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March 31, 2023

Via Electronic Mail (rule-comments@sec.gov)

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

Re: File No. S7-29-22: Disclosure of Order Execution Information

Dear Ms. Countryman:

Robinhood Financial, LLC and Robinhood Securities, LLC[1] (together, "Robinhood") submit this letter in response to the U.S. Securities and Exchange Commission's ("Commission" or "SEC") recent rule proposal related to Rule 605 under Regulation NMS ("Proposed Rule 605" or "Proposal").[2] This is one of four rules the SEC has simultaneously proposed to completely restructure the U.S. securities markets (collectively, the "Proposals"). Together, these four rules would transform retail investing by having the government and self-regulatory organizations ("SROs") mandate and then micromanage what fees can be charged, what prices retail investors must receive, where retail investors' trades must be executed, and what information must be provided to investors. The breadth and complexity of these Proposals is unprecedented and unworkable. Moreover, in many areas, the Proposals are based on scant data, secret data, or no data at all. And, in several instances, the SEC openly concedes that they could result in worse prices and more expensive transactions for retail investors and cause retail investors to leave the securities markets.[3]

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[1] Both of these FINRA-member broker-dealers are wholly owned subsidiaries of Robinhood Markets, Inc.

[2] Proposing Release, Disclosure of Order Execution Information, Exchange Act Release No. 96493 (Dec. 14, 2022), 88 Fed. Reg. 3786 (Jan. 20, 2023) ("Rule 605 Proposing Release").

[3] *E.g.*, Proposing Release, Order Competition Rule, Exchange Act Release No. 96495 (Dec. 14, 2022), 88 Fed. Reg. 128, 221 (Jan. 23, 2023) ("OCR Proposing Release") ("[I]f the Proposal results in the elimination of zero-commission trading, retail trading volume could decline and the overall pool of liquidity could shrink …."); Proposing Release, Regulation Best Execution, Exchange Act Release No. 96496 (Dec. 14, 2022), 88 Fed. Reg. 5440, 5534 (Jan. 27, 2023) ("Reg Best Ex Proposing Release") (potential for worse prices in illiquid securities); Reg Best Ex

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Due to the scope and complexity of the Proposals and the dearth of supporting evidence, the Commission has made it difficult for the public to understand or meaningfully assess the collective impact of the rules, including their costs and negative effects on the marketplace. But one thing is certain: If adopted, they will push us backwards, towards a time when investing was less efficient, less accessible, and less fair. The SEC's Proposals will reverse a recent retail investor revolution, which Robinhood is proud to have facilitated, that allows everyday Americans to build long-term wealth through investing. Robinhood's model has transformed retail investing for the better and saved investors billions of dollars and counting. The innovations we spearheaded in the market, such as commission-free trading, no account minimums, fractional shares, and the first non-employer IRA with a match were possible because for the last fifty years, the SEC did what Congress authorized it to do—it encouraged competitive, innovative, and efficient markets. We now have a highly competitive system that facilitates innovation and is accessible to any individual who wants to participate. As a result, we no longer have a marketplace dominated by the "haves." The historical "have nots"—blue collar workers, women and people of color, young Americans and first-time investors, people from rural communities and inner cities alike, gig economy workers and freelancers—now participate in unprecedented numbers in the U.S. stock market.

Today, Robinhood has over 23 million customers, many of whom are younger and more diverse than yesterday's investors.[4] Our customers hail from every state in the country and are a representative cross-section of America. We're proud of our customer base, but we're not unique. Across the industry, retail-focused broker-dealers followed

Proposing Release, 88 Fed. Reg. at 5530, 5533, 5536 (retail investors may be required to pay commissions due to increased transaction costs); Proposing Release, Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, Exchange Act Release No. 96494 (Dec. 14, 2022), 87 Fed. Reg. 80,266, 80,280 (Dec. 29, 2022) ("Tick Size Proposing Release") (pricing increments that are too small can lead to decreased displayed liquidity, added complexity, and increased risk of stepping ahead).

[4] Press Release, Robinhood, Robinhood Markets, Inc. Reports February 2023 Operating Data (Mar. 13, 2023), https://investors.robinhood.com/news/news-details/2023/Robinhood-Markets-Inc.-Reports-February-2023-Operating-Data/default.aspx (23.1 million total funded accounts); Gretchen Howard, *Latinx Investors Are Part of the New Wall Street*, Robinhood: Blog (Oct. 12, 2021), https://blog.robinhood.com/news/2021/10/12/latinx-investors-are-the-new-face-of-wall-street-and-crypto ("We see more than double the industry average of Latinx and Black investors on our platform, and we know that new investors in 2020 were younger and more diverse than experienced investors."); SEC, *Staff Report on Equity and Options Market Structure Conditions in Early 2021*, at 9 (2021), https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf ("Robinhood reported that its average customer is 31 years old and has a median account balance of $240.").

Robinhood's lead—dropping costly commissions and account minimums—and in the process opened nearly 70 million more accounts by late 2021 as compared to the number open in late 2017.[5] This is truly revolutionary progress. As policymakers on both sides of the aisle have long recognized, participating in the securities markets is the best way for individual Americans to generate long-term wealth, reduce our country's persistent income and investing diversity gaps, and drive economic growth. In recent decades, the U.S. securities markets have transformed from a marketplace wholly dominated by a handful of broker-dealers and exchanges that stifled competition, where most Americans could not afford to participate, to today's markets where the cost of trading has never been lower, stock prices have never been better, competition is thriving, and market participation has never been more widespread.

The Commission has historically recognized the importance of investor participation in the markets and taken steps to encourage more efficient markets that work better for the retail investor. Until now. Out of a misguided sense that government mandates should dictate where, how, and at what prices trades may occur, the Commission now proposes to upend the entire structure of today's securities markets with these four proposed rules. While we all agree that the markets must work for the benefit of retail investors, the SEC's complex and unsupported Proposals would not advance this goal. Instead, the Proposals are collectively regressive and would unwind much of the significant progress that has been made to drive costs down and encourage retail investor participation over the past half century. As altered by the Proposals, the customer experience in our markets will be slower, pricier, and less competitive; capital formation will be more difficult for smaller issuers; and increasing costs will likely expel from the market many of those investors who have only recently begun to participate. In other words, the Commission is trying to fix a market that isn't broken—and will break it in the process. For the above and other reasons, certain of the Proposals should be withdrawn in their entirety, and the others must be clarified, modified, and harmonized before they can be adopted.

The SEC's proposed rules can be ranked in order of most reckless and harmful to least intrusive:

- First, with its experimental so-called ***Order Competition Rule*** (or "Proposed OCR"), the SEC would—for retail investors only—revert to the exchange oligopolies that Congress directed it to abolish fifty years ago. The Proposed OCR would force retail orders to a single type of venue (a subset of exchanges) and a

[5] Staff of H.R. Comm. on Fin. Servs., 117th Cong., *Game Stopped: How the Meme Stock Market Event Exposed Troubling Business Practices, Inadequate Risk Management, and the Need for Legislative and Regulatory Reform* 6 fig.1 (Comm. Print 2022).

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single order execution method ("qualified auctions") purportedly because the SEC is concerned that in today's market, retail customers may not get the benefit of *all* market participants (particularly large institutional investors) competing for their orders. But the SEC admits it does not know whether or which parties will participate in these auctions—in fact, it admits that large institutions may *not* participate.[6] The SEC also admits that auctions could result in worse prices for retail investors.

This radical proposal would cut off retail investors' access (through retail broker-dealers) to the well-developed system of venues that vigorously compete for their order flow and provide best execution and other services. That competition drives venues to improve prices, lower costs, and improve services for retail investors. The upshot of the Proposed OCR would be that retail investors' orders will be forced into government-mandated, centralized marketplaces that, while residing within for-profit corporations, effectively operate as public utilities with regulatory immunity and limited liability if they have technology problems, i.e., there is little recourse if investors are unhappy with the prices they receive due to errors. Indeed, the SEC acknowledges that retail investors could experience slower and less certain trading at worse prices while institutional investors and professional traders will continue to benefit from the competition provided by off-exchange venues and market makers. And that, in turn, will likely breed confusion and frustration, causing many retail investors to lose faith in the markets and stop participating altogether. These extreme, negative consequences are not mere speculation; the SEC admits that the Proposed OCR may drive retail investors out of the market. Further, our review of the Commission's economic analysis demonstrates that instead of saving investors $1.5 billion (which the Commission estimates), the Proposed OCR is likely to cost investors between $2.5 and $3 billion. This rule should be rejected in its entirety.[7]

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[6] *See* Letter from David Howson, Executive Vice President & Global President, Cboe Global Markets, et al., to Vanessa Countryman, Sec'y, SEC (Mar. 24, 2023), https://www.sec.gov/comments/s7-32-22/s73222-20161714-330556.pdf (group of commenters including institutional investors object to the Proposed OCR and instead support improvements that come from "competitive forces" and "innovative, market-driven solutions").

[7] Notably, one of the exchanges that would be eligible to host qualified auctions has also recommended the Commission not adopt a prescriptive requirement to send retail orders to auctions and instead argued for market-driven innovations and enhancements. Letter from Hope M. Jarkowski, General Counsel, NYSE, to Vanessa Countryman, Sec'y, SEC, at 9 (Mar. 13, 2023), https://www.sec.gov/comments/s7-31-22/s73122-20159561-327567.pdf.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

- Through its proposed ***Regulation Best Execution*** (or "Proposed Reg Best Ex"), the SEC would create unnecessary regulatory obligations that are, at best, redundant because there is already a comprehensive set of best execution standards in place. Existing best execution rules of SROs (including the Financial Industry Regulatory Authority ("FINRA")) not only require broker-dealers to achieve the best price reasonably available for customers, they also require broker-dealers to regularly and rigorously test whether they have done so and subject broker-dealers to SRO examinations for compliance with those rules. While neither articulating any weakness in the current regulatory structure nor materially changing the fundamental best execution standard that broker-dealers are already required to follow, Proposed Reg Best Ex makes compliance with those obligations so onerous and expensive that the natural result, as the SEC expressly acknowledges, could change firms' business models, result in fewer retail broker-dealers, and increase fees and costs to retail investors with no evidence of any material additional benefit. This rule should be rejected in its entirety.

- The proposed ***Minimum Pricing Increment (Tick Size), Access Fee, and Transparency Rule*** ("Tick Size Proposal") would (among other things) harmonize and reduce the minimum price increment at which exchanges and other market participants can quote and trade exchange-listed stocks, restricting the increments at which investors can trade. We support sensible changes to tick size, access fees, and market data infrastructure, but believe the current proposal lacks support for the significant changes to market structure that the SEC proposes. The SEC should take a more incremental, data-driven approach and, first, fully implement the Market Data Infrastructure ("MDI") Rules, which will make additional information regarding orders available to the marketplace (e.g., new round lot sizes, odd-lot information, and auction information), and therefore help to fill key gaps in publicly available market data, encourage further price improvement, and make more data accessible to investors at lower prices by introducing competition into an otherwise monopolistic data market. Then, the SEC should repropose reasonable and incremental changes to minimum pricing increments. We believe a thoughtful approach would be to: (a) reduce the minimum pricing increments to $0.005 for tick-constrained stocks that would more clearly benefit from narrower tick sizes; (b) allow for a six-to-12-month period to study the effects of these changes on market quality; and, then (c) if warranted after further analysis, consider additional reductions to the minimum pricing increments as well as larger minimum pricing increments for less liquid stocks with naturally wider spreads, providing a mechanism to roll back any changes that, after analysis, decrease market quality. The SEC should also adopt exchange access fee caps that are proportional to the minimum pricing increments based upon existing access fee caps (30% of the tick size). Changes

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beyond those contemplated here risk increasing price volatility and confusion on the part of investors who may find that they are not receiving the prices they thought they would when they submitted their orders due to rapidly changing quotations.

- Finally, with its ***Proposed Rule 605***, the Commission would expand reporting entities and expand or modify the types of data that must be disclosed so that broker-dealers and their retail customers can better assess the quality of the execution prices they receive. We believe this proposal should be refined, but support adoption of a modified version of the proposal.

The Proposals are also problematic because they overlap in ways that are contradictory, redundant, and mutually exclusive. If the Proposals are implemented and some successfully meet their objectives, others would be unnecessary. For these reasons, none of the Proposals may properly become law without being clarified and reproposed. And while there are certainly opportunities to improve on an already well-functioning marketplace, adopting a complex and interdependent suite of rules that would upend almost every aspect of trading for retail investors would be rash and unsupportable. Instead of proposing a thoughtful, incremental, and data-driven approach to reforming market structure inefficiencies and competitive imbalances, the SEC has taken a "Rube Goldberg machine" approach to rulemaking. This approach appears to be designed to experiment with the retail market—at the expense of retail investors—by implementing multiple solutions to the same alleged problem at once, rushing headlong into unknowable consequences without a plan (or even the ability) to measure the impact of different rules or recalibrate its approach as the market responds.

