VIRTU FINANCIAL

April 18, 2022

VIA ELECTRONIC DELIVERY

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: **Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange"; Regulation ATS for ATSs That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSs That Trade U.S. Treasury Securities and Agency Securities, Release No. 34-94062; File No. S7-02-22 (Jan. 26, 2022)**[1]

Dear Ms. Countryman:

Virtu Financial, Inc. ("Virtu")[2] appreciates the opportunity to submit this letter in response to the above-referenced rule proposal issued by the Securities and Exchange Commission (the "SEC" or "Commission") on January 26, 2022 (the "Proposal").

While we recognize that the intent of the Proposal is to enhance the regulatory construct governing a fundamental and critical component of the infrastructure of our capital markets, we respectfully submit that the Commission has failed to meet its burden in justifying why the proposed changes are needed, or the benefits of the proposed changes, and in doing so the Commission has deviated from its mission and statutory authority. Most notably:

1. **The Commission has exceeded its statutory authority by failing to conduct an adequate economic analysis in recommending the Proposal. Specifically, the Proposal:**
   - **A. Fails to Clearly Identify the Justification for the Proposed Rule**
   - **B. Fails to Calculate a Baseline**
   - **C. Fails to Consider Alternatives**
   - **D. Fails to Consider Economic Consequences of the Proposal (Both Benefits and Costs)**
2. **The Commission has exceeded its statutory authority in expanding the definition of "exchange" to include marketplaces that "make available" non-discretionary methods for buyers and sellers to agree to the terms of a trade [including so-called "Communication Protocol Systems" ("CPS") that utilize investors' trading interest]**

---

[1] U.S. Securities and Exchange Commission, Proposed Rule, *Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange"; Regulation ATS for ATSs That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSs That Trade U.S. Treasury Securities and Agency* Securities, Release No. 34-94062; File No. S7-02-22 (Jan. 26, 2022), *available at* https://www.sec.gov/rules/proposed/2022/34-94062.pdf.

[2] Virtu is a leading financial firm that leverages cutting edge technology to deliver liquidity to the global markets and innovative, transparent trading solutions to its clients. Virtu operates as a market maker across numerous exchanges in the U.S. and is a member of all U.S. registered stock exchanges. Virtu's market structure expertise, broad diversification, and execution technology enables it to provide competitive bids and offers in over 25,000 securities, at over 235 venues, in 36 countries worldwide. Virtu broadly supports innovation and enhancements to transparency and fairness that increase liquidity and promote competition to the benefit of all marketplace participants and investors.

3. **The proposed amendments to Reg ATS and Reg ATS-N are unwarranted, will harm the marketplace, and will result in unnecessary costs and burdens that are harmful to investors**

I. Background

Before we express our views on the substance of the Proposal and respond directly to the Commission's specific requests for comment, we would like to share some observations about the process that preceded its release. The Proposal traces its origins to the Commission's prior concept release (the "2020 Concept Release") and rule proposal (the "2020 Proposal") on the topic of Regulation ATS ("Reg ATS").[3] We note, however, that the comments sought in response to the 2020 Concept Release and the potential changes contemplated in the 2020 Proposal focused exclusively on fixed income markets and marketplaces – and primarily on government securities markets and marketplaces. The 2020 Concept Release and 2020 Proposal generated substantial commentary from potentially impacted investors, market participants, and other commentators, with nearly two dozen comment letters submitted, many of which are referenced and considered within the current Proposal. Importantly, the 2020 Concept Release and 2020 Proposal did *not* include any discussion, request for comment, or proposal focused on U.S. equities markets. As such, the current Proposal reflects no formal input, commentary, or reaction from U.S. equities markets participants and investors, all of whom may have reasonably assumed that the 2020 Concept Release and 2020 Proposal would not result in changes to existing rules applicable to U.S. equities markets.

This reasonable assumption has turned out to be incorrect as the Commission has taken the unorthodox step of expanding the 2020 Proposal into the current Proposal and bringing within its ambit *substantial* and *disruptive* proposed changes to how U.S. equities markets operate, without having first canvassed market participants and investors for their views on whether and how proposed changes would improve efficiency and competition in the equities markets or otherwise promote capital formation, and indeed whether there exists any shortcoming or problem for which the expansion of the exchange/ATS regulatory ambit may provide a remedy. Instead, without an understanding of market practices, the Commission issued the Proposal consisting of in excess of 650 pages and over 200 questions (with many requests containing multiple questions).

The challenges and burdens associated with the unorthodox and procedurally questionable approach taken by the Commission are, of course, compounded by the inadequate 30-day period the Commission has allowed for commenters to digest, synthesize, analyze, and respond to the Proposal. While we recognize that the Commission has emphasized the delay between the Proposal's announcement and its publication in the Federal Register as a mitigant, this comes as little solace for market participants and investors as they must be prepared for publication in the Federal Register at any point, at which time the clock begins ticking. We question the appropriateness of mandating such a short comment period and believe that any sincere desire to engage with market participants and investors on a proposal would require a comment period of at least 60 days, depending on the scope of the proposal.

