will be subject to far more robust regulation, while ATSs will continue to be exempt from many of those requirements. The Commission must strengthen the Proposal to further close this regulatory gap and to better protect investors seeking appropriate venues for their securities trades.

BACKGROUND AND SUMMARY

Regulation ATS was adopted in 1998 to address the growth of alternative trading systems that functioned electronically and provided many of the same services as securities exchanges. Despite convulsive changes in the equity markets, a litany of misconduct by dark pools, and the resulting harm to investors, Regulation ATS has not been updated since its adoption nearly eighteen years ago. Meaningful reform was badly needed then, and it is long overdue now. The SEC has allowed the markets and

[1] Better Markets, Inc. is a nonprofit organization that promotes the public interest in the domestic and global capital and commodity markets. It advocates for transparency, oversight, and accountability in the financial markets.

[2] *See* Release No. 34-76474, 80 Fed. Reg. 80998 (Dec. 28, 2015).

technology to completely pass it by, to the detriment of those markets and investors. It is time for that to change.

Under Regulation ATS, registered broker-dealers operating a trading system are exempt from registration as a national securities exchange as long as they simply disclose certain basic, nonpublic information on Form ATS and file it with the Commission.

The SEC's approach under Regulation ATS has been fundamentally flawed since its inception. As alternative trading venues began to approach the scale of trading services, trading volume, and complexity that is typical of exchanges, the Commission could have designed a regulatory framework that created a level playing field between exchanges and ATSs. Instead, they elected to allow ATSs to perform all the essential functions of exchanges with substantially less oversight. Indeed, under current Regulation ATS, the core requirement is simply a notice filing of Form ATS with the Commission. Those forms are non-public and do not even require approval by the SEC. Such submissions provide only limited information on ATS operations and no information about conflicts of interest whatsoever. The substantive minimalism of Regulation ATS was philosophically misguided from the very beginning.

Three core problems grew out of this misguided approach. First, the equity markets became less transparent. As a result, market participants increasingly struggled to identify the venues with the best order execution quality, and market efficiency suffered accordingly. Second, competitive imbalances among and between functionally similar trading centers—ATSs and exchanges—grew. And third, conflicts of interest arising from the operational complexities of ATSs, including the dual roles of the broker-dealer as ATS operators and as brokers, proliferated, all while remaining invisible to investors.

A number of recent ATS enforcement cases illustrate the opaque nature of these conflicts of interest and how they pose a serious threat to investors. For example, in 2011, the Commission brought an enforcement action against Pipeline Trading Systems for publicly representing that no proprietary trading took place in its dark pool. But in fact, not only did one of the firm's affiliates engage in proprietary trading in the pool, but it also secretly used confidential client information to front-run its subscribers' trades.[3] More recently, the Commission sanctioned Investment Technology Group, Inc. for failing to disclose that its proprietary trading desk was trading within its pool and enjoying certain informational advantages over other subscribers.[4] And in yet another example, the Commission took enforcement action

[3] *See In the Matter of Pipeline Trading Systems LLC, Fred J. Federspiel, and Alfred R. Berkeley III*, Securities Exchange Act Release No. 9271 (Oct. 24, 2011).

[4] *In the Matter of ITG Inc. and Alternet Securities Inc.*, Securities Exchange Act Release No. 75672 (Aug. 12, 2015).

against UBS Securities LLC for offering high speed traders special order types that gave them an advantage over other classes of subscribers.[5]

With this as background, on November 18, 2015, the Commission voted unanimously to propose amendments to Regulation ATS under the Securities Exchange Act of 1934 (the "Exchange Act") that impose wide-ranging new disclosure requirements on ATSs that transact in National Market System ("NMS") stocks. The extensive level of disclosure required under the Proposal and the role it envisions for the SEC in reviewing and ultimately approving the design and operations of NMS Stock ATSs is a recognition of the exchange-like nature of NMS Stock ATSs. Certainly, the Proposal aligns the regulation of NMS Stock ATSs more closely with the way in which national securities exchanges are regulated. The Proposal is also a reflection of the SEC's broader, appropriate focus on needed reforms in our equity market structure.