Because each individual proposal must be considered as both a standalone rule *and* a changeable aspect of a larger structural transformation, we set forth below in **Section I** our comments on the totality of the Commission's plan, including the cumulative effects of adopting multiple rules simultaneously and how each proposed rule would affect and be affected by the others. We then set forth in **Section II** a specific discussion regarding Proposed Rule 605. Our comments are organized as follows.

I. THE COLLECTIVE IMPACT OF THE PROPOSALS

A. Today's Securities Markets Work Well For Retail Investors.

B. The Proposals Would Upend The Current Industry Practices That Have Worked Well For Investors And Issuers In Multiple Interrelated Ways.

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C. The Proposals Violate Federal Law.

D. The SEC Shouldn't Experiment With Retail Investors' Financial Futures: Rulemaking Must Be Data-Driven, Supportable, And Incremental.

II. INVESTORS DESERVE ENHANCED EXECUTION QUALITY DISCLOSURES, BUT THE SEC'S PROPOSAL IS OVERLY COMPLICATED AND COULD LEAD TO MISLEADING REPORTS

A. Rather Than Overcomplicating Rule 605, The SEC Should Update Rule 606 To Include Additional Execution Quality Statistics.

B. Certain Of The SEC's Proposed Changes May Create Misleading Or Confused Reports Of Execution Quality.

C. Disclosure Enhancements Should Be Adopted And Implemented Before The SEC Considers More Intrusive Market Structure Rule Changes.

We provide our comments with a number of caveats.

First, it is impossible for us—or anyone—to comment on all the possible permutations that may arise depending on how the Commission chooses to reject, modify, or proceed with the Proposals. Integral to the public's ability to participate in the rulemaking process is the agency's obligation to "reveal the agency's views 'in a concrete and focused form'"[8]—to tell the public what it is *actually* proposing. When an agency's proposal is too nebulous or "open-ended,"[9] "interested parties will not know what to comment on" and will be unable to meaningfully critique the proposal.[10] Here, the Commission's proposals fail to provide the basic notice required by the Administrative Procedure Act because they do not inform the public what the Commission *is actually proposing to adopt*. Even without considering eventual changes that might be made to any individual proposals, given the inconsistencies between the proposals themselves, the Commission cannot conceivably adopt each rule as proposed at the same time. The net effect is that the Commission has failed, at this time, to give the public notice of what combination of rules

[8] *United Church Bd. for World Ministries v. SEC*, 617 F. Supp. 837, 839 (D.D.C. 1985) (quoting *Small Refiner Lead Phase-Down Task Force v. EPA*, 705 F.2d 506, 548 (D.C. Cir. 1983)).

[9] *Prometheus Radio Project v. FCC*, 652 F.3d 431, 453 (3d Cir. 2011).

[10] *United Church Bd.*, 617 F. Supp. at 839 (quoting *Small Refiner Lead*, 705 F.2d at 549).

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

it reasonably expects to adopt. For this reason alone, the Commission must repropose the rules. The Commission's failure to provide proper notice is exacerbated here by the difficulty of reasonably estimating the compound effect of these interconnected rules in this brief comment period, particularly where the Proposals may overlap, result in contradictory or unpredictable outcomes, or obviate each other.

Second, the Commission consistently underestimates costs and overstates benefits in its flawed economic analyses, often relying on assumptions instead of real data and never providing (or even attempting to provide) a coherent and unified statement about the collective costs and benefits of the total proposed rule set. Furthermore, the Commission fails to adequately incorporate and offset the benefits that the already approved MDI Rules will have once implemented, while simultaneously introducing new costs by scaling back data content and substantially delaying the introduction of competition into the data market relative to the MDI Rules' adopted implementation table. The suite of rules the Commission has proposed as a whole is more complicated, more expensive, and more burdensome than the sum of its parts. If the Commission proposes to change any individual proposal, it is imperative that the industry have another opportunity to comment on how the adjustments or revisions would collectively affect market structure.

Third, the short time frame for comment, as well as the lack of transparency around significant CAT data used by the Commission to support its proposals, has precluded market participants like Robinhood from fully testing the Proposals with data, which is particularly necessary given the lack of empirical support the Commission itself has provided. Given that it is impossible for even market professionals to comprehensively study and comment on the rules, certainly retail investors—our customers—cannot be expected to engage meaningfully in this process despite Chair Gensler's calls for retail investor input.[11] We object and request that, after Commission staff work through the voluminous comment file anticipated on these proposals, a more reasonable, incremental

[11] The SEC's Proposals are a marked departure from its rulemaking process relating to Regulation Best Interest, for example, where the SEC first conducted a study, solicited industry and investor input, proposed a rule with a lengthy comment period, and made adjustments based on those comments. Similarly, when the SEC adopted its last significant market structure changes—Regulation NMS—it first spent five years undertaking "a broad and systematic review to determine how best to keep NMS up-to-date." Final Rule, Regulation NMS, Exchange Act Release No. 51808 (June 9, 2005), 70 Fed. Reg. 37,496, 37,497 (June 29, 2005). Prior to even proposing Regulation NMS, the SEC's review "included multiple public hearings and roundtables, an advisory committee, three concept releases, the issuance of temporary exemptions intended in part to generate useful data on policy alternatives, and a constant dialogue with industry participants and investors." *Id.* This is the type of careful, data-driven approach the SEC should take here.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

and integrated proposal be reproposed with a manageable comment period so that firms and customers can assemble and evaluate the requisite data and meaningfully participate in this process.

In short, for the public to have the notice and opportunity to comment guaranteed by the securities laws and the Administrative Procedure Act, the Commission must put forward a coherent, cohesive proposal. If the requisite data is secret and available only to the Commission, a reasonable period of time must be allowed for others to assemble the requisite data to construct and run the regression analyses and simulations required to reasonably assess this hodgepodge of proposed changes. Further, the Commission does not appear to have considered the market instability it would introduce by requiring financial institutions to implement so many new and confusing infrastructure and technical changes. The Commission's willingness to indulge in widespread experimentation is reckless and directly contrary to decades of Commission action. Since its inception 90 years ago, the Commission has thoughtfully and continuously assessed the fairness and competitiveness of U.S. markets and calibrated its rules based on data and experience.[12] It has never before thrown a large plate of rulemaking spaghetti up against a wall to see what sticks. It should not do so now.

I. THE COLLECTIVE IMPACT OF THE PROPOSALS

The Proposals must be considered collectively as well as individually. To do that, we address in this Section the collective impact of the Commission's Proposals including:

- How the SEC's efforts, as directed by Congress, have historically encouraged competition and innovation among diverse venues and, as a result of these opportunities to compete for retail order flow, the markets have become more fair and efficient (**Section I.A**);

- How the Commission's four proposed rules would collectively upend the current industry practices that have worked well, resulting in harm to retail investors, smaller issuers, and the U.S. securities markets as a whole (**Section I.B**);

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[12] *See, e.g.*, Chair Arthur Levitt, SEC, Speech, Dynamic Markets, Timeless Principles (Sept. 23, 1999), https://www.sec.gov/news/speech/speecharchive/1999/spch295.htm ("The Commission believed then, as we do now, that our role is not to impose or dictate the ultimate structure of markets. Rather, it is to establish, monitor, and uphold the framework that gives competition the space and sustenance to flourish. Markets can then develop according to 'their own genius' for the ultimate benefit of investors.").

- How the Proposals exceed the SEC's statutory mandate and fail to provide a reasonable or comprehensive economic analysis, and the ways in which federal law prohibits the Commission from taking these discriminatory, anti-competitive, and unsupportable actions (**Section I.C**); and

- How the Commission's Proposals dangerously depart from traditional rulemaking, and why the SEC should continue to adhere to its time-honored incremental, data-driven approach instead of experimenting with the U.S. securities markets and the financial futures of retail investors (**Section I.D**).

A. Today's Securities Markets Work Well For Retail Investors.

Robinhood's mission is to "democratize finance for all" and make the securities markets work better for retail investors. In many ways, this mission has become a reality. The current U.S. market structure model "has delivered significant benefits for retail investors,"[13] as Chair Gensler acknowledged in his swearing-in testimony in 2021.[14] Today:

- Retail investors pay dramatically less in commission costs (in most cases, zero) and execution fees than they have in the past, saving investors over $17 billion in the last two years and counting.[15]

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[13] Comm'r Mark T. Uyeda, SEC, *Statement on Proposed Rule Regarding Order Competition* (Dec. 14, 2022), https://www.sec.gov/news/statement/uyeda-order-competition-20221214; *see also infra* notes 15-19 and accompanying text.

[14] *Nominations of Gary Gensler and Rohit Chopra: Hearing Before the S. Comm. on Banking, Housing & Urban Affairs*, 117th Cong. 8 (2021) (statement of Gary Gensler, Nominee), https://www.banking.senate.gov/imo/media/doc/Gensler%20Testimony%203-2-21.pdf.

[15] S.P. Kothari et al., *Commission Savings and Execution Quality for Retail Trades* 1-2 (Dec. 2, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3976300 (finding that "[s]ince the industry adopted Robinhood's zero-commission model in late 2019, retail investors have saved tens of billions in trading commissions, with Robinhood customers alone saving $11.9 billion during 2020-2021"); Samuel Adams & Connor Kasten, *Retail Order Execution Quality under Zero Commissions* 7-8 (Jan. 7, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3779474 ("Based on the commission rate for Charles Schwab before the commission cut, $4.95 per trade, and an estimated trade size of 200 shares … the average commission payment per hundred shares was $2.475. … The average payment per hundred shares of marketable and marketable limit orders by Citadel Securities to TD Ameritrade, Charles Schwab, and E*TRADE in January 2020 was $0.14.").

- Spreads are tighter than ever.[16] This results in retail investors receiving better prices, more price improvement, and higher investment returns.[17] Robinhood alone has provided $8 billion in price improvement over the past two years.[18]

- Innovation in product offerings and technology have made the securities markets more accessible than ever to retail investors. Retail brokers, and Robinhood in particular, have rolled out products and services that meet the needs and wants of today's retail investors and removed barriers to retail participation in the stock market, such as high-quality, user-friendly trading apps; fractional share trading; accounts with no minimum balances; jargon-free financial education; and access to tools and information previously available only to professional investors.[19]

As a result of broker-dealers like Robinhood focusing on increased retail access to the markets, today's retail investors are younger, have smaller account balances, and are more racially and ethnically diverse than they have been in the past.[20] Retail investors

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[16] Charles Schwab, *U.S. Equity Market Structure: Order Routing Practices, Considerations, and Opportunities* 6 ex.2 (2022) (bid-ask spread was ~90bps in 1994; now in single digit bps).

[17] OCR Proposing Release, 88 Fed. Reg. at 133 ("The narrower the spreads, the lower the prices at which they will buy and the higher the prices at which they will sell, which translate into lower trading costs and higher investment returns."). *See also* Douglas Chu, CEO, Virtu Financial, Measuring Real Execution Quality, Benefits to Retail are Significantly Understated 2 (Aug. 27, 2021), https://virtu-www.s3.amazonaws.com/uploads/documents/virtu-real-pi_20210827.pdf ("Virtu alone provided over $3B in Real Price Improvement to retail investors in 2020").

[18] S.P. Kothari et al., *Commission Savings and Execution Quality for Retail Trades* 1 (Dec. 2, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3976300 (finding that "[d]uring 2020-2021, Robinhood customers benefited from more than $8 billion in price improvement compared to the national best bid and offer prices").

[19] *See* Shane Swanson, *The Impact of Zero Commissions on Retail Trading and Execution* 4 (2020), https://www.greenwich.com/equities/impact-zero-commissions-retail-trading-and-execution ("On the whole, Greenwich Associates finds that retail investors, in fact, have never had it better. Not only have their commission costs come down to zero, but the services they receive have never been more advanced.").

[20] *See* Mark Lush et al., *Investing 2020: New Accounts and the People Who Opened Them, FINRA Consumer Insights: Money and Investing*, Feb. 2021, at 2, https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf ("[N]ew investment platforms began addressing some of the traditional barriers to investing, such as not knowing how to open an account, limited access to a financial professional, the perception that large sums of money are required to enter the market, and sensitivity to the costs of investing.").

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opened accounts at record rates in 2020-2021, and today, almost 150 million Americans (approximately 60%) own stocks.[21] Today, there are no wealth or income barriers to opening a brokerage account; investors do not need to maintain an account minimum or pay high upfront fees to a broker to invest and trade. A retail investor can invest without paying a commission, and she can do it all on her mobile phone, with a user-friendly interface that demystifies the financial markets. She can invest any time of day, including after business hours. And the investor has all the information she needs within reach—she doesn't need to hire an expensive broker or adviser who will charge for recommendations or investment advice. Retail investors are able to easily invest because today's markets are fair, fast, transparent, low-cost, and liquid. A retail investor's order generally gets filled immediately in the amount she seeks, at or better than the price she sees on her screen at the time she places her trade.[22]

Due to this increased retail participation in the markets and the emergence of new, lower-cost products and services, retail investors have saved billions for their retirement and other financial goals.[23] This is something policymakers on both sides of the aisle have long desired.[24] But these benefits for retail investors should not be taken for granted;

[21] Lydia Saad & Jeffrey M. Jones, *What Percentage of Americans Own Stock?*, Gallup (May 12, 2022), https://news.gallup.com/poll/266807/percentage-americans-owns-stock.aspx.