It also bears noting that, since proposing the changes to Reg ATS in January 2022, the SEC has released at least 13 additional rule change proposals with overlapping comment periods. Many market participants and investors, including Virtu, will be significantly impacted by some or all of these proposals. The SEC's issuance of so many proposals in such a truncated time period is inconsistent with the established notice and comment process and deprives the entire industry from providing meaningful responses –

[3] U.S. Securities and Exchange Commission, Proposed Rule; Request for Comment; Concept Release, *Regulation ATS for ATSs that Trade U.S. Government Securities, NMS Stock, and Other Securities; Regulation SCI for ATSs that Trade U.S. Treasury Securities and Agency Securities; and Electronic Corporate Bond and Municipal Securities Markets*, Release No. 34-90019; File No. S7-12-20 (Sept. 28, 2020), *available at* https://www.sec.gov/rules/proposed/2020/34-90019.pdf.

VIRTU FINANCIAL

constraining the valuable feedback available for the Commission to consider. It would appear based on the SEC's abnormal cadence and haste to distribute releases at its current pace (as reflected in the chart below) that the staff may only be going through the motions with no real interest in learning from responses from commentors. Obviously, time and the actions of the Commission will tell if this is correct.

#	**Proposal Date**	**Comments Due by (*at the latest)**	**Proposal**
1	1/26/2022	4/18/2022	SEC Proposes Amendments to Include Significant Treasury Markets Platforms Within Regulation ATS
2	1/26/2022	3/21/2022	SEC Proposes Amendments to Enhance Private Fund Reporting
3	2/9/2022	4/25/2022	SEC Proposes to Enhance Private Fund Investor Protection
4	2/9/2022	4/11/2022	SEC Proposes Cybersecurity Risk Management Rules and Amendments for Registered Investment Advisers and Funds
5	2/9/2022	4/11/2022	SEC Issues Proposal to Reduce Risks in Clearance and Settlement
6	2/10/2022	4/11/2022	SEC Proposes Rule Amendments to Modernize Beneficial Ownership Reporting
7	2/10/2022	4/11/2022	SEC Proposed Changes to Two Whistleblower Program Rules
8	2/25/2022	4/26/2022	SEC Proposes Short Sale Disclosure Rule, Order Marking Requirement, and CAT Amendments
9	3/9/2022	5/9/2022	SEC Proposes Rules on Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure by Public Companies
10	3/21/2022	5/20/2022*	SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors
11	3/23/2022	5/23/2022*	SEC Proposes Amendments to Remove References to Credit Ratings from Regulation M
12	3/28/2022	5/27/2022*	SEC Proposes Rules to Include Certain Significant Market Participants as "Dealers" or "Government Securities Dealers"
13	3/30/2022	5/30/2022*	SEC Proposes Rules to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections
14	4/6/2022	6/6/2022*	SEC Proposes Rules Relating to Security-Based Swap Execution and Registration and Regulation of Security-Based Swap Execution Facilities

Finally, as described in detail below, we observe that the Commission did not and has not analyzed or attempted to properly analyze the benefits and costs of those aspects of the Proposal that would expand the definition of "exchange" which would potentially capture swaths of the market previously commonly understood to be neutral tools and technology products. We note that many products and workflow or technology tools have emerged during the decades since the adoption of Reg ATS and its definitions and exemptions, which shaped the contours of the regulatory perimeter. These tools, products, and services provide substantial value to many investors who rely on these offerings to streamline their transactions in equities in a more efficient manner than they could with legacy and antiquated technologies. These efficiencies include access to liquidity and size not otherwise available on exchanges and ATSs, reduced market impact and execution costs, and mitigation of exchange and ATS fees.

The potential expansion of the SEC's regulatory authority to include these neutral technology tools and products may jeopardize their existence and/or increase their costs bases, either of which ultimately raises costs for investors and could deprive them of the significant benefits that streamlined workflows provide to the marketplace – *i.e.*, enabling investors to interact with market participants more efficiently. Unfortunately, these significant costs were not considered by the Commission, which declined to engage in an adequate economic analysis of the Proposal as required, **nor was the purported benefit against which such costs could be compared articulated or specified within the Proposal.**

Further, the Proposal's requests for comment attempt to place the burden of cost analysis on the commenter – the implication being that the SEC is empowered to enact any rule that it wishes without demonstrating a market failure that needs to be addressed or the costs and benefits of a rule change, so long as no commenter presents a quantifiable costs/benefit or market impact assessment. Also telling are the many requests in the Proposal for commenters to submit data – further evidencing that the Commission was not armed with sufficient information to engage in the robust economic analysis required before a proposed rule appropriately may be advanced.[4]

For example, the Commission admits that it lacks adequate data on the use of systems that would qualify as CPSs by non-ATS trading systems operating in the OTC equity market, as well as data sufficient to estimate the number or trading volume of inter-dealer quotation systems or other OTC equity trading systems that operate as communication protocol systems and are not registered as broker-dealers.[5] These are essential data points that need to be analyzed in order for the Commission to assess the benefits and costs of the Proposal, and the absence of data further demonstrates the Commission has not met its burden. In sum, the Commission's approach is not consistent with the Administrative Procedure Act.