The new rule is an improvement on the status quo, but it ultimately falls short in three key respects. First, the Commission's fundamental approach of differential regulation of ATSs and exchanges remains intact, yet it is less and less justifiable in light of the increased trading volumes and complexities that characterize our contemporary equity markets and ATSs in particular. Now, more than ever, it is critical that ATSs be subject to essentially the same regulatory requirements as exchanges. This was apparent even in 2010, when then-Senator Edward E. Kaufman urged the Commission to "harmonize rules across all market centers to ensure exchanges and ATSs are competing on a level playing field that serves the interests of all investors."[6]

Second, concerns about a level playing field aside, the rule must be strengthened. As the release notes, "transparency is a hallmark of the US securities markets and a primary tool by which investors protect their own interests."[7] The proposed rule makes important progress in this area. However, the rule must do more to elucidate when an investor may be facing a real or potential conflict of interest. And where a material conflict of interest exists, the Proposal should ban such conflicts. In addition, the Proposal must give the Commission a range of enforcement sanctions for progressively more serious violations, rather than just the blunt instrument of a declaration of ineffectiveness.

Finally, the rule should be expanded to cover more than just NMS ATS. The scope of the Proposal should be widened to include dark pools that trade Treasury bonds, corporate bonds, municipal securities, and non-NMS equities, or alternately, the Commission should act separately to bring transparency to those ATSs as well. There is no legitimate reason why the oversight of dark trading pools should not be enhanced across the board, so that all investors receive commensurate levels of transparency and protection, regardless of the particular type of security they wish to trade.

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5 *In the Matter of UBS Securities LLC*, Securities Exchange Act Release No. 74060 (Jan. 15, 2015).
6 80 Fed. Reg. 81012 (Dec. 28, 2015).
7 80 Fed. Reg. 81001 (Dec. 28, 2015).

OVERVIEW OF THE PROPOSAL

The essential features of the Proposal are as follows:

- NMS Stock ATSs must file Form ATS-N and receive a declaration of effectiveness from the SEC to be exempt from the regulations applicable to national securities exchanges.

- Form ATS-N requires disclosures that pertain to the activities of the broker-dealer operator and its affiliates in connection with the NMS Stock ATS, as well as disclosures relating to the manner of operations of the NMS Stock ATS.

- Form ATS-N must be certified by an authorized person of the NMS Stock ATS, and that signatory must confirm that the Form ATS-N is "current, true and complete."

- Amendments to Form ATS-N must be submitted in the event of any "material" change to the NMS Stock ATS's operations or to the activities of the broker-dealer operator or its affiliates that are disclosed in the Form ATS-N.

- NMS Stock ATS must maintain written safeguards and procedures to protect confidential subscriber information.

- Form ATS-N and all related orders and notices will be publicly available on the SEC's website.

COMMENTS

I. The Proposal's disclosure requirements alone will not fully protect investors nor establish parity in the regulation of ATSs and exchanges, but they represent an important first step that lays a foundation for future regulatory oversight and accountability measures in line with requirements applicable to exchanges.

The Proposal is an important first step toward bringing greater transparency, more fair competition, and above all, stronger investor protections in the realm of NMS Stock ATSs and the associated activities of their broker-dealer operators. But it is only a first step.

The most notable characteristic of the Proposal is that it is almost entirely oriented toward requiring enhanced disclosure, rather than imposing substantive duties and standards of conduct on ATSs. Ultimately, relying on disclosure alone to drive ATSs toward more equitable practices when they have considerable countervailing financial incentives is unlikely to succeed. And it is certainly incapable of establishing level competition among ATSs and exchanges.