[22] Market makers often provide retail brokers additional liquidity above and beyond the amount available at the best quoted price. For example, if a retail investor places an order to purchase 300 shares and the best quoted price is 100 shares, market makers provide retail brokers with size improvement and often will fill the 300-share order in its entirety, generally at, or most likely better than, the best quoted price.

[23] For example, investors have had billions of dollars in savings, just by trading lower-cost index products. Sam Potter, *The Indexing Boom Has Saved S&P Investors a Cool $357 Billion*, Bloomberg (July 29, 2021, 11:18 AM), https://www.bloomberg.com/news/articles/2021-07-29/the-indexing-boom-has-saved-s-p-investors-a-cool-357-billion#xj4y7vzkg.

[24] *See, e.g.*, *Oversight of the U.S. Securities and Exchange Commission: Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 117th Cong. 1 (2021) (testimony of Chair Gary Gensler, SEC), https://www.banking.senate.gov/imo/media/doc/Gensler%20Testimony%209-14-21.pdf ("We keep our markets the best in the world through efficiency, transparency, and competition. These features lower the cost of capital for issuers, raise returns for investors, reduce economic rents, and democratize markets."); *Appropriations for Fiscal Year 2020: Hearing before the Subcomm. on Fin. Servs. & Gen. Gov't of S. Comm. on Appropriations*, 116th Cong. 6 (2019) (statement of Chair Jay Clayton, SEC), https://www.govinfo.gov/content/pkg/CHRG-116shrg19104901/pdf/CHRG-116shrg19104901.pdf ("Other countries want to replicate [U.S. retail investor participation] because such broad investor participation in our capital markets is a significant competitive advantage for our economy, and participation in our capital markets has made many Americans' lives better and their

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they are a modern phenomenon and the product of decades of private sector innovation and incremental change guided by Congress and the SEC. Fifty years ago, there were much higher trading costs and much lower levels of retail investor participation. Only about 25 million Americans (12%) owned stock in 1975.[25] Even when a retail investor could access the markets (overcoming obstacles such as minimum account balance requirements), trading itself was expensive due to high broker commissions and high exchange fees.[26] Those commissions and fees were high because of the uncompetitive nature of the industry. Before 1975, broker-dealers were generally required to execute trades for their customers on exchanges.[27] The exchanges operated much like public utilities because of the oligopoly they enjoyed. Without competition or with limited competition, exchanges and broker-dealers could impose high costs. And because

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retirements more secure."); Chair Mary Jo White, SEC, Speech, Opening Remarks at the Fintech Forum (Nov. 14, 2016), https://www.sec.gov/news/statement/white-opening-remarks-fintech-forum.html ("There is relatively widespread agreement that fintech innovations have the potential to transform key parts of the securities industry—and to do so in ways that could significantly benefit investors and our capital markets."); Chair Mary L. Schapiro, SEC, Speech, Remarks at the Stanford University Law School Directors College (June 20, 2010), https://www.sec.gov/news/speech/2010/spch062010mls.htm ("[I]n an area very near to my heart, how can we increase voter participation by retail investors?"); Chair Arthur Levitt, SEC, Speech, Plain Talk About Online Investing (May 4, 1999), https://www.sec.gov/news/speech/speecharchive/1999/spch274.htm ("All of us are participants in an extraordinary social phenomena. The democratization of our markets is a desirable development which regulators should not frustrate. Our mission is not to prevent losers or to modulate the sometimes mercurial movement of our markets.").

[25] Richard Phalon, *Owners of Stocks Decline by 18.3 Percent Since 1970*, N.Y. Times (Dec. 10, 1975), https://www.nytimes.com/1975/12/10/archives/owners-of-stocks-decline-by-183-percent-since-1970-shareholders.html (25 million Americans owned stock); Bureau of the Census, U.S. Dep't of Com., Series P-25, No. 601, *Current Population Reports: Projections of the Population of the United States: 1975 to 2050* 2 (1975), https://www.census.gov/content/dam/Census/library/publications/1975/demo/p25-601.pdf (total population of approximately 212 million).

[26] *See, e.g.*, Charles M. Jones, *A Century of Stock Market Liquidity and Trading Costs* 2 (May 23, 2002), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=313681 (finding that "average proportional commissions on NYSE stocks climbed steadily from 1925 to the late 1960's and early 1970's to a high of almost 1%").

[27] Jason Zweig, *Lessons of May Day 1975 Ring True Today*, Wall St. J. (Apr. 30, 2015, 11:20 PM), https://www.wsj.com/articles/lessons-of-may-day-1975-ring-true-today-the-intelligent-investor-1430450405; Fred Tomczyk, *Lessons from 40 Years of Mayday on Wall Street: Column*, USA Today (May 1, 2015, 6:32 AM), https://www.usatoday.com/story/opinion/2015/05/01/mayday-anniversary-wall-street-investment-column/26463281/.

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exchanges are SROs that enjoy immunity from private claims under federal law and rule-based limitations on liability, broker-dealers had limited ability to hold them accountable when retail investors suffered substantial losses due to exchange problems.

1. The Benefits That Retail Investors Enjoy Today Are The Result Of The SEC Encouraging Venue Competition And Eschewing A Centralized Model For Order Execution.

As with any industry that relies on a public utility model for underlying infrastructure, the securities industry was long characterized by lack of incentive to innovate or increase efficiency.[28] Trading in listed securities occurred primarily on the New York Stock Exchange ("NYSE") and, to a lesser extent, the American Stock Exchange ("AMEX").[29] This centralized model (or oligopoly) led to complacency. And this complacency led Congress to conclude in 1975 that "[r]ather than responding to changing investor needs and striving for more efficient ways to perform their essential functions, the principal stock exchanges and the majority of established securities firms appear to have resisted industry modernization and to have been unable or unwilling to respond promptly and effectively to radically altered economic and technological conditions."[30]

Congress addressed the "lack of venue competition" problem by empowering the Commission to facilitate the development of an equity market structure that was more flexible and competitive, and that would be driven by "changing economic circumstances consistent with the public interest" rather than "unnecessary and artificial restraints on competition."[31] Congress conducted extensive hearings, reviewed reports from the SEC, Department of Justice, and industry participants, and recorded over 4,600 pages of testimony from almost 100 witnesses.[32] Coming out of these extensive proceedings, the Securities Acts Amendments of 1975 ("1975 Amendments") laid the groundwork for major market structure changes that occurred over the next several decades. The 1975 Amendments authorized the Commission to facilitate the development of a national

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[28] Jason Zweig, *Lessons of May Day 1975 Ring True Today*, Wall St. J. (Apr. 30, 2015, 11:20 PM), https://www.wsj.com/articles/lessons-of-may-day-1975-ring-true-today-the-intelligent-investor-1430450405.

[29] In 1972, NYSE accounted for 71.4 percent of trading volume; AMEX accounted for 17.5 percent of trading volume, and smaller regional exchanges and over-the-counter trading collectively accounted for 11.1 percent. H.R. Rep. No. 94-123, at 49-50 (1975).

[30] S. Rep. No. 94-75, at 1 (1975).

[31] H.R. Rep. No. 94-123, at 44.

[32] *Id.* at 45.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

market system ("NMS") with the goals of assuring economically efficient trading and fair competition among broker-dealers, exchanges, and other market centers. Most notably, one of the first changes the SEC recognized that it needed to make under its new authority was to eliminate exchanges' oligopoly on order execution by eliminating prohibitions against off-exchange trading. That paved the way for more competition and the emergence of off-exchange markets and market makers.

The Commission did not stop there. The Commission pursued changes and improvements to the NMS, over time and incrementally through studies, pilots, and rulemaking. Many of the changes it made were designed to further enhance competition and break up the virtual oligopoly of the primary exchanges. The Commission's 1996 order handling rules opened the door for quote-based competition between exchanges and off-exchange venues like emergent alternative trading systems ("ATSs"), then known as electronic communications networks, or ECNs.[33] The Commission also eliminated NYSE's prohibition on off-exchange trading in NYSE-listed stocks. At each turn, the Commission's actions increased competition and therefore increased incentives to innovate, drive efficiencies, reduce commissions and fees, and enhance the retail investor's overall experience.

This was not always a certain outcome. There have been instances in the past where the SEC has also considered centralizing the U.S. securities markets. But each time the Commission considered this type of model, it has wisely abandoned such efforts. One such instance was in the early 2000s, when the SEC explored the creation of a centralized limit order book or "CLOB." This centralized framework for market structure, which has troubling similarities to the Commission's Proposed OCR, was never adopted because it reduced the opportunity for markets to compete and failed to strike "the appropriate balance of market competition and order competition."[34] Even the then-Chairman of the Federal Reserve weighed in, noting the dangers when policymakers micromanage the markets:

> We would do well to borrow the advice offered to the medical profession and, first, do no harm. It has never proved wise for policymakers to try to direct the evolution of markets, and it strikes me as especially problematic at this juncture. The structure of our

[33] Adopting Release, Order Execution Obligations, Exchange Act Release No. 37619A (Sept. 6, 1996), 61 Fed. Reg. 48,290 (Sept. 12, 1996).

[34] *Regulation NMS: The SEC's View: Hearing Before the Subcomm. on Cap. Mkts., Ins. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 109th Cong. (2005) (testimony of Chair William H. Donaldson, SEC), https://www.sec.gov/news/testimony/ts031505whd.htm.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

> equity markets is extraordinarily dynamic; hardly a week goes by that a new trading venue is not announced or an enhancement to an existing system is not trumpeted …. Given the pace of change in our markets, it is difficult to contemplate how a government mandate could be implemented; systems might well be obsolete before we were half-way through the planning process.[35]

The SEC's Division of Market Regulation also recognized in its Market 2000 report the dangers of doing what the SEC is proposing to do today. There, the Division correctly stated that imposing a centralized order execution facility on the markets was not only inconsistent with the SEC's historic approach to rulemaking, but also bad policy:

> The determination to refrain from imposing a single structure on the equity markets … is, in many respects, the same judgment the Commission made following enactment of the 1975 Amendments. The Commission could have required the creation of a single order-execution facility or the abrogation of all restraints on competition. Implicitly, the Commission rejected both approaches and, instead, pursued discrete, incremental market improvements. The strength and size of the U.S. equity markets today are testament to the fundamental soundness of the Commission's judgment at that time. The Division continues to believe that the vitality and variability of private-sector solutions to market structure issues justifies a limited Commission role.[36]

When the SEC eventually adopted and then implemented Regulation NMS in 2007, it chose a framework for connecting exchanges and off-exchange market centers together with market data and a trade-through rule. The SEC wisely avoided micromanaging where and how orders could be executed and at what price, and sought to strike a balance between order-by-order competition and venue competition.[37] The result was dramatic. NYSE saw its market share in its listed securities decrease from nearly 80% to approximately 20% as a result of the increased competition from Nasdaq, ECNs, and

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[35] *Evolution of Our Equity Markets: Hearing Before the S. Comm. on Banking, Hous. & Urban Affs.*, 106th Cong. (2000) (testimony of Chair Alan Greenspan, Federal Reserve Board), https://www.federalreserve.gov/boarddocs/testimony/2000/20000413.htm (cautioning against a CLOB).

[36] Div. of Mkt. Regul., SEC, *Market 2000: An Examination of Current Equity Market Developments* 15 (1994) https://www.sec.gov/divisions/marketreg/market2000.pdf.

[37] Final Rule, Regulation NMS, 70 Fed. Reg. at 37,498-99.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

broker-dealers.[38] These new participants have contributed to lower fees, tighter spreads, better prices, and better services for retail customers. They should not now be painted as villains by policymakers, including by Chair Gensler.[39]

2. Today's Market Structure Enhances Competition Between Market Venues, To The Benefit Of Investors.

As described above, under the Commission's stewardship, the market has evolved from mandated trading on utility-like exchanges to a competitive landscape in which exchanges compete with each other and with other trading venues. Like most retail brokers, Robinhood can send trades directly to exchanges to be executed or to other broker-dealers called off-exchange market makers or wholesalers, which can directly execute the customer orders or, consistent with their own best execution obligations, send them to exchanges or ATSs or other liquidity providers. Chair Gensler has demonized off-exchange trading[40] and the Commission's Proposals would marginalize or eliminate the role of wholesalers and other off-exchange sources of liquidity. Wholesalers and other off-exchange venues were born, grew, and thrived primarily due to the exchanges' historical failure to innovate and compete. As the market has evolved, off-exchange venues have developed innovations and services to compete against exchanges and other market centers including the following:

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[38] Memorandum from SEC Div. of Trading & Markets, to SEC Market Structure Advisory Comm. 11 tbl.2 (April 30, 2015), https://www.sec.gov/spotlight/emsac/memo-rule-611-regulation-nms.pdf; *id.* at 12 tbl.4 (percentage of off-exchange executions increased by 21.6% for NYSE-listed stocks and 9.2% for Nasdaq-listed stocks after Rule 611 of Reg NMS was implemented).