II. The Commission has exceeded its statutory authority by failing to conduct an adequate economic analysis in recommending the Proposal

The Commission's rulemaking authority is described in the agency's Canon of Ethics. Specifically, in exercising its rulemaking power:

[4] *See, e.g.*, Request 181 ("Do you agree that trading in the Treasury securities market is concentrated in a few large ATSs? Please provide data to support your position."); Request 206 ("Do you agree with the Commission's assessment of the costs of the proposed amendments? If not, please provide as many quantitative estimates to support your position on costs as possible."); Request 207 ("The Commission requests that commenters provide any insights or data they may have on the costs associated with the proposed broker-dealer requirements for Communication Protocol Systems that are operated by non-broker-dealers."); Request 209 ("Would Government Securities ATSs also incur direct compliance costs (non-PRA based) as SCI entities?... Please explain and provide cost estimates or a range for cost estimates, if possible."); p. 315 ("Commenters are requested to provide empirical data in support of any arguments or analyses.").

[5] *See supra* n. 1 at 413-14.

VIRTU FINANCIAL

> "The Commission performs a legislative function. The delegation of this power by the Congress imposes the obligation upon the members to adopt rules necessary to effectuate the stated policies of the statute in the interest of all of the people. Care should be taken to avoid the adoption of rules which seek to extend the power of the Commission beyond proper statutory limits. Its ***rules should never tend to stifle or discourage legitimate business enterprises or activities, nor should they be interpreted so as unduly and unnecessarily to burden those regulated with onerous obligations***. On the other hand, the very statutory enactments evidence the need for regulation, and the necessary rules should be adopted or modifications made or rules should be repealed as changing requirements demand without fear or favor."[6] (emphasis added)

When promulgating rules under the Securities Exchange Act, the Commission is required to conduct an economic analysis of the likely consequences of a rule. The Securities Exchange Act provides that the Commission must always consider "the impact any . . . rule or regulation would have on competition," and may not adopt any "rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of" the securities laws. 15 U.S.C. § 78w(a)(2). In addition, in connection with facilitating the establishment of a national market system for securities, the SEC is expressly required to have "due regard for the public interest" and the "protection of investors." 15 U.S.C. § 78k-1(a)(2). In considering the "public interest," the Commission must also consider, "whether the action will promote efficiency, competition and capital formation." 15 U.S.C. § 78c(f). **Courts have held that, in considering the impact of a rule on efficiency, competition and capital formation, the Commission has a "statutory responsibility to determine the likely economic consequences of a rule."** *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011); see also *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005).

In conducting its economic analysis, the Commission is required to follow the standards set forth in Executive Order 12866, which states:

> "In deciding whether and how to regulate, agencies ***should assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating***. Costs and benefits shall be understood to include both quantifiable measures (to the fullest extent that these can be usefully estimated) and qualitative measures of costs and benefits that are difficult to quantify, but nevertheless essential to consider. Further, in choosing among alternative regulatory approaches, agencies should select those approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity), unless a statute requires another regulatory approach."[7] (emphasis added)

In 2012, the Commission's Division of Risk, Strategy, and Financial Innovation – now known as the Division of Economic and Risk Analysis ("DERA") – and the Commission's Office of the General Counsel ("OGC") issued guidance on economic analysis in Commission rulemakings.[8] The guidance provides that each rulemaking include a sound economic analysis with the following elements:

- "(1) a statement of the **need** for the proposed action (*i.e., a market failure that needs to be addressed)*;

[6] 17 C.F.R. § 200.67 - Power to adopt rules.
[7] Executive Order 12866, Regulatory Planning and Review (Sept. 30, 1993). As an independent regulatory agency, the Commission is not legally bound by the requirements in Executive Order 12866. However, the Commission has recognized that these principles represent accepted standards of good practice in conducting rulemaking proceedings.
[8] Current Guidance on Economic Analysis in SEC Rulemakings (Mar. 16, 2012), *available at* http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

- (2) the definition of a **baseline** against which to measure the likely economic consequences of the proposed regulation;
- (3) the identification of **alternative** regulatory approaches; and
- (4) an **evaluation of the benefits and costs** – both quantitative and qualitative – of the proposed action and the main alternatives identified by the analysis."

DERA and OGC also noted that "[h]igh-quality economic analysis is an essential part of SEC rulemaking. It ensures that decisions to propose and adopt rules are informed by the best available information about a rule's likely economic consequences, and allows the Commission to meaningfully compare the proposed action with reasonable alternatives, **including the alternative of not adopting a rule**."[9](emphasis added)

In proposing amendments to Reg ATS and Rule 3b-16, the Commission has **failed to "assess all costs and benefits of available regulatory alternatives"** and has **failed to demonstrate that "changing requirements" warrant an updated rule**, and that there is sound policy basis underlying such changes; that is, the Proposal fails to articulate the **need for the proposed** rule changes and the **rationale for why such changes purportedly would help** promote "efficiency, competition, and capital formation." The Commission also has failed to explain or justify its reasoning for "whether and how to regulate" in this area, as required under Executive Order 12866, and has ignored its own OGC guidance to identify a market failure that needs to be addressed.

Among other items, the 654-page Proposal would impose sweeping, material and burdensome obligations on market participants by (i) expanding the definition of exchange to include "communication protocol systems;" ("CPS") (ii) expanding Reg ATS to cover "Government Securities ATSs;" (iii) extending Regulation SCI to cover Government Securities ATSs; and (iv) expanding requirements for ATSs that trade NMS stock and other securities. The results of this would be harmful for investors. The nature and scope of the proposed amendments would dramatically alter market structure and impose untenable costs on market participants in a way that would clearly ***"stifle or discourage legitimate business enterprises or activities."***[10] Furthermore, as described in greater detail below, the Proposal's attempt at economic analysis fails to "***assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating***."[11]

The defects in the Commission's economic analysis of the economic impact the Proposal would have on wide swaths of investors in the marketplace that will be affected by any eventual regulation render the Proposal invalid under any reading of the Administrative Procedures Act, Executive Order 12866, and the Commission's own Canon of Ethics and related guidance.