Those concerns notwithstanding, the Commission is to be applauded for the comprehensiveness of the required disclosures under Proposed Form ATS-N. These disclosure requirements appropriately cover the activities of broker-dealers and their affiliates in connection with NMS Stock ATSs as well as the manner of operations of the NMS Stock ATS in thorough detail. These disclosures will provide valuable information on areas of the equity markets that had previously been largely opaque, resulting in greater insight for investors on ATS trading services, fees, market data, order types, and trading algorithms.

II. Simply requiring the disclosure of the underlying facts that give rise to conflicts of interest at an ATS is of relatively little value; the Proposal must be strengthened to include an outright ban on all material conflicts of interest and to require clear and explicit disclosure of all permitted conflicts of interest designated as such.

The Proposal will undoubtedly be useful to investors who seek to learn more about the potential conflicts of interest that can arise when the business interests of a broker-dealer operator or its affiliates clash with the interests of market participants that trade on the ATS. For example, the Proposal requires ATSs to disclose whether they or any of their affiliates are submitting trades to the ATS. In addition, ATSs would be required to disclose whether they (or any subset of their subscribers) retain any advantages over other subscribers, such as preferential access to special order types or trade information. And the Proposal would require ATSs to disclose their policies and procedures for ensuring the confidentiality of subscribers' information. These ATSs would also have to identify the positions of employees and third parties that have access to this information.

Conflicts such as these have been at the heart of a number of recent enforcement cases brought by the SEC, highlighting the refusal or inability of dark pools to properly manage their conflicts of interest. Such conflicts represent a significant and growing area of concern for investors. The Commission is to be commended for beginning to shine a light on these conflicts. As a result, market participants will be better equipped to assess whether they are trading on a level playing field with other subscribers and less likely to fall victim to promises of safety and fair treatment that, all too often, have turned out to be illusory or false.

Although the Proposal contains these constructive provisions aimed at illuminating conflicts of interest, more must be done before the goal of actually stamping out harmful conflicts can be achieved. One troubling aspect of the Proposal is the underlying premise that: "anything goes, as long as it is disclosed." Accordingly, the Commission should strengthen the Proposal by actually banning material conflicts of interest that may arise between an ATS and its affiliates, rather than relying on disclosure alone to generate conflict-reducing market incentives. Material conflicts of

interest should not be tolerated, and no amount of disclosure can provide the necessary protection for investors against such conflicts.

At minimum, the Commission must do more to help investors identify conflicts of interests. The Proposal requires the disclosure of considerable volumes of information, and many of the ingredients of common conflicts of interest will be embedded in that information. But the Proposal does not actually require clear disclosure of conflicts as such. Instead, investors will have to sift through large amounts of information, connect disparate data points, and analyze their implications to uncover conflict of interests. Such conflicts may be hidden deep within the complex structure and operations of an ATS, and this disclosure scheme does little to make them readily apparent to investors.

While it is beneficial to require ATSs to actually spell out the details of the form that a conflict of interest may take, this disclosure scheme would be much more useful if it required the explicit disclosure of conflicts as conflicts—perhaps in a section of the form entitled "Conflicts of Interest"—using plain language and a simple, clear format.

Helping investors cope with damaging real and potential conflicts of interest appears to be a primary aim of the Proposal. The best way to achieve this end is by simply creating a flat, enforceable bar against material conflicts of interest. And as to any permitted conflicts of interest, the Proposal must require more explicit and helpful disclosures, including summaries that use the label "conflicts of interest."

III. The Proposal's reliance on "blunt instrument" enforcement mechanisms will create opportunities for ATSs to game and evade the Proposal's provisions without being subject to meaningful consequences.

The Proposal's primary enforcement mechanism is the SEC's ability to declare a Form ATS-N ineffective, thus prohibiting an ATS from operating as an NMS Stock ATS. Though a declaration of ineffectiveness does not prevent an NMS Stock ATS from filing a new Form ATS-N, it would engender serious business disruptions for a period of months at minimum.