[39] *See, e.g.*, *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide, Part III: Hearing Before the H. Comm. on Fin. Servs.*, 117th Cong. 92 (2021) (testimony of Chair Gary Gensler, SEC) https://www.govinfo.gov/content/pkg/CHRG-117hhrg44837/pdf/CHRG-117hhrg44837.pdf ("The high concentration of retail orders routed to a small number of wholesalers raises a number of questions about market structure. In essence, does this segmentation and related sector concentration best promote fair, orderly, and efficient markets?"); *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide: Hearing Before the H. Comm. on Fin. Servs.*, 117th Cong. 91 (2021) https://www.govinfo.gov/content/pkg/CHRG-117hhrg43966/pdf/CHRG-117hhrg43966.pdf (statement of Rep. Maxine Waters, Chairwoman, H. Comm. on Fin. Servs.) ("I'm more concerned than ever that some investors are being fleeced, and massive market makers … may pose a systemic threat to the entire system.").

[40] *See, e.g.*, Chair Gary Gensler, SEC, *Statement on Proposal to Enhance Order Competition* (Dec. 14, 2022), https://www.sec.gov/news/statement/gensler-order-competition-20221214.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

- ***Price Improvement.*** When a wholesaler "internalizes" a customer trade (that is, trades directly with the customer from its own inventory), it will provide the retail customer at least the best published price that any member of any exchange is willing to pay—the national best bid and/or offer ("NBBO"). But wholesalers typically go beyond that and provide an even better price. That's known as "price improvement." When Robinhood evaluates where to send new customer orders, it analyzes a number of factors including, most importantly, how much price improvement its customers have received from each wholesaler.[41] Wholesalers provide more price improvement in order to compete with exchanges and other venues for more order flow from retail broker-dealers.

- ***Size Improvement and Certain Executions.*** Wholesalers also provide "size improvement" by executing the full size of customers' orders at the best available price, even when the customer's order is larger than the best displayed bid or offer. For example, if a customer wants to buy 150 shares, the best price displayed in the market could be limited to 100 shares. To purchase the remaining 50 shares, the customer would typically have to pay a higher price. But wholesalers often execute the entire 150-share order at the best price displayed in the market, in order to provide "size improvement" and remain competitive with other market venues.

- ***Guaranteed Executions in All Stocks, Including Thinly Traded Stocks.*** Because wholesalers compete with each other and with exchanges, they are incentivized to invest in their relationships with broker-dealers by executing and providing favorable pricing to all of the retail broker-dealer's customer orders. When orders for thinly traded or less liquid stocks are sent to exchanges, they may not get executed because there are no willing counterparties to the trade. If they do get executed, they are more likely to experience price "disimprovement," that is, an investor buying a thinly traded stock will pay prices increasingly higher than the NBO as the few counterparties in the market become less and less willing to sell. To compete for order flow, wholesalers are incentivized to internalize orders that would not otherwise get executed or would get executed at deteriorating prices because they are particularly difficult to trade and generally not profitable,

[41] Robinhood does not consider the amount of payment for order flow ("PFOF") as one of these factors because it receives the same PFOF rate from every wholesaler to which it routes.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

> such as orders in thinly traded stocks in which fewer market participants want to trade.[42]

This execution model helps explain why Robinhood's customers (and customers at other broker-dealers that route orders to wholesalers for execution) receive the NBBO or better on the vast majority of their orders.[43] In short, off-exchange trading venues provide benefits to retail broker-dealers and their customers that exchanges do not in order to compete with each other and with exchanges to execute retail investors' trades. These benefits relate not only to price and size improvement but also to speed, certainty, and consistency in executions as well as services like trade corrections for orders entered erroneously by retail customers. And, unlike exchanges, off-exchange venues do not have rule-based limited liability to investors when something goes wrong, such as the "trading glitch" on the NYSE earlier this year, which affected hundreds of stocks.[44] The current market structure incentivizes both order competition and venue competition, as envisioned by the 1975 Amendments and as solidified in Regulation NMS, and retail investors enjoy the benefits of being able to invest easily and at a low cost. The Proposals would upend today's equity markets and reverse much of the progress that the Commission has made in facilitating a competitive, efficient market structure.

B. The Proposals Would Upend The Current Industry Practices That Have Worked Well For Investors And Issuers In Multiple Interrelated Ways.

1. The Proposals Will Harm Retail Investors And Small Companies With Less Actively Traded Securities.

The Proposals ignore the economic realities that govern on- and off-exchange trading and would dismantle the current system of healthy venue competition, which has benefited retail investors and U.S. securities markets more generally. While the full cumulative effect of these four inconsistent and changeable proposed rules is unclear, one thing is certain: Retail investors and issuers, particularly small companies with less actively traded

[42] Ironically, the SEC calls this a "valuable service." *See* OCR Proposing Release, 88 Fed. Reg. at 186 ("[W]holesalers receive order flow from retail brokers that contains variation in quoted spreads and adverse selection risk, wholesalers can target an average level of price improvement across this heterogeneous order flow, resulting in a relatively consistent degree of execution quality.").

[43] *Our Execution Quality*, Robinhood, https://robinhood.com/us/en/about-us/our-execution-quality/ (last visited Mar. 27, 2023) (84.79% of orders receive the NBBO or better).

[44] *NYSE Says Manual Error Triggered Major Trading Glitch*, Reuters (Jan. 25, 2023, 11:52 AM), https://www.reuters.com/markets/us/nyse-says-sell-short-restriction-was-triggered-erroneously-2023-01-25/.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

securities, will be worse off than they are today. We summarize these harms below and describe them more fully in our individual letters regarding each of the proposed rules.

As a result of both the ***Proposed OCR*** and ***Proposed Reg Best Ex***, retail investors will:

- Experience delay and uncertainty when placing orders to buy stock;[45]
- Frequently receive worse pricing as a result of delayed order executions and/or the curtailment of broker-dealer judgment on how to execute an order;[46]
- Receive even worse pricing for stock trades, especially those stocks of smaller companies that are traded less frequently due to the reduced competition among venues executing retail orders;[47] and
- Experience new or higher costs and other fees to invest and trade, including potentially paying commissions, and have less access to innovative products and services as compliance and transaction costs across the industry rise and some broker-dealers' revenue sources, including payment for order flow ("PFOF") are reduced or eliminated.[48]

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[45] The SEC acknowledges that qualified auctions will undermine prompt and certain executions of retail orders by making retail order execution "less streamlined" and introducing "a new layer of intermediation" that indisputably will slow down execution of customer orders. OCR Proposing Release, 88 Fed. Reg. at 226.

[46] To be sure, the SEC concedes in the OCR Proposing Release that some orders will receive worse executions due to slippage and price disimprovement. The SEC acknowledges that there is no guarantee that a retail order will be filled in full or in part during a qualified auction and, at the same time, slippage may occur because there is the "potential that the NBBO could change while the qualified auction was in process." *Id.* at 214. The SEC also acknowledges that "a segmented order would not have certainty of an execution in a qualified auction at a price equal to the NBBO or better." *Id.* at 147.

[47] *Id.* at 215.

[48] Notably, the SEC acknowledges throughout the release that commissions may return or increase for retail customers as a result of the implementation of Proposed Rule 615. *E.g.*, *id.* at 179 ("The Proposal could also result in costs to individual investors, such as some retail brokers potentially resuming charging commissions for NMS stock trades, although the likelihood of this may be low."); *id.* at 216 ("An additional concern is that if the Proposal results in a significant or complete loss of PFOF, then retail brokers would be forced to start charging commissions again for online NMS stock and ETF trades."); *id.* at 218 ("One concern is that the loss of PFOF would cause PFOF brokers, and potentially other discount brokers, to resume charging commissions for online NMS stock trades. Just as PFOF brokers led discount brokers

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The SEC acknowledges that investors generally receive *worse* executions on exchanges than they do today from off-exchange market makers.[49] By marginalizing or eliminating the role of off-exchange market makers, the Proposed OCR and Proposed Reg Best Ex will reduce meaningful competition with exchanges for retail investor order flow and trigger these harmful effects.

Today, broker-dealers like Robinhood are *not* required to send every customer order directly to an exchange. Rather, broker-dealers are required to seek "best execution" for their customers' orders, no matter which venue ultimately executes the order. This discretion to choose the best place to execute a customer's order ultimately benefits the retail customer because it means that broker-dealers like Robinhood can choose among different competing venues—including off-exchange market makers, ATSs, and exchanges—to find the place that will provide the best price reasonably available. The flight of retail orders from exchanges to wholesalers was driven by a multitude of competitive factors as described above, and the primary reason that retail order flow has not returned to exchanges is that exchanges have failed to win back that order flow through competitive pricing, innovation, and service (including protection on errors).

The equity market structure that exists today in the U.S. is the reason why retail investors enjoy exceptional executions and the U.S. securities markets are the most liquid, transparent, and fair markets in the world. Under the SEC's Proposals, this current framework will disappear as retail orders are redirected to newly contrived, experimental auctions operated by SROs. The result is predictable: (1) there will be fewer brokers competing to provide the best executions and services to retail customers; (2) retail investors will no longer be guaranteed speedy and certain executions at the best available price or better; (3) retail investors will no longer be assured of having disputes promptly resolved if there is a glitch or erroneous price; and (4) retail investors will pay more to trade.

There are also numerous flaws in the ***Tick Size Proposal*** that could make the stock market worse for retail investors. First, the SEC's proposal to narrow tick sizes to tenths and fifths of a cent ($0.001 and $0.002, respectively) would likely decrease the available orders (liquidity) at the best displayed bid and offer. Among other things, the Tick Size Proposal could cause "flickering quotations" (where a stock quote rapidly switches back and forth

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into zero-commission trading in 2019, it is possible they too could lead discount brokers back to charging commissions if they stopped receiving PFOF."); *id.* at 225 ("If wholesalers reduce PFOF or begin charging a fee for routing services, PFOF retail brokers would have to absorb this cost and earn lower profits and/or pass on a share of this cost to their customers.").

[49] *E.g.*, *id.* at 198 tbl.14.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

between prices) that would frustrate and confuse investors, who may find that they are not receiving the prices they thought they would when they submitted their orders. This problem will only be made worse by reducing incentives to display trading interest and increasing incentives to engage in "pennying"—whereby quicker market participants can gain trading queue priority and snatch up better-priced orders before other investors by adjusting their bid and offer prices by an economically insignificant amount—increasing trading costs for investors. Second, the proposed changes could harm investors and U.S. markets by forcing them into overall worse execution prices. In particular, the harmonization of quoting and trading increments could leave retail investors with fewer price increments at which market participants are willing to interact with their order flow. Stated differently, by reducing liquidity providers' flexibility to execute investors' orders at prices that are better than their quotes, the Tick Size Proposal would deprive investors of additional price improvement, a stated goal of both the Proposed OCR and Proposed Reg Best Ex. Notwithstanding the harms that the Tick Size Proposal would cause to the markets, it also has the potential to create operational challenges for market participants and to confuse retail investors by unnecessarily complicating how stock trading works.

2. The Proposals Are Both Duplicative And Contradictory.

In addition to harming retail investors and the securities markets overall, the Proposals are problematic from a fundamental rulemaking and process perspective. Each rule, if implemented, would change the landscape in ways that could make the other rules unnecessary or redundant. At the same time, the Proposals are contradictory.

For example, the Proposed OCR would—for retail investors only—revert to the exchange utility model that Congress directed the SEC to abolish fifty years ago. Off-exchange market makers would no longer be permitted to immediately execute a customer order at any price at or better than the NBBO unless they can offer the government-mandated midpoint price or better.[50] The "problem" the SEC claims it is trying to solve with the Proposed OCR is that retail investors are not receiving as much price improvement as they theoretically could. As discussed above, this so-called problem may be mitigated at least in part after the SEC's MDI Rules are implemented. The SEC also believes that Proposed Rule 605 would improve execution quality for both individual and institutional investors, in terms of execution prices, speed of execution, size improvement, and fill rates, by increasing competition between firms handling customer orders.[51] This so-called price improvement "problem" also may be moot if the SEC's Tick Size Proposal is implemented.

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[50] As another example of the Proposals' engaging in price-setting by mandating midpoint executions, *see* Reg Best Ex Proposing Release, 88 Fed. Reg. at 5460.