A. Specific defects in economic analysis

Although the Proposal purports to set forth an economic analysis that may satisfy the requirements under the law, the analysis is superficial and falls short in numerous key respects. In many ways, it appears as though the SEC understands the requirements outlined in the OGC's guidance for rulemaking; however, the Proposal simply lists the requirements and does not address them.

1. Failure to Clearly Identify the Justification for the Proposed Rule

First, the economic analysis fails to "[c]learly identify the justification for the proposed rule"[12] as required under the SEC's own guidance. The Proposal alleges that there is an unlevel playing field in

---

[9] *Id*.
[10] *Supra* n. 6.
[11] *Supra* n. 7.
[12] *Id*.

the fixed income space,[13] contending that in marketplaces where CPS are prevalent, "market participants cannot avail themselves of the same investor protections, fair and orderly market principles, and Commission oversight that apply to today's registered exchanges or ATSs."[14] However, the Proposal fails to explain or substantiate why this so-called "regulatory gap" is harmful to investors or why subjecting these market centers to the heightened requirements of Reg ATS will address any perceived deficiencies in the current regulatory framework for the fixed income markets. **Simply put, the Commission does not articulate reasons why or how the Proposal will provide any benefits to investors in the fixed income market. Further, the Proposal's rationale for why the amendments should be applied to the equities markets is even more tenuous and unsupported.**

A clear justification of the substantive need for a rule change is a critical part of a proper economic analysis. If the economic analysis lacks a clear, persuasive justification, this also undermines the other components of the economic analysis. A clear articulation of why rulemaking is necessary forms the logical underpinnings for the third prong of the SEC's guidance (identifying reasonable alternatives) and the fourth prong (analyzing the consequences of the proposed rule and the alternatives). Evidence of market failure, abuse, or inefficiencies in the "baseline" world (*i.e.*, the current regulatory regime) is crucial as a logical precursor to claiming that the proposed rule will have any benefits, such as fixing the problems observed in the baseline world.

Evidence of a market failure is particularly important if the benefits of the rule cannot be quantified but can only be described qualitatively. In a well-functioning, well-regulated market, additional regulations that are redundant or do not address any problems would not be expected to generate significant additional benefits. In such cases, the purported economic analysis may be limited to vague statements about the benefits of more regulation, such as that the rule will benefit market participants and investors by increasing investor protection or enhancing Commission oversight. However, without a clear understanding of how the proposed rule will actually address a documented problem, such statements should not be viewed as evidence of actual benefits.

It appears the only justification given in the Proposal is the idea that CPSs are functionally similar to exchanges/ATSs and should therefore be regulated the same way. For example, the Proposal claims that CPSs "engage in similar market activities" as exchanges/ATS but are not regulated as such.[15] Further, the Proposal claims that CPSs have lower "investor protections, fair and orderly market principles, and Commission oversight."[16] However, the Proposal **does not**: (i) demonstrate that the level of regulation/investor protections in CPSs is inadequate given the existing regulatory framework in place for broker dealers (and other market participants); or (ii) provide any evidence that any market participants or investors have been harmed under the current regime.

In the absence of any evidence of market failure or systematic abuse/harm to investors, creating a "more level competitive landscape"[17] is not a sound justification for imposing unnecessary rules. There are myriad examples of entities with similar economic functions facing different regulatory structures under existing law, where lawmakers or the SEC have determined that the same type/level of regulation is not necessary for all entities (*e.g.*, private vs. public issuers, larger vs. smaller issuers, private vs. registered investment companies' funds, and so on.). It would be woefully inefficient to impose a uniform regulatory structure on market structures that are fundamentally different. The proposed rule inappropriately adopts a

---

[13] *Supra* n. 1 at 26.
[14] *Supra* n. 1 at 25.
[15] *Id.*
[16] *Id*.
[17] *Supra* n. 1 at 26.

VIRTU FINANCIAL

one-size-fits-all approach to regulating trading systems (without demonstrating the benefits of a one-size-fits-all approach) rather than being tailored to the specifics of individual platforms.

Finally, the logic for whether to expand the scope of Reg ATS seems starkly different for fixed income markets and equity markets, where much of the current activity is already executed on exchanges and ATSs. The little justification provided in the Proposal is focused almost entirely on fixed income markets. Even if the economic analysis were deemed adequate (which it is not) in justifying or scoping certain fixed income CPS under Reg ATS, that does not imply that there is a need to impose new requirements on NMS equity systems.

2. Failure to Calculate a Baseline

Second, the economic analysis fails to calculate a baseline in that it does not clearly explain what customer protections are available under the current status quo and identify regulatory gaps. The Commission argues that the main purported benefits envisioned by the Proposal are: (i) potential benefits of increased safeguarding of confidential customer information, due to extension of rules in Reg ATS; (ii) potential benefits of increased resiliency due to Reg SCI requirements; (iii) potential benefits associated with "Fair Access"[18]; and (iv) potential benefits associated with post-trade price transparency and associated improvements in price discovery.