This is a serious sanction, and to invoke it, the Commission must go through an extensive process. The SEC can only declare a Form ATS-N ineffective after providing an ATS with notice and the opportunity for a hearing and after finding that a declaration of ineffectiveness is "necessary or appropriate" in the public interest and consistent with investor protection.

The SEC provides examples of when it would declare a Form ATS-N ineffective; one such example occurs when the form's required disclosures are found to be "materially" deficient in its "key" attributes. The remainder of the examples pertain to inconsistent disclosures and non-compliance with the federal securities laws.

Materially deficient disclosures, inconsistent disclosures, or disclosures that reveal violations of the federal securities laws are all major causes for concern. Thus, the logic of this enforcement scheme is plain enough: serious violations will result in serious sanctions.

The defect in this enforcement scheme is also apparent: What action can the Commission take if there are ambiguous, seemingly incomplete, or otherwise questionable disclosures that do not rise to the level of material deficiency, or that seem serious without rising to a level that should result in a declaration of ineffectiveness? Certainly, the Proposal permits the Commission to extend the review period or ask for additional information, but there are no intermediate sanctions available that would motivate compliance on the part of an ATS that is determined to withhold information or muddy the waters with confusing disclosures.

Such intermediate sanctions should be available. They should include monetary fines and temporary suspensions of the right to operate as an NMS Stock ATS without notice or hearing. The Commission should incorporate such sanctions into the Proposal to ensure compliance with the considerable level of disclosure that it requires.

Note that the Proposal's certification and liability components do not adequately address the need for an intermediate layer of sanctions to ensure that enforcement under the rule can be tailored to the full range of potential violations. The Proposal provides that each Form ATS-N will be considered a "report" for purposes of the Exchange Act, and thus it is unlawful for any person willfully and knowingly to make false and misleading statements with respect to a material fact in the Form ATS-N. And an authorized person of the NMS Stock ATS must confirm as a signatory that the contents of Form ATS-N are "current, true, and complete."

This is a meritorious component of the Proposal. Nonetheless, the required showing for securities fraud involves "willful and knowing" false statements with respect to a "material" fact in the form. The knowledge and willfulness elements of securities fraud have historically been difficult to prove, and disclosure statements are inherently susceptible to gaming and ambiguous responses that do not rise to the level of outright fraud. A fraud liability overlay is no substitute for an array of immediate enforcement sanctions for progressively more serious violations.

IV. The scope of the Proposal should be widened to include dark pools that trade other types of securities, including Treasury bonds, corporate bonds, municipal securities, and non-NMS equities, or alternately, the Commission should act separately to bring transparency to those ATSs as well.

As demonstrated above, the Proposal must be strengthened in a number of respects to ensure better oversight of all ATSs that offer a trading venue for NMS securities. These regulatory enhancements should also be extended to all ATS, regardless of the specific type of security in which they trade.

Conceptually, this is the right approach. All investors in securities deserve equally robust protections against conflicts of interest and assurances of access to transparent information relating to their trading venues. And all trading venues should be able to conduct their businesses on a level regulatory playing field, again regardless of the types of securities trading they seek to offer to investors.

Extending the enhanced protections of the Proposal, as modified in accordance with these comments, to all types of ATS is also the optimal regulatory policy from a pragmatic point of view. Lax or piecemeal regulation cannot be justified with arguments to the effect that trading in certain securities is sparse and that we should allow for innovation in those markets before adopting more effective regulatory measures. This approach is simply delaying the inevitable while in the meantime allowing investors to be needlessly victimized and market participants to be needlessly burdened with unfair disparities in regulatory treatment. The best course is to move forward with broad-based reforms as to all ATS, in fulfillment of the SEC's overarching duty to protect investors and ensure the integrity of the marketplace.

CONCLUSION

We hope that these comments are helpful as the Commission finalizes its Proposal.

Sincerely,

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