[51] Rule 605 Proposing Release, 88 Fed. Reg. at 3832.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

That proposal would substantially reduce the trading increment (by a tenth, a fifth, and a half) which would "enhance the opportunity for [retail investor] orders to receive more favorable prices than they receive in the current market structure," also a key objective in the Proposed OCR. The Tick Size Proposal would also require off-exchange and exchange venues to quote and trade at the same price increments, which could result in greater parity in execution quality. Furthermore, the obligation to route orders to one of the OCR auctions only if a broker is unable to achieve a midpoint price becomes extreme and unrealistic in a market where the minimum tick size is $0.001. In effect, for nearly half of market volume, the combined proposals would require executions at an effective increment of $0.0005. Notably, the Commission does not comment on whether the drastic changes required by the Proposed OCR would still be necessary if more order information is made publicly available after the MDI Rules, Proposed Rule 605, and/or Tick Size Proposal are implemented.

The very same arguments could apply to Proposed Reg Best Ex. Increased disclosure and changes to pricing increments could improve execution quality and render this rule unnecessary. At the same time, the Proposed OCR also could render Proposed Reg Best Ex unnecessary because the Proposed OCR virtually eliminates any discretion a broker-dealer has to handle a retail customer order (and thus any potential conflicts); rather than seeking the best market for a customer order (as Proposed Reg Best Ex would require), broker-dealers would be required to send all retail orders in NMS stocks to a qualified exchange. Through its Proposed Reg Best Ex, the SEC also would change how broker-dealers use the NBBO and measure price improvement to assess execution quality. It would require retail broker-dealers that receive PFOF to incorporate extensive new data into their decision-making and transform how they decide where to route customer orders. While these decisions by broker-dealers would presumably be significantly impacted by the imposition of mandatory qualified auctions, the SEC fails to analyze or explain how changes to the Proposed OCR would affect Proposed Reg Best Ex, or vice versa.

At the same time, the Proposed OCR is inconsistent with Proposed Reg Best Ex and Proposed Rule 605. For example, both proposed rules identify speed of execution as important criteria for execution quality. However, the Proposed OCR devalues speed as an important metric because this rule would intentionally slow down the execution of retail customer orders and force these orders to venues (i.e., qualified auctions) where there is no certainty that they will be executed at all.

In sum, out of misplaced concern that off-exchange trading and PFOF somehow deprive retail investors of potential price improvement, the Commission's Proposals attempt to do everything, everywhere, all at once. The SEC would try to improve investors' ability to analyze off-exchange trading and vote with their feet (Proposed Rule 605), while also

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

changing how off-exchange venues are required to price customer trades (the Tick Size Proposal), while also making compliance more expensive for certain broker-dealers routing customer orders to off-exchange venues (Proposed Reg Best Ex), while also prohibiting certain types of off-exchange trading with retail investors (the Proposed OCR). Each proposal seeks to address the same alleged problem in a different way, creating multiple redundancies and conflicts. It is not clear where the impact of any one rule might begin and end, making it impossible for the public to make sense of the incoherent set of Proposals and undermining the Commission's attempts at rulemaking. This leaves one to suspect that the Commission itself does not reasonably expect to adopt all of these rules and is effectively hedging its bets or potentially anticipating that one proposal could draw comments that would indirectly be supportive of another. For investors and market participants, this process is needlessly complex, confusing, and possibly misleading.

C. The Proposals Violate Federal Law.

The SEC's Proposals to abruptly and fundamentally transform the structure of the U.S. securities markets are not only bad policy, but they are unlawful because they (1) lack any meaningful cost-benefit analysis and are therefore inconsistent with the SEC's statutory duty to consider their effects; (2) exceed the SEC's statutory authority; and (3) are arbitrary and capricious.

1. The Proposals Independently And Cumulatively Fail To Provide A Reasonable Cost-Benefit Analysis.

The SEC's economic analysis is woefully insufficient. Under Sections 3(f), 11A(a)(1)(c), and 23(a)(2) of the Exchange Act, the SEC has a statutory duty to consider the effect of a new rule on efficiency, competition, and capital formation. More specifically, the SEC is required to "consider or determine whether an action is necessary or appropriate in the public interest" and "in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[52] The SEC is not permitted to adopt any rule that "would impose a burden on competition not necessary or appropriate" in furtherance of its mandate.[53] Its "failure to 'apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation' makes

[52] 15 U.S.C. § 78c(f).

[53] *Id.* § 78w(a)(2).

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promulgation of the rule arbitrary and capricious and not in accordance with law."[54] The SEC's analysis falls short in a number of significant ways.

First, the Commission fails to meaningfully grapple with existing regulatory protections and other regulatory initiatives that have already been adopted, but not yet implemented. The SEC cannot accurately assess any potential increase or decrease in competition, capital formation, or efficiency without fully considering the existing baseline.[55] That baseline includes rules already adopted and slated to be implemented, yet the Commission fails to account for the anticipated impact of pending market infrastructure enhancements. Without doing so, it cannot accurately assess the relative benefit of additional initiatives that might prove to be redundant or even counterproductive after the changes it has already adopted have taken effect. Specifically, the SEC adopted its MDI Rules more than two years ago to enhance the quality and accessibility of market data and address gaps in existing publicly available market data, such as the fact that it only includes pricing information for certain types of orders (e.g., orders of 100 shares or more). The MDI Rules are intended to ameliorate these flaws. Among other things, they would revise the NBBO to redefine round lot, establish a data field for the best available orders smaller than a round lot ("odd lots"), add orders priced outside an exchange's best bid and offer (called "depth of book"), and add orders participating in auctions. These changes are anticipated to inform the Proposals' analyses regarding price improvement for retail customers (including differences in price improvement between on- and off-exchange executions).

The MDI Rules are now law. They are part of the baseline and are intended and expected to improve market data in a manner that, among other things, leads to additional price improvement—something each proposal individually seeks to achieve. Chair Gensler has stated, "The NBBO is designed to aggregate information across different exchanges. I believe there are signs, however, that the NBBO is not a complete enough representation of the market."[56] Chair Gensler criticizes the NBBO for, among other things, failing to reflect odd lots and being priced (by legal requirement) in pennies and not smaller increments. But these structural deficiencies in existing market data may prevent the NBBO from more fully reflecting market interest, and therefore make it more difficult for broker-dealers and their customers to assess whether they actually received "best"

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[54] *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (quoting *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (2005)).

[55] *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178 (D.C. Cir. 2010).

[56] Chair Gary Gensler, SEC, Speech, Prepared Remarks at the Global Exchange and FinTech Conference (June 9, 2021), https://www.sec.gov/news/speech/gensler-global-exchange-fintech-2021-06-09.

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execution. Since the MDI Rules are intended to improve market data to better reflect available trading interest in the market, this might change trading behavior in a way that obviates the need to impose more costly and onerous structural and technical changes on market participants. The Commission cannot assess these potential new rules until the MDI Rules are fully implemented. But the SEC is leapfrogging over the MDI Rules, ignoring how they will improve the NBBO, to remake the entire structure of the equities market. Without even assessing the extent to which the proposed rules would still be necessary after the MDI Rules are fully implemented, the Commission would require market participants to implement extensive technology changes, subscribe to new forms of data, dilute or eliminate the value of off-exchange venues, and introduce the risk of unknowable and unintended consequences.

Second, the Commission does not even attempt to analyze the cumulative costs and benefits of its overlapping and sometimes inconsistent Proposals. The Commission provides its cost-benefit analysis for each specific proposal, but it has not provided a comprehensive analysis. For example, the Commission estimates that Proposed Reg Best Ex will *increase* competition between venues, but its Proposed OCR would *decrease* venue competition by redirecting retail orders to "qualified auctions," which are likely to be run by a small handful of exchanges. Ironically, the Commission would reinstate a centralized model that forces orders to exchanges after Congress and the SEC spent a quarter of a century dismantling a structure that required orders to be executed on exchanges.

Third, the Commission significantly overstates potential benefits and underestimates costs within each rule proposal. For example, the Commission's Proposed OCR estimates that investors could gain $1.5 billion or more in potential price improvement.[57] Not only does this amount to a paltry sum per investor that does not outweigh the costs of the proposal (let alone the cumulative costs of the other proposals), the Commission's premise for this purported $1.5 billion savings is fundamentally flawed. The SEC incorrectly presumes that all money paid to broker-dealers as PFOF will be redirected to retail customers in the form of greater price improvement. This presumption lacks any merit. By the SEC's own admission, there is no guarantee that market participants will participate in qualified auctions and, if they do not participate, investors could receive worse prices.[58] The $1.5 billion also assumes that orders sent to qualified auctions will experience slippage, i.e., the offer rising before a buy order can be executed or the bid falling before a sell order can be executed, at the same rate and to the same degree as orders executed off-exchange. This is an exceedingly unlikely assumption; orders executed in or following exchange auctions are more likely to experience a higher degree

[57] OCR Proposing Release, 88 Fed. Reg. at 130.

[58] *Id.* at 214.

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of slippage,[59] due to both inevitable execution delays and the lack of any obligation by auction participants to interact with retail orders, unlike the guarantees provided by wholesalers. Indeed, our analysis estimated that rather than a $1.5 billion benefit to customers, the Proposed OCR would *cost* customers an estimated $2.5 to $3 billion.[60]

Moreover, the $1.5 billion in *potential, speculative* price improvement is also not a "benefit" when one considers that, today, investors receive a greater amount of certain, predictable price improvement with no commissions. Over the last two years, Robinhood alone has provided $8 billion and counting in price improvement to its retail customers. If the price improvement provided by all other broker-dealers is added with Robinhood's and considered over time, it easily dwarfs $1.5 billion.[61] It is not a "benefit" to retail investors or U.S. markets if the SEC forces them to forfeit a predictable amount of price improvement so that they could, theoretically, sometimes receive a marginally higher amount on certain trades. The SEC's analysis also assumes that the "benefits" of the Proposed OCR will be *on top of* existing price improvement that retail investors receive; it does not sufficiently consider that its Proposals would disrupt the market structure so much that existing price improvement cannot be relied upon to continue at the same levels. It is also not clear how much additional benefit would result from the Proposed OCR's qualified auctions after the implementation of the MDI Rules, Proposed Rule 605, and the Tick Size Proposal.

In its eagerness to vilify off-exchange trading and PFOF, the Commission also significantly underestimates the costs of its Proposals. The Proposals are fueled by a perceived urgency to enhance price improvement because the Commission believes, without support for that belief, that retail customers are being cheated out of additional price improvement opportunities. The Commission is focused, in particular, on why wholesalers do not *always* provide more price improvement—and the Commission has blamed PFOF. However, the Commission already has reviewed this practice numerous times, including recently in 2000, 2010, and 2016. Each time, based on data and analysis, the Commission repeatedly decided that PFOF should not be eliminated because of its

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[59] *Id.* at 214-15.

[60] See Appendix A to the letter we submitted regarding Proposed OCR (File No. S7-31-22).

[61] For example, a study by one wholesaler indicates that they alone provided $3 billion in price and size improvement to retail investors in 2020. Douglas Chu, CEO, Virtu Financial, Measuring Real Execution Quality: Benefits to Retail Are Significantly Understated 2 (Aug. 27, 2021), https://virtu-www.s3.amazonaws.com/uploads/documents/virtu-real-pi_20210827.pdf.

potential benefits.[62] Rather, PFOF—like trading commissions—may be a conflict that can and should be managed, as with other conflicts, through disclosure and regulation.[63] In fact, a substantial body of research has shown that PFOF does not have a material economic impact on execution quality[64] and, by reducing customer transaction costs, it

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[62] *See, e.g.*, Memorandum from SEC Div. of Trading & Mkts., to Equity Mkt. Structure Advisory Comm. (Jan. 26, 2016), https://www.sec.gov/spotlight/equity-market-structure/issues-affecting-customers-emsac-012616.pdf; Concept Release on Equity Market Structure, Exchange Act Release No. 61358 (Jan. 14, 2010), 75 Fed. Reg. 3593 (Jan. 21, 2010); Off. of Compliance Inspections and Examinations & Off. of Econ. Analysis, SEC, *Special Study: Payment for Order Flow and Internalization in the Options Markets*, https://www.sec.gov/news/studies/ordpay.htm#SUMMARY (Dec. 19, 2000); Final Rule, Payment for Order Flow, Exchange Act Release No. 34902 (Oct. 27, 1994), 59 Fed. Reg. 55,006 (Nov. 2, 1994).

[63] PFOF creates conflicts of interest that must be disclosed and managed—it would not be appropriate for a broker-dealer to route a customer order to a venue that provides worse executions for customers but pays higher PFOF rates to the broker-dealer. *See, e.g.*, Exchange Act Rule 10b-10(d)(8). Robinhood, consistent with industry practice across retail broker-dealers, receives the same PFOF rates from every wholesaler to whom it routes orders. *See also* Jim Swartwout, *Demystifying Payment for Order Flow*, Robinhood (Mar. 4, 2021), https://robinhood.engineering/demystifying-payment-for-order-flow-119581544210.