However, in order to evaluate whether these benefits are real, and how large they are, the SEC must consider the extent to which these protections are present or absent in the baseline (status quo) market. The Proposal does not. The Proposal should consider the degree to which other existing regulations already help with safeguarding of customer confidential information, such as FINRA rules for any systems operated by a broker or the oversight of banking regulators for systems operated by a non-BD bank. Again, the Proposal does not. The SEC should also consider the existing inspections and enforcement regime that should already help prevent abuse of customer confidential information. Once again, the Proposal comes up short.

Regarding resiliency, Reg SCI is motivated by concerns about systemic risk and functionality during times of market stress. The baseline section of the Proposal should provide evidence on which CPS in which markets are large enough and systemically important enough to trigger the concerns underlying Reg SCI. The Proposal does not. The Proposal should also provide more evidence on the extent to which CPS are already providing a level of resiliency consistent with Regulation SCI. Without this information, the SEC cannot assess whether imposing new requirements on CPS will generate any benefits.

Regarding post trade transparency, the baseline section should make clear this is already a reality for equity CPS, and for a bond CPS operated by a FINRA member who reports trades to TRACE and EMMA.[19] Therefore, forcing Reg ATS on equity and bond CPSs would not generate the desired benefit. The baseline section should also consider evidence as to whether price discovery in the market for government securities is poor in the current market, and whether post-trade reporting is needed to help with price transparency. The Proposal does not include this analysis.

---

[18] *See Supra* n. 1 at 102 ("[T]he Commission is proposing that a Government Securities ATS will be subject to the Fair Access Rule if, during at least four of the preceding six calendar months: (1) it had three percent or more of the U.S. Treasury Securities average weekly dollar volume traded in the United States as provided by the SRO to which such transactions are reported; or (2) it had five percent or more of the Agency Securities average daily dollar volume traded in the United States as provided by the SRO to which such transactions are reported.").

[19] TRACE, short for the Trade Reporting and Compliance Engine is a FINRA-developed framework that facilitates the mandatory reporting of over-the-counter transactions in eligible fixed income securities by broker-dealers who are FINRA members. EMMA, short for Electronic Municipal Market Access, is a similar reporting framework for municipal securities administered by the Municipal Securities Rulemaking Board.

In sum, if the Proposal fails to provide evidence in the baseline of insufficient protection along these dimensions, then it also fails to establish that the rule has any incremental benefits. As we see here, the Proposal imposes costs but has no benefits, and the alternative of "doing nothing" would be better than the proposed rule.

3. Failure to Consider Alternatives

Third, the economic analysis fails to discuss or consider a number of alternatives that could address the stated objectives of the Proposal. **Understandably, it is difficult to assess alternative solutions when a problem has not been identified.** Assuming the Commission can find evidence that the "baseline" regime provides insufficient protections in these areas, then the economic analysis should consider whether there are alternative ways such protections can be enhanced. For example:

- Should the Commission require that the operator of a CPS that trades securities be registered as a broker dealer (but without the CPS being subject to Reg ATS)?
- If the CPS is operated by a non-BD bank, are bank regulations insufficient to safeguard customer information?
- If the CPS is operated by a BD, are FINRA rules insufficient to safeguard customer information?

The Proposal does not consider any of these alternatives and therefore fails the third prong of the SEC's guidance.

4. Failure to Consider Economic Consequences of Proposal (Both Benefits and Costs)

Finally, the economic analysis fails to appropriately consider the economic consequences – both the benefits and the costs – that could flow from the Proposal.

New regulation on broker-dealer systems could cause brokers to discontinue services, chill innovation, or increase costs to investors. The Proposal fails to establish that all would-be CPSs covered by the proposed rule are economically similar to exchanges and existing ATSs. The Proposal would put new regulatory burdens on brokers who operate systems currently outside of the scope of the proposed new rule, or who might seek to innovate new such systems in the future. The Proposal also fails to consider whether ATSs should be given limited legal liability (as exchanges have today) or whether exchanges should be required to register as broker-dealers (and, accordingly, be subject to FINRA's broker-dealer rules).

These burdens translate to higher costs and worse experiences for end users (investors), which the Commission readily and directly acknowledges:

> "The proposed amendments to extend Regulation ATS to Communication Protocol Systems, Currently Exempted Government Securities ATSs, and Current Government Securities ATSs and Regulation SCI to significant Government Securities ATSs and certain Communication Protocol Systems would result in a number of compliance costs. The Commission believes that compliance costs could be passed through (e.g., via higher fees) to market participants, resulting in higher trading costs."[20]

Yet the Commission also readily and directly acknowledges that it is unable to quantify the costs and benefits that would flow if the Proposal were adopted, and admits that it does not have sufficient data to quantify the economic benefits and costs of the proposed changes:

> "The Commission has attempted, where possible, to quantify the benefits and costs anticipated to result from the amendments to Exchange Act Rule 3b-16, Regulation ATS, and Regulation SCI. However, as explained in more detail below, because the Commission

[20] *Supra* n. 1 at 451.

> does not have, and in certain cases does not believe it can reasonably obtain data to inform the Commission on certain economic effects, the Commission is unable to quantify certain economic effects. Further, even in cases where the Commission has some data, it might not be practicable to perform a quantitative analysis due to the number and type of assumptions necessary to quantify certain economic effects, which would likely render any such quantification unreliable."[21]

By the Commission's own admission, the Proposal's economic analysis is deficient in its assessment of the economic consequences – both benefits and costs – that would result if it were adopted.

Equally concerning, mandating ATS registration and aggregation of volumes from all ATSs at the parent level and compliance with the incredibly onerous Reg SCI would very likely result in a reduction in the number of platforms, potentially constraining market liquidity, increasing spreads, and making our capital markets less attractive for innovative new businesses looking to raise capital. The Proposal ignores the fact that there are legitimate business reasons for certain market participants to have multiple ATS, and that forcing aggregation at the parent level will undermine those legitimate business purposes. Finally, we question the claims in the Proposal concerning the purported benefits in the form of "price discovery and liquidity." This seems like a stretch given the lack of data supporting that claim.

III. The Commission has exceeded its statutory authority in expanding the definition of "exchange"

Congress specifically and narrowly defined "exchange" in the Securities Exchange Act of 1934:

> "The term 'exchange' means any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange."[22]

Contrary to the Commission's contention in the Proposal, Congress did not intend for the statutory definition to be broadly and flexibly interpreted. **The Proposal's expansion of the definition to include CPS is an attempt by the Commission to expand its authority without demonstrating a need to further regulate market participants in a way that was never envisioned by Congress.** Expanding the definition of exchange as broadly as contemplated by the Proposal would be a very slippery slope that could lead to the SEC asserting its authority in a manner that Congress never intended.

A. The Proposal Contorts Commonly Understood Meaning of "Exchange"

The SEC's approach inappropriately stretches and contorts the commonly understood meaning of "exchange." Under current Rule 3b-16,[23] an exchange is defined as a marketplace that "***uses*** established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade." The Proposal would distort that definition to include a marketplace that "***makes available*** established, non-discretionary methods (whether by providing a trading facility or communication protocols, or by setting rules) under which buyers and sellers can interact and agree

[21] *Supra* n. 1 at 431.
[22] 15 U.S. Code § 78c(a)(1).
[23] 17 CFR § 240.3b-16 - Definitions of terms used in Section 3(a)(1) of the Act.

to the terms of a trade." In the current, commonly understood formulation, the marketplace sets rules for all. In the proposed formulation, the marketplace merely has to make some functionality available that each individual user can use their own discretion to set, and that can be different for every user. The Proposal also abandons the concept in the current definition of an exchange of bringing together "the ***orders*** for securities of ***multiple buyers and sellers***", and replaces it with the notion of bringing "together ***buyers and sellers*** of securities ***using trading interest***." These changes represent a material shift from the current regulatory construct where a central marketplace sets the non-discretionary methods for buyers and sellers to interact, to a decentralized marketplace where individual market participants and investors set their own unique, non-discretionary methods for trading.

B. The Proposal Fails to Define "Communication Protocol System"

Moreover, the Proposal is woefully deficient in that the key term – "CPS" – is not even defined. The Proposal offers a few examples but fails to provide any rationale for the examples. We worry that this ambiguity could lead to the SEC effectively defining CPS through the enforcement process. We are also concerned that the Proposal underestimates the number of systems that could be deemed to be CPSs, and therefore is not supported by the Proposal's already tenuous economic analysis. Footnote 72 of the Proposal clearly establishes that single dealer platforms are out of scope.[24] However, the examples of CPS identified in the Proposal seem to conflict with themselves. For example, the Proposal references platforms that "stream indications". Accordingly, it is unclear whether a single dealer platform that streams indications of interest would be classified as a CPS under the Proposal. To the extent that the Commission moves forward with a final rule, it is critical that the agency confirms the existing framework for single dealer platforms – *i.e.*, any system however constructed that only has a single dealer that is the counterparty to every buyer and every seller and assumes the risk of every trade is not an exchange as defined under Rule 3b-16. The Commission should also reconfirm prior guidance that incidental matching of orders by market makers similarly is not activity that meets the definition of an exchange.

While the Proposal is clear about what ***is not*** included in the definition of CPS, what ***is*** included is ambiguous. The Proposal's failure to define the term CPS poses many challenging issues and will make compliance exceedingly difficult. If the Commission identifies a policy reason and legal basis for regulating CPSs, it should propose a new set of rules for them rather than define them as "exchanges" and try to fit them into the Reg ATS framework. Defining CPSs as "exchanges" could have significant negative impact on market structure, including cross-border regulatory implications. Many broker-dealers that would be impacted by the proposed changes are subject to regulatory frameworks governing trading in foreign jurisdictions, such as MiFID II. The Proposal fails to address how the new proposed definition of exchange would interact with the obligations of market participants in non-U.S. jurisdictions, and it is unclear whether the Commission even consulted with those jurisdictions about the potential impact on market structure.

As a consequence, any effort by the Commission to regulate CPSs should be undertaken as part of a more unified approach including proper economic analysis in assessing what (if any) regulatory measures are warranted for the activities at issue. Any changes to the regulatory construct for ATSs should be accomplished as part of a more thorough review similar to the process that was followed when the Commission adopted Regulation NMS, including notice and comment and a re-

---

[24] *Supra* n. 1 at n. 72 ("The Commission is not proposing to amend Exchange Act Rule 3b-16(b), which excludes from the definition of 'exchange' systems that perform only traditional broker-dealer activities, including: systems that route orders to a national securities exchange, a market operated by a national securities association, a broker-dealer for execution, or systems that allow persons to enter orders for execution against the bids and offers of a single dealer if certain additional conditions are met. These systems would continue to not fall within the definition of 'exchange.'").

proposal after the Commission has had the opportunity to hear from the public and consider how best to address any identified market failures and establish a baseline involving CPSs.