[64] *See, e.g.*, Christopher Schwarz et al., *The "Actual Retail Price" of Equity Trades* (Sept. 14, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4189239 (finding that "[a]cross brokers, variation in PFOF cannot explain the large variation in price execution"); Samuel Adams & Connor Kasten, *Retail Order Execution Quality under Zero Commissions* (Jan. 7, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3779474 (suggesting that "the elimination of commissions for retail investors improved execution quality for orders directed to third-party market makers"); Pankaj K. Jain et al., *Trading Volume Shares and Market Quality: Pre- and Post-Zero Commissions* (Dec. 2, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3741470 (finding that "effective spreads decline[d]" after the introduction of zero-commission trading); James J. Angel et al., *Equity Trading in the 21st Century: An Update* (2015), https://www.worldscientific.com/doi/10.1142/S2010139215500020 (stating that "the revenues that brokers obtain from their order flows may be competed away as they lower their commissions and offer greater service to their customers in an attempt to attract their orders. Indeed, evidence exists that suggests that competition among brokers to obtain customer order flow has driven a significant portion of these payments [for order flow] back to retail customers"); Robert H. Battalio et al., *To Pay or Be Paid? The Impact of Taker Fees and Order Flow Inducements on Trading Costs in U.S. Options Markets* (Nov. 3, 2011), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1954119 (In comparing options exchanges that use a maker-taker model to exchanges that use a PFOF model, researchers found that "[f]ocusing solely on execution prices, we find that the cost of liquidity on exchanges utilizing the PFOF model is 80 bps higher than on exchanges utilizing maker-taker pricing. Nevertheless, when taker fees are incorporated into the analysis, the cost of liquidity on the PFOF exchanges is 74 bps lower." (emphasis added)).

also can improve execution quality. Notably, the Commission acknowledges that PFOF is a cost to the wholesaler, but "is not a cost to investors."[65]

Fourth, although the SEC repeatedly claims that its Proposals "may" have certain effects, the SEC fails to substantiate those predictions "beyond mere speculation."[66] The SEC's claimed "benefits" are unknown. The costs of the Proposals are also wholly unknown to the SEC by its own admission. And where the SEC has recognized costs, its assessment does not fully or accurately factor in all costs. For example, one impact of the Proposals will likely be to eliminate certain widespread, well-functioning market arrangements, such as PFOF, entirely. The SEC's economic analysis, however, does not sufficiently acknowledge, let alone account for the impacts of, such changes.[67] If the SEC wants to eliminate PFOF or other order execution practices that are called into question by the Proposals, like off-exchange execution, it must own up to it and factor those changes into its analysis.

2. The Proposals Exceed The SEC's Statutory Authority.

The Proposals fail at the outset because they exceed the SEC's statutory authority. Like other federal agencies, the SEC "'literally has no power to act … unless and until Congress confers power upon it.'"[68] Here, Congress instructed the SEC to "facilitate" the "establishment of a [NMS] for securities."[69] The Commission, under this authority, is not

[65] OCR Proposing Release, 88 Fed. Reg. at 206 n.520 ("The Commission does not adjust wholesaler realized spreads for the PFOF they pay to retail brokers because PFOF, while a cost to wholesalers, is not a cost to investors.").

[66] *Bus. Roundtable*, 647 F.3d at 1150. For example, the Commission's economic analysis in the OCR Proposing Release is replete with highly speculative language. *E.g.*, OCR Proposing Release, 88 Fed. Reg. at 178 ("While acknowledging there is substantial uncertainty in the eventual outcome, the Commission estimates that qualified auctions as designed by the Proposal would result in additional price improvement for the marketable orders of individual investors that could reduce the average transactions costs of these orders by 0.86 basis points ('bps') to 1.31 bps."); *id.* ("Given this estimate, the Commission preliminarily estimates that the Proposal could potentially result in a total average annual savings").

[67] Proposed Reg Best Ex acknowledges that many broker-dealers may choose to "de-conflict" by ceasing to pay or accept PFOF or other remuneration, but the impact of this is not fully considered by the SEC.

[68] *N.Y. Stock Exch. LLC v. SEC*, 962 F.3d 541, 553 (D.C. Cir. 2020) (quoting *La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986)) (alteration in original).

[69] 15 U.S.C. § 78k-1(a)(2).

an "'economic czar' for the development of a national market system,"[70] nor may it "dictate the ultimate configuration of the [NMS] or, through regulatory fiat, force all trading into a particular mold."[71] Congress envisioned a more limited role. As Section 11A of the Exchange Act provides, the Commission, in facilitating the establishment of an NMS, may issue certain specific rules to govern the interconnectedness of the various preexisting trading venues—for example, by regulating the "distribution" of "quotations."[72] Neither Section 11A nor any other provision has granted the SEC an unlimited license to rework almost every facet of the equity market's structure, from root to branch. Indeed, if Congress *had* granted the SEC a power of such "vast economic and political significance," it would have said so "clearly,"[73] not scattered that authority across the nearly dozen ancillary provisions the Commission cites throughout its proposals.[74] The SEC's assertion of "unfettered authority" to redraw the U.S. market structure raises serious constitutional concerns, as the Constitution "provides strict rules to ensure that Congress," not a federal agency, "exercises the legislative power."[75] The SEC's authority must be read to avoid unnecessarily triggering such serious constitutional concerns.

According to the Proposals, the SEC states that it is primarily basing its authority on Section 11A of the Exchange Act, but the Commission misapplies Section 11A. The Commission often cites as the source of its authority the general statement of policy objectives in Section 11A(a), but policy objectives do not convey rulemaking authority. The Commission must look to Section 11A(c) for specific delegations of rulemaking authority; however, as already noted, none of those specific grants authorize the market-structure remake the Commission envisions here. This is not to say that the policy objectives are *irrelevant* to the analysis; Congress explicitly constrained the Commission's rulemaking authority by requiring the Commission to exercise that authority "in accordance with [Section 11A's] findings" and "objectives,"[76] but that is just another reason why the Commission's proposals are unlawful. Specifically, Section 11A bars the Commission from taking regulatory action unless it furthers (1) fair competition among

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[70] S. Rep. No. 94-75, at 12 (1975).

[71] Development of a National Market System, Exchange Act Release No. 15871 (Mar. 29, 1979), 44 Fed. Reg. 20,360, 20,360 (Apr. 4, 1979).

[72] 15 U.S.C. § 78k-1(c)(1)(A).

[73] *West Virginia v. EPA*, 142 S. Ct. 2587, 2605 (2022) (quoting *Utility Air Regulatory Group v. EPA*, 573 U.S. 302, 324 (2014)).

[74] *See, e.g.*, OCR Proposing Release, 88 Fed. Reg. at 242.

[75] *Jarkesy v. SEC*, 34 F.4th 446, 459 (5th Cir. 2022).

[76] 15 U.S.C. § 78k-1(a)(2).

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broker-dealers, exchanges, and other market centers, and (2) the economically efficient execution of securities transactions. The Proposals contravene both of these objectives. Rather than encourage competition, the Proposals would establish an anti-competitive framework for handling retail orders, picking winners and losers among execution venues, intermediaries, investors, and issuers. Also, rather than encouraging efficient securities transactions, the Proposals would create a system where retail orders could languish unexecuted in auctions, or be executed at an inferior price due to delay and quote volatility, as opposed to receiving immediate executions at or better than the best available price, like they do today. U.S. equity markets work so well for investors of all types today precisely because the SEC has (at least until now) endeavored to strike the appropriate balance between venue competition and order competition.

The Proposals also have the cumulative effect of preferencing exchanges over other venues and market participants. In particular, the Proposed OCR mandates that all broker-dealers route what the SEC considers "profitable order flow" away from off-exchange market makers to qualified auctions. Wholesalers would be prohibited from executing retail investors' orders as principal unless they comply with the limited and impractical exception in that rule—executing orders at a government-set price of the midpoint between the best bid and ask. The Tick Size Proposal's reduction of the minimum pricing increments would make this proposition all the more difficult by spreading trading interest among too many ticks and reducing the available liquidity at the midpoint. The Commission has unabashedly admitted the anticompetitive nature of its proposal: "Qualified auctions could reduce wholesaler market share for the execution of the orders of individual investors, <u>which could result in the transfer of revenue and profit from wholesalers to other market participants</u>" (specifically, exchanges).[77] This admission alone should render the proposal illegitimate.[78]

By forcing retail orders to exchange auctions where there is no liquidity backstop, the SEC's proposal would inflict significant harm on retail investors and create inefficient

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[77] OCR Proposing Release, 88 Fed. Reg. at 179. In addition to discriminating against broker-dealers, the SEC would discriminate against certain exchanges by putting up barriers to competition to new entrants that may want to receive retail order flow: "[t]he 1% threshold also would impose a hurdle for a new entrant that wished to register as a national securities exchange to become an open competition trading center." *See id.* at 152.

[78] *Cf.* Comm'r Luis A. Aguilar, SEC, Speech, An Insider's View of the SEC: Principles to Guide Reform (Oct. 15, 2010), https://www.sec.gov/news/speech/2010/spch101510laa.htm ("[A]nother guiding principle is that we must resist creating two-tiered markets or separate standards of protection. This means that we should not carve out areas where, it is thought, certain protections are not necessary, depending upon the investor, the intermediary, or the investment. The fact is there is only one capital market and it is highly integrated.").

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executions, which is further inconsistent with the Commission's mandate. Rather than recalibrating the delicate balance of power between exchanges and off-exchange venues in a targeted fashion, the SEC would stifle competition from off-exchange trading by dictating that retail order flow be sent to exchanges' qualified auctions.[79] These centralized auctions would likely be run by a small number of exchanges that would be largely unaccountable to the retail investors whose orders they handle. Off-exchange market centers would be prohibited from competing for retail investors' orders unless they complied with government price-setting terms. The SEC's *de facto* mandate to route to exchanges would reestablish exchanges as quasi-utilities that lack incentive to innovate or compete.[80]

The SEC's Proposed Reg Best Ex also tilts the market in favor of exchanges. Under this rule, nearly every order a wholesaler touches, whether it routes an order to an ATS as riskless principal or internalizes it, will be considered a "conflicted transaction" and subjected to heightened procedures, compliance costs, and evaluation. In contrast, exchanges are not subject to any best execution obligation with regard to retail investors' orders. Orders executed on exchanges will not be considered "conflicted transactions," even though the exchanges also may provide PFOF in the form of rebates and pricing tiers, which raise similar conflicts of interest concerns.

Exchanges are already competitively advantaged today, relative to off-exchange venues. For example, only exchanges can sell and set prices for proprietary data products and related technical infrastructure that broker-dealers must pay for in order to meet their regulatory obligations. The Commission's Proposed OCR would exacerbate this issue by driving all retail trading to exchanges and therefore consolidating all retail market data with the exchanges. The Tick Size Proposal would also increase the exchanges' market power with respect to market data. Combined with the MDI Rules, the Tick Size Proposal would increase the need for broker-dealers to access the exchanges' proprietary depth-of-book market data feeds. The Commission's Proposals do not consider how this monopoly over data and connectivity could affect costs for broker-dealers, but it is plausible that exchanges would exploit this advantage by raising costs. Exchanges are publicly traded companies with a responsibility to make decisions in their shareholders' best interest by increasing profits. As former Commissioner Robert Jackson noted: "[W]e at the SEC have far too often continued to treat the exchanges with the same kid gloves

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[79] Instead of sending orders to exchanges, market makers could execute retail orders at the midpoint of the NBBO but doing so is not practical or economical in all instances.

[80] In the past, when exchanges were largely government utilities, they were mutualized, not-for profit entities. The idea of quasi-utilities is all the more egregious in today's world where exchanges are generally for-profit, publicly traded companies.

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we applied to their not-for-profit ancestors. The result is that, even while one of our fundamental mandates is to encourage competition, the SEC has stood on the sidelines while enormous market power has become concentrated in just a few players."[81] The Commission's Proposals would only further augment exchanges' market power.

Exchanges, to be sure, face some constraints on their ability to compete with off-exchange execution venues. For example, off-exchange market centers and exchanges are generally subject to the same rule prohibiting them from accepting, ranking, or displaying orders in increments smaller than a penny.[82] Yet, in practice, while off-exchange venues frequently execute orders in price increments smaller than one penny, exchanges often do not because it is, in the SEC's words, "impractical."[83] It has been argued that this impracticality limits exchanges' ability to compete in terms of providing price improvement; however, this imbalance can be easily corrected through a tailored approach—including changes to existing exchange rules—without throwing the baby out with the bathwater. A tailored approach to addressing these concerns would increase competition and improve market quality by empowering exchanges to compete at the same level as off-exchange market centers rather than reducing off-exchange market centers' ability to compete by imposing unnecessary restrictions or costs. Concentrating more market power at exchanges is particularly anti-competitive because exchanges are protected from liability when there is a problem, as there was earlier this year at the NYSE. On January 24, a technical issue at the NYSE caused wild price swings in its opening auction, resulting in erroneous prices for hundreds of stocks.[84] When events like these occur, investors whose trades were executed at erroneous prices have little recourse against exchanges, which have limited liability to investors whose orders are sent there. When Nasdaq experienced "glitches" during Facebook's 2012 IPO, trading for as many as 30 million shares was affected.[85] By one estimate, Nasdaq's glitch cost investors $500

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[81] Comm'r Robert J. Jackson Jr., SEC, Speech, Unfair Exchange: The State of America's Stock Markets (Sept. 19, 2018), https://www.sec.gov/news/speech/jackson-unfair-exchange-state-americas-stock-markets.

[82] Some limited exceptions have been made for exchanges' Retail Liquidity Programs to permit them to accept and rank orders in subpenny increments. *Cf.* OCR Proposing Release, 88 Fed. Reg. at 144 & n.151 (citing the SRO rule change approvals for RLPs).

[83] Tick Size Proposing Release, 87 Fed. Reg. at 80,271-72.

[84] Alexander Osipovich, *NYSE Glitch Causes Erroneous Prices in Hundreds of Stocks*, Wall St. J. (Jan. 24, 2023, 7:26 PM), https://www.wsj.com/articles/dozens-of-nyse-stocks-halted-in-opening-minutes-after-wild-price-swings-11674585962.

[85] Jenny Strasburg et al., *Nasdaq's Facebook Problem*, Wall St. J. (May 21, 2012, 8:02 AM), https://www.wsj.com/articles/SB10001424052702303610504577416530447015656.

million, yet it repaid only $62 million when all was said and done.[86] While investors have little recourse against national securities exchanges, non-exchange market centers like market makers are directly accountable to retail broker-dealers because they are incentivized to compete for order flow. Therefore, when a "glitch" impacts a retail investor's order, both the off-exchange market maker and the customer's broker-dealer typically take responsibility for the glitch and make the customer whole. The SEC's anti-competitive Proposals would marginalize both broker-dealers and off-exchange venues, ultimately harming retail investors.

3. The Proposals Are Arbitrary And Capricious.

Even apart from the absence of statutory authority, the SEC's Proposals are arbitrary and capricious because they are (1) unnecessary, (2) ineffective and counterproductive, and (3) afford the public no meaningful ability to comment.

First, the SEC proposes these changes without any evidence they are necessary or even supportable. In particular, Proposed OCR and Proposed Reg Best Ex are unnecessary because they are solutions in search of a problem. Retail investors have never had it better; millions of investors trade today with no commissions and no account minimums, have a wider selection of investment opportunities than ever before (for example, through products like fractional shares and access to IPOs), and manage their own finances with intuitive, easy-to-use platforms. The evidence clearly shows that commission-free trading has saved retail investors billions of dollars; that the current markets create opportunities to trade stocks that would otherwise likely be too expensive for retail investors; and that for all types of stocks, retail investors are able to buy lower and sell higher than ever before.[87] The SEC tries to rebut that data only with admissions

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[86] Josh Constine, *NASDAQ's Glitch Cost Facebook Investors ~$500M. It Will Pay Out Just $62M. IPO Elsewhere*, TechCrunch (Mar. 25, 2013, 2:49 PM), https://techcrunch.com/2013/03/25/ip-oh-my-gosh-all-that-money-just-disappeared.

[87] *See, e.g.*, S.P. Kothari et al., *Commission Savings and Execution Quality for Retail Trades* 1 (Dec. 2, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3976300 ("PFOF has saved retail investors billions in unnecessary fees by allowing broker-dealers like Robinhood to eliminate trading commissions. We also find that retail investors, and especially Robinhood customers, have enjoyed substantial price improvements on trades executed off-exchange and that off-exchange retail trades generally experience better execution quality than trades of similar sizes on public exchanges."); James Angel et al., *Equity Trading in the 21st Century* 5 (USC Marshall Sch. Bus., Working Paper FBE 09-10, 2010), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1584026 (finding that virtually every measurable dimension of U.S. equity market quality has improved—generally finding that execution speeds and retail

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that it does not know what impact its proposed market transformation would have, cannot predict those impacts, and has no evidence to support the cost-benefit analysis it is required to conduct. Moreover, existing rules and regulations, like existing FINRA best execution Rule 5310, as well as the extensive SEC and FINRA guidance that has developed around best execution, *already* address the topics Proposed Reg Best Ex purportedly attempts to fix. Stated another way, the SEC has not and cannot identify any market failure that cannot be addressed by the existing rule set.

Second, not only are the Proposals unnecessary, they will create harmful, counterproductive consequences, as the combined impact of the rules will introduce delay and uncertainty into retail order execution, and drive up costs for retail investors. The combined costs of the proposed rules are extensive. The Proposals will make markets less competitive, investing more expensive, and capital formation more difficult for smaller issuers. Market competition will decrease as a result of the combined impact of the proposed best execution and order competition rules which will, among other things, impose the Commission's politicized view on what is best for retail customers, rather than allowing competitive forces to reveal, as they already have, what customers actually value—low-cost trading through retail broker-dealers that are able to offer superior services and consistent, high quality executions as a result of the current market structure.

The Proposed OCR and Proposed Reg Best Ex also threaten capital formation, especially for less actively traded securities, which tend to be the securities of smaller companies, by reducing customers' ability to have orders in those securities executed at advantageous prices, thus further draining liquidity for these companies, as described above. And the markets will be less efficient because, among other reasons: (1) many of the currently proposed rules are duplicative of or substantially overlap with existing rules; (2) the proposed auctions intentionally introduce delay and an additional layer of intermediation into the execution of retail orders; and (3) the rules threaten the role of off-exchange trading, which has contributed to huge efficiencies for retail investors in recent decades.

Finally, and as noted above, the Proposals fail to afford the public proper notice and a meaningful ability to comment. The issues reflected in the SEC's proposal are not just ones of substance, but of process. The SEC is doing too much too quickly, leaving neither the public nor the SEC itself the time needed to develop thoughtful, data-driven, and properly tailored proposed rules. The overlapping, interlocking and foundational nature of all of the changes the SEC proposes to make—coupled with the uncertainty as to which

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commissions have fallen; bid-ask spreads have fallen and remain low; and market depth has increased).

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provisions will or will not make the final cut—exacerbates the problem, as no one reasonably knows what the final suite of rules will look like and how they will interact in an already interconnected and complex market structure environment. The SEC needs to return to the drawing board, work with the industry and investors on developing a more concrete, reasonable proposal, and then reopen the comment period.

D. The SEC Shouldn't Experiment With Retail Investors' Financial Futures: Rulemaking Must Be Data-Driven, Supportable, And Incremental.

Robinhood stands with retail investors and is always in favor of enhancing the markets for their benefit. We pioneered zero-commission, no-account-minimums trading, as well as other products and services that have opened the markets up to millions of new investors. We provide high quality education and training. We are committed to the democratization of finance for all, not just the wealthy. But the Proposals, as a whole and in some cases individually, would not make the market better for retail investors. The specific flaws in each rule are set forth below and in our separate letters regarding each of the other Proposals. Apart from these substantive flaws, there are process flaws, as discussed above, that make the Proposals unlawful. Rather than taking the necessary time to engage in rulemaking based on a methodical, data-driven approach, the SEC's rulemaking appears to be based on a political agenda, unsupported speculation and theories.

This is not surprising based on the Inspector General's report on the SEC's recent management and performance challenges. As that report observed, the aggressive agenda that has characterized *this* SEC has had a negative effect on rule proposals:

> We met with managers from the SEC's divisions of Trading and Markets, Investment Management, Corporation Finance, and Economic and Risk Analysis, some of whom raised concerns about increased risks and difficulties managing resources and other mission-related work because of the increase in the SEC's rulemaking activities. For example, some reported … difficulties hiring individuals with rulemaking experience. In the interim, managers reported relying on detailees, in some cases with little or no experience in rulemaking. Others told us that they may have not received as much feedback during the rulemaking process, either as a result of shortened timelines during the drafting process or because of shortened public comment periods. … [S]ome believed that the more aggressive agenda—particularly as it relates to high-profile rules that significantly impact external stakeholders—potentially

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> (1) limits the time available for staff research and analysis, and (2) increases litigation risk.[88]

This is not acceptable and shouldn't be the case. The SEC historically has been data-driven and methodical. This is a basic tenet of SEC rulemaking that has been long recognized by SEC Commissioners and should not be controversial.[89] As aptly noted by Commissioner Aguilar, when it comes to rulemaking and market structure, "[k]nowledge is always better than speculation."[90] The carelessness with which the SEC has proposed this massive transformation, cloaked in 1,600 pages of technical jargon, is antithetical to sound public policy. Rather than rushing to implement multiple, significant rule changes with unknown and likely severe consequences, we join commenters representing a variety of market participants in urging the SEC to take a thoughtful and incremental approach to market

[88] Off. of Inspector Gen., SEC, *The Inspector General's Statement on the SEC's Management and Performance Challenges* 3 (2022), https://www.sec.gov/files/inspector-generals-statement-sec-mgmt-and-perf-challenges-october-2022.pdf (emphasis added).

[89] *See, e.g.*, Comm'r Luis A. Aguilar, SEC, Speech, Exemplifying Fundamentals—Back to Basics (Mar. 28, 2011) https://www.sec.gov/news/speech/2011/spch032811laa.htm ("A regulator must possess expertise that is informed by current, accurate data and must exercise judgment that is grounded in the mission of the institution and service to the public at large."); Chair Mary Jo White, SEC, Keynote Address: Securities Traders Association 83rd Annual Market Structure Conference, Equity Market Structure in 2016 and for the Future (Sept. 14, 2016), https://www.sec.gov/news/speech/white-equity-market-structure-2016-09-14 (touting the Commission's "deliberate, data-driven process to assess … more fundamental changes to equity market structure" because "[b]road changes to this market structure—especially those executed precipitously or without adequate data—can have serious unintended consequences for investors and issuers as their impact is fully realized, sometimes years down the road"); Comm'r Robert J. Jackson, Jr., SEC, *Statement on the Proposed Transaction Fee Pilot for NMS Stocks* (Mar. 14, 2018), https://www.sec.gov/news/statement/statement-johnson-open-meeting-nms-2018-03-14 ("More broadly, targeted pilot programs—particularly in complex areas like this one [i.e., how fees and rebates affect order routing], where intuitions are strong but evidence is scant—are and should continue to be a critical part of our rulemaking effort. They allow us to generate valuable data to determine whether and how rulemakings might benefit investors—and to carefully tailor them to investors' needs.").

[90] Comm'r Luis A. Aguilar, SEC, *U.S. Equity Market Structure: Making Our Markets Work Better for Investors* (May 11, 2015), https://www.sec.gov/news/statement/us-equity-market-structure.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

structure reform.[91] Anything different would be an irresponsible and unlawful experiment with retail investors' finances.

At Robinhood, we agree that the markets have evolved for the better for retail investors, thanks to greater competition among market centers and trading venues that have flourished since Congress and the SEC eliminated the exchange oligopoly 50 years ago. This elimination has allowed market makers and other trading venues to compete against exchanges to provide the best executions for retail investors. Notwithstanding these gains, we agree there are certain improvements that can be made to further benefit retail investors and allow exchanges to better compete with off-exchange execution venues. Accordingly, we support the following, data-driven approach to enhancing market structure:

- First, fully implement the MDI Rules.

- Second, enhance the current order execution disclosures required by SEC Rules 605 and 606. This letter identifies specific changes the SEC should make to its proposed rule.

- Third, repropose the Tick Size Proposal with a minimum pricing increment of $0.005 for tick-constrained stocks, and adopt exchange access fee caps that are proportional to the minimum pricing increments based upon existing access fee caps, as outlined in our letter on this proposal.

These are improvements that can and should be made through a methodical, study-backed and data-driven approach. Unfortunately, the changes that the SEC has proposed are neither methodical nor driven by study or data, resulting in serious flaws. Rather, the SEC's sweeping Proposals, based on speculation and theory rather than data and analysis, will harm investors and the markets by introducing an unprecedented level of instability and uncertainty into the world's largest, most stable, and most accessible markets. As former Commissioner Aguilar aptly stated, "new regulatory regimes and rules

[91] *E.g.*, Letter from Hope M. Jarkowski, General Counsel, NYSE, to Vanessa Countryman, Sec'y, SEC (Mar. 13, 2023), https://www.sec.gov/comments/s7-31-22/s73122-20159561-327567.pdf; Letter from David Howson, Executive Vice President & Global President, Cboe Global Markets, et al., to Vanessa Countryman, Sec'y, SEC (Mar. 24, 2023), https://www.sec.gov/comments/s7-32-22/s73222-20161714-330556.pdf.

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promulgated by the SEC must have real and verifiable investor protections."[92] These Proposals do not come close to that standard.

II. INVESTORS DESERVE ENHANCED EXECUTION QUALITY DISCLOSURES, BUT THE SEC'S PROPOSAL IS OVERLY COMPLICATED AND COULD LEAD TO MISLEADING REPORTS

The SEC's Proposal seeks to solve two issues with current Rule 605, which requires market centers to periodically disclose specified information about the execution quality the market center provides to orders: First, broker-dealers that are not market centers do not make available to the public statistics about execution quality provided to investor orders. Second, the execution quality metrics reported under Rule 605 have become outdated since the rule was initially adopted in 2000. Robinhood supports rule changes to address both of these issues. With respect to the first issue, however, the SEC's Proposal to expand Rule 605 to broker-dealers that are not market centers is overly complicated and costly. The SEC should instead update current Rule 606, which already applies to non-market center broker-dealers, to require additional information regarding execution quality. Regarding the second issue, Robinhood generally agrees with the SEC's Proposal, but believes that certain aspects of it should be modified, such as the requirement to measure execution quality relative to the best displayed odd lot, because, as currently drafted, these elements of the Proposal would create a misleading or skewed picture of execution quality.