Fundamentally, we also continue to believe that it is inappropriate to apply Reg ATS to all electronic platforms that may "facilitate" trading between and among market participants. In a 2021 letter submitted in response to the 2020 Proposal, SIFMA raised serious concerns about imposing regulation on firms that serve merely as "informational conduits" and particularly doing so without first conducting a study on the impact of additional regulation of such firms.[25] We strongly agree that much more study and analysis of whether there is a market failure that needs to be addressed, and of the impact such a sweeping change would have on market structure, is warranted before expanding the reach of Reg ATS to cover such workflow technologies and trading tools. **Unless and until the Commission can persuasively justify that a change is needed, it is impossible for market participants and investors to assess and weigh the potential costs and benefits and market impact to judge whether the scope of the proposed solutions is appropriately tailored.**

C. The Proposal Fails to Validate a Change in Circumstances Warranting a Rule Revision

The Proposal also fails to explain why the Commission believes the original rationale for the current definition of "exchange" and the specified exemptions has changed. There is no indication that Congress has expressed a need for a change in the statutory definition of exchange of the nature the Commission is proposing and, as articulated above, the Proposal fails to identify a problem or market failure that needs to be addressed or why the current regulatory construct is deficient. While we appreciate that certain technology platforms can operate as non-ATSs under the current regulatory construct, there is no data that we are aware of establishing that the status quo is contributing to a market failure or harming investors.

IV. Reg ATS updates will harm the marketplace and are unwarranted

The Proposal fails to adequately articulate what has changed since the time when Reg ATS was adopted that warrants making these changes now. The original adopting release for Reg ATS comprehensively articulated a basis for exempting certain activity, like trading in government securities, from Reg ATS. The current Proposal offers no justification of the need for combining the volume of different trading systems or aggregating trading systems at the parent level. Additionally, the Commission has not provided evidence of any investors being harmed by the current regime or how the proposed regime would improve investors' outcomes.

Moreover, the proposed updates to Reg ATS will harm the marketplace and market participants and investors. For example, lowering the Reg SCI and Fair Access thresholds (which are already low), combined with the expanded definition of "exchange" and the proposal to aggregate ATS activity at the parent level could increase the amount of ATSs subject to Reg SCI and Fair Access. This could significantly increase operational costs and regulatory risk of operating an ATS, potentially reducing the number of unique ATSs and thus the amount of unique liquidity available in the market.

Notably, these effects would be felt most significantly by issuers and investors in less-liquid and small-cap names. Constraining liquidity in any segment of the marketplace is harmful; constraining liquidity in small-cap and thinly traded securities could have a harmful negative impact on capital formation and could discourage companies from accessing our markets to raise capital. By definition, thinly traded securities do not trade very often, which makes it easier for an

[25] SIFMA Letter to Vanessa Countryman (Mar. 1, 2021), *available at* https://www.sec.gov/comments/s7-12-20/s71220-8431290-229613.pdf.

ATS to hit the Fair Access (and Reg SCI) thresholds in those securities. The proposed aggregation of volume across ATSs would make it more likely to hit the thresholds, creating a disincentive to commit capital in these securities in ATSs, potentially increasing investors' cost to trade.

V. Reg ATS-N updates also are unwarranted and will result in unnecessary costs and burdens

Virtu is a staunch supporter of regulatory enhancements that call for more comprehensive disclosure and incentivize increased innovation and competition in the marketplace. While we are not necessarily opposed to the additional disclosure requirements for NMS securities contemplated under the proposed amendments to Reg ATS-N, we question whether they are needed. As with the proposed amendments to Reg ATS, the SEC has failed to substantiate the existence of a market failure that warrants amendments to Form ATS-N. The Commission recently adopted final rules amending Reg ATS-N in 2018, and the Proposal fails to articulate what has changed since that action to warrant further updates to the rule.

The Proposal contemplates a significant number of changes to Reg ATS-N that will be very costly to implement – and the Commission has not articulated how the proposed changes will benefit investors. Further, once again, the Proposal attempts to place the burden of demonstrating quantifiable costs and harm on the commenter without articulating a need for the proposed changes.[26]

When the amendments to Reg ATS were enacted to provide for the filing of Form ATS-N, Virtu was supportive of the enhancements that the new form would provide. Even before the adoption of Form ATS-N, Virtu made the material portions of its Form ATS available on its website to provide information about how Virtu's ATS operated and how other Virtu business units interacted with Virtu's ATS. Form ATS-N brought a level of uniformity to how all ATSs disclosed information.

Virtu dedicated several of its personnel who collectively spent over one hundred hours drafting the new form ATS-N for the two ATSs Virtu operates. We believe other ATS operators similarly collectively spent hundreds if not thousands of hours drafting their forms. As is evidenced by the fact that the SEC issued a *Notice of Extension of Commission Review Period* for virtually every ATS that filed the new Form ATSs, and despite good faith efforts to faithfully complete the forms in the manner we all believe was intended by the SEC, the SEC nonetheless had to extend its time to declare the forms effective for another 120 days beyond the initial compliance date for virtually every ATS that filed a Form ATS-N.

While the current Proposal appears largely aimed at the markets for fixed income securities, the Commission nonetheless, as part of the current Proposal, will require ATSs that only trade NMS securities to file an amendment to their Forms ATS-N so that their disclosures will meet all the new requirements of Form ATS-N. As is discussed in other parts of our comment letter, the new Proposal recasts what had been a well understood framework for defining an exchange to a new ambiguous framework that we believe is largely unworkable, without any basis or evidence for why such changes are warranted.

Within that framework, new categories of information will be required, including new information about types of subscribers (proposed Part III, Item 1), monitoring and surveillance (proposed Part III, Item 9), interaction with related markets (proposed Part III, Item 11), the identity of liquidity providers (proposed Part III, Item 12), and post-trade processing (proposed Part III, Item 21).

[26] *See supra* n. 4.

In addition, NMS stock ATSs would be required to reorganize responses to existing information, including, among others, (i) to move disclosures related to the activities of employees of the broker-dealer operator or its affiliates that service the operations of the ATS and another business unit of the broker-dealer operator or affiliate; (ii) to separately discuss information relevant to trading facilities or rules for bringing together orders of buyers and sellers; (iii) to disclose information related to use of non-firm trading interest; and (iv) to disclose any differences in treatment among subscribers, persons whose trading interest is entered into the ATS by a subscriber of the broker-dealer operator, the broker-dealer operator, and any affiliates of the broker-dealer operator.

We believe that Form ATS-N as currently crafted already provides an adequate framework for the material disclosures the SEC contemplates. The SEC has not articulated a market failure that is occurring under the current regime or how the new regime would benefit investors. However, we know that the changes advanced by the SEC's Proposal will likely require ATS operators to again spend cumulatively thousands of hours redrafting forms that were adopted barely two years ago. As the SEC is aware, these were not just hours spent only by the industry, but also by the SEC's own staff. Furthermore, the implementation deadlines for these changes are unrealistically short, and the Commission's time (only 30-40 hours) and cost estimates (below-market rates) for the industry to implement these changes are grossly underestimated.

Finally, combining equities and fixed income in the same Form Reg ATS-N could have the unintended consequence of reducing transparency and creating confusion. It will be exceedingly challenging for readers of the Form to interpret how the questions and responses apply distinctly to equities or fixed income.

In sum, the proposed changes to Reg ATS-N are a dangerous example of "scope creep" from amendments that purportedly are intended to update the regulatory regime for fixed income, but that also will have sweeping impact and impose substantial costs and burdens and create confusion in the equities markets.

VI. Proposed path forward

The proposed amendments represent regulatory overreach and vastly expand the SEC's authority to regulate ancillary market participants and impose redundant new rules on participants already subject to regulation. If adopted, the amendments would stifle innovation, and dramatically change the existing market structure for both fixed income and equities – all without a stated benefit. The Proposal would also needlessly impose vast and unwarranted costs and burdens on a wide cross-section of investors and other market participants. We believe the existing regulatory construct governing ATSs is adequate and promotes competition, transparency, and efficiency in the marketplace. In addition, commercial competitive pressure and the ability for investors to choose their service providers drives the market to provide greater transparency, value, and services to investors.

We respectfully submit that, instead of seeking to advance to a final rule, the Commission should undertake a much more thorough review of market structure considerations related to ATSs. To that end, we recommend that the Commission convert the Proposal to a "concept release" (or at least treat it as such) that would assist the SEC in determining whether further rulemaking is warranted. Armed with the robust information and data that the Proposal's comment file is likely to generate, the Commission would be much better equipped to determine whether there is a market failure that needs to be addressed and, if so, to issue a new proposal that is narrowly tailored and targeted squarely to achieve the desired benefits necessary to address specific market structure deficiencies under the existing framework.

Virtu would welcome the opportunity to participate in that process and serve as a resource to the Commission in identifying aspects of the regulatory framework that could be enhanced and in framing narrowly tailored solutions.

* * *

Virtu has long been a vocal proponent of smart, data-driven regulation that supports the goals of enhancing transparency, fostering robust competition among market participants, and ensuring the high quality of the retail investor experience. Unfortunately, the Commission's Proposal does none of these things. Instead, the Proposal represents an unsubstantiated attempt by the Commission to impermissibly expand its regulatory authority to include neutral technology products and service providers, and, in the process, impose substantial and needless burdens and costs on market participants which will ultimately be borne by end investors.

We strongly agree with Commissioner Peirce's observation that any effort to enhance the regulatory regime governing market structure "must take into account the potentially cataclysmic risks of inadvertently making things worse through sloppy or rushed rulemaking that introduces uncertainty for market participants and investors or that deprives the public and the Commission of the opportunity to devote careful attention to thinking through the full implications of the proposed rules."[27] Virtu believes that the Commission's Proposal has significant risk of "making things worse" and that it "could deter innovation and dissuade new entrants from entering into the market for trading venues, execution services, and liquidity provision."[28]

Respectfully submitted,

Douglas A. Cifu
Chief Executive Officer

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Allison H. Lee, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
Dr. Haoxiang Zhu, Director, Division of Trading and Market

[27] Hester Peirce, Commissioner, U.S. Securities and Exchange Commission, *Dissenting Statement on the Proposal to Amend Regulation ATS* (Jan. 26, 2022), available at https://www.sec.gov/news/statement/peirce-ats-20220126.
[28] *Id*.