Updating order execution quality disclosures, with the modifications discussed in this comment letter, is a necessary first step before considering Proposed Reg Best Ex and the Proposed OCR. First, disclosure rules in and of themselves may improve retail order execution quality such that these more intrusive rules are not required. The SEC contemplates that amending Rule 605 could improve execution quality, including by improving execution prices, execution speeds, size improvement, and fill rates.[93] These potential benefits are likely enhanced when combined with the anticipated effects of the pending MDI Rules and our recommended changes regarding the Tick Size Proposal. As we discussed *supra* Section I, the MDI Rules, by adjusting round lot sizes and enhancing the information displayed on the consolidated market data feeds, are expected to increase competition and encourage price improvement, and a sensible tick size reform that would allow for half-cent pricing increments could further achieve these goals. If these changes sufficiently address the SEC's concerns about the quality of execution of

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[92] Comm'r Luis A. Aguilar, SEC, Speech, An Insider's View of the SEC: Principles to Guide Reform (Oct. 15, 2010), https://www.sec.gov/news/speech/2010/spch101510laa.htm.

[93] Rule 605 Proposing Release, 88 Fed. Reg. at 3872.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

retail investor orders, the other Proposals are not needed. Second, the economic analyses purportedly supporting Proposed Reg Best Ex and the Proposed OCR are based, at least in part, on the exact Rule 605 data that the SEC says is incomplete and outdated. This undermines the validity of those rule proposals. Accordingly, the SEC should withdraw those two Proposals until the MDI Rules, Rule 605 amendments (which we believe should be modified consistent with our comments below), and a modified tick size approach have taken effect and been given time to affect market practices. It then needs to reevaluate—using improved execution quality data—whether additional market structure rulemaking is even necessary.

A. Rather Than Overcomplicating Rule 605, The SEC Should Update Rule 606 To Include Additional Execution Quality Statistics.

Robinhood supports increasing investor access to broker-dealers' execution quality data. However, the SEC's Proposal for expanding Rule 605 is overly complicated. By way of background, the SEC adopted Rule 605 (then Rule 11Ac1-5) in 2000 to require market centers to publicly disclose, on a monthly basis, standardized information regarding their handling and execution of orders.[94] Rule 605 was intended to work in tandem with Rule 606 (then Rule 11Ac1-6), which, in turn, required broker-dealers that route orders *to* market centers to disclose the identity of the market centers to which they route and material facts regarding the nature of their relationships with such market centers.[95] The two rules together were intended to increase "the visibility of order execution and routing practices."[96] In theory, a customer of a broker-dealer could review the broker-dealer's Rule 606 report to see where the customer's orders were routed, and both the customer and the retail broker-dealer could review the corresponding market center's Rule 605 report to view the execution quality provided by that market center. This would "empower market forces with the means to achieve a more competitive and efficient national market system for public investors."[97]

In the years since implementation of Rules 605 and 606, however, it has become apparent that the reports cannot be used as contemplated because "Rule 605 reports prepared by market centers commingle orders from all broker-dealers that send covered order flow to the reporting market center. Yet a market center may provide different execution

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[94] Adopting Release, Disclosure of Order Execution and Routing Practices, Exchange Act Release No. 43590 (Nov. 17, 2000), 65 Fed. Reg. 75,414 (Dec. 1, 2020).

[95] *Id.* at 75,414-15.

[96] *Id.* at 75,415.

[97] *Id.*

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

quality to customers of different broker-dealers, and in some cases this difference may be substantial."[98] Accordingly, the SEC has posited—and we agree—that there should be a way to provide investors with execution quality statistics that are specific to a particular broker-dealer. The SEC proposes to accomplish this by requiring broker-dealers who introduce or carry 100,000 or more customer accounts through which NMS stocks are traded to produce Rule 605 reports, in addition to the Rule 606 reports that they currently produce. For the following reasons, the SEC should not subject a new category of broker-dealers to reporting requirements under Rule 605, but rather should amend Rule 606 to require these broker-dealers to include additional execution quality statistics.

First, Proposed Rule 605's expansion to broker-dealers who introduce or carry 100,000 or more customer accounts through which NMS stocks are traded is not, realistically, going to get usable execution quality information into the hands of individual investors. Rule 605 reports provide execution quality statistics broken down first on a symbol-by-symbol basis. Within each symbol, the data are further broken down into order categories, such as market orders, marketable limit orders, and different types of nonmarketable limit orders. There are currently five categories; Proposed Rule 605 would create six categories. And within each order type category, the data are broken down by order size. There are currently four order size buckets; Proposed Rule 605 would create seven size buckets. That means for each symbol, there may be up to 20 (current) to 42 (proposed) rows of data. There are approximately 8,500 NMS stocks,[99] so each report could contain up to approximately 170,000 to 357,000 rows of data. This data is generally meant to be loaded into a spreadsheet and analyzed. It has proven not to be a particularly useful format for individual investors.[100] The SEC acknowledges that Rule 605 reports are of

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[98] Rule 605 Proposing Release, 88 Fed. Reg. at 3795; Comm'r Mark T. Uyeda, SEC, *Statement on Proposed Rule Regarding Disclosures of Order Execution Information* (Dec. 14, 2022), https://www.sec.gov/news/statement/uyeda-order-execution-20221214.

[99] Office of Analytics and Research, Division of Trading and Markets, SEC, *Empirical Analysis of Liquidity Demographics and Market Quality for Thinly Traded NMS Stocks* 1 (2018), https://www.sec.gov/files/thinly_traded_eqs_data_summary.pdf.

[100] Rule 605 Proposing Release, 88 Fed. Reg. at 3833 ("It is likely that the extent to which individual investors directly access Rule 605 reports is currently limited. Several market participants have stated that Rule 605 reports have low usage among individual investors, including at least one commenter to the Commission's Concept Release on Equity Market Structure, and some EMSAC committee members."); *id.* at 3796 ("The Commission is mindful that Rule 605's execution quality reports contain a large volume of statistical data, and as a result it may be difficult for individual investors to review and digest the reports."); *id.* at 3877 ("The benefits of the proposed amendments for transparency, competition, and execution quality may be limited if market participants are not likely to make use of the additional information available under the proposed amendments, e.g., because this information is

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limited utility even to *institutional* investors who have significantly greater expertise and means to digest the high volume of complex information.[101] And the volume and complexity of Rule 605 reports would only increase if Proposed Rule 605 were adopted because more market participants, more orders, and more statistics would be included in the reporting, making them even harder to read.[102]

Second, requiring the broker-dealers that are already subject to Rule 606 to prepare new Rule 605 reports would be an unnecessarily costly exercise. This is not a type of report that broker-dealers that are not also market centers generally prepare. They will need to build the infrastructure to consume, process, and format the required data, or will need to pay a vendor to do so. The SEC estimates that a vendor solution could cost a broker-dealer up to an additional approximately $42,000 per year, plus initial startup costs.[103] Based on Robinhood's experience preparing Rule 606 reports, we believe this is an underestimation of annual costs associated with Proposed Rule 605, including because it neglects to take into account dedicated staff time needed for data reconciliation and validation and other ongoing compliance costs. As described in the preceding paragraph, it is unclear whether the proposed Rule 605 reports will result in any corresponding benefits to investors, who may find the format too unwieldy and difficult to review. Accordingly, we do not believe the cost-benefit tradeoff supports Proposed Rule 605.

Instead of unnecessarily imposing additional costs on the industry to create new Rule 605 reports that may not have the desired result of empowering investors to analyze broker-dealers' execution quality, the SEC should require broker-dealers that already publish Rule 606 reports (which we expect would include all of the broker-dealers that would be subject to Proposed Rule 605, among others) to add execution quality statistics to their Rule 606 reports. Rule 606 reports currently identify, for each month, the venues to which the broker-dealer routed customer orders, the volume of orders sent to each venue, and the net and average payment made/received for orders sent to each venue (broken down by market, marketable limit, and nonmarketable limit orders). These are summary, aggregate statistics that are human-readable, unlike Rule 605 reports.

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difficult to access or is not useful to market participants due to the availability of other sources of information about execution quality.").

[101] *Id.* at 3834-35.

[102] *Id.* at 3877 ("Furthermore, the volume and complexity of data produced by Rule 605 reports (i.e., both the number of rows and columns of Rule 605 reports) would increase as a result of the proposed amendments to modify the coverage of orders and expand the information required by Rule 605. Both of these factors could make the evaluation of the raw data in Rule 605 reports costlier.").

[103] *Id.* at 3829.

Columns could be added to the Rule 606 reports that show standard metrics of execution quality, such as effective over quoted spread, price improvement percentage, price improvement per share, and size improvement. Supplementing the existing Rule 606 reports with execution quality data would solve the problem the SEC identified of investors not being able to match up their broker-dealer's Rule 606 report with market centers' Rule 605 reports. To this end, all necessary execution quality data would be in the Rule 606 report, right next to the routing data. And, because Rule 606 reports contain aggregated information per venue per order type, it would solve this problem in a way that balances the desires for readability and completeness.

This alternative approach of updating Rule 606 reports has another benefit: investors could better compare a broker-dealer's execution quality directly to the other information the broker-dealer is required to report in its Rule 606 reports. Specifically, execution quality data would appear side-by-side with data regarding PFOF and rebates that broker-dealers receive for routing investors' orders to certain market centers. The SEC has acknowledged that it is important to present such information along with execution quality data;[104] this can only be accomplished by supplementing Rule 606—it will not be accomplished by expanding the scope of Rule 605. Putting execution quality and conflict-of-interest-related data side-by-side is also an ideal way to mitigate potential conflicts of interest. When Rule 606 amendments were proposed in 2016 and adopted in 2018, the SEC acknowledged that the purpose of adding more detailed disclosure regarding payments paid or received for the different order categories "would enable market participants to better assess the extent to which the broker-dealer is effectively managing the potential conflicts of interest, as well as the quality of their broker-dealer's retail order routing and execution services."[105] Adding data regarding execution quality

[104] *Id.* at 3795-96 ("With respect to orders submitted on a held basis, broker-dealers must include information about their payment relationships with execution venues in quarterly reports prepared pursuant to Rule 606(a)(1). Without information about the execution quality that broker-dealers in the business of routing customer orders obtain for those orders, market participants and other interested parties lack key information that would facilitate their ability to evaluate how these payment relationships may affect execution quality.").

[105] Proposing Release, Disclosure of Order Handling Information, Exchange Act Release No. 78309 (July 13, 2016), 81 Fed. Reg. 49,432, 49,441 (July 27, 2016); *id.* at 49,462 ("The Commission also preliminarily believes that greater transparency between the routing practices of marketable and non-marketable limit orders would allow customers and other market participants to better assess whether broker-dealers are effectively managing their potential conflicts of interest. For example, the Commission understands that broker-dealers may be incentivized to route marketable and non-marketable limit orders to certain venues based on their fee or rebate schedule to the benefit of the broker-dealer. Providing greater public transparency between the routing practices of marketable and non-marketable limit orders could increase competition among broker-dealers and minimize the potential conflicts

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to these reports, adjacent to the information regarding PFOF and other routing incentives, would further this goal even more.

In sum, rather than requiring the complex changes and new reports reflected in Proposed Rule 605, the SEC should update Rule 606 to require enhanced execution quality statistics. This suggested approach would be far less burdensome and costly to market participants. It also constitutes a far more investor-friendly alternative for addressing the lack of access to certain broker-dealer execution quality statistics.

If, however, the Commission decides—despite our comments—to require broker-dealers that are not market centers to report under Rule 605, it should at least require *all* broker-dealers to do so. The Commission "estimates that there are approximately 153 broker-dealers that carry at least one customer trading in NMS stocks and options, and 1,110 broker-dealers that introduce at least one customer trading in NMS stocks and options."[106] Only approximately 85 of those broker-dealers introduce or carry more than 100,000 customer accounts and therefore would be subject to Proposed Rule 605.[107] This amounts to only 6.7% of broker-dealers who would be preparing Rule 605 reports under Proposed Rule 605.[108] If the Commission's true goal is to give investors enhanced insight into execution quality and how their broker-dealers handle customer orders, there is no reason to exclude the vast majority of broker-dealers. Customers who use smaller broker-dealers are just as entitled to information about how their orders are or may be handled

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of interest between maximizing revenue and the duty of best execution."); Final Rule, Disclosure of Order Handling Information, Exchange Act Release No. 84528 (Nov. 2, 2018), 83 Fed. Reg. 58,338, 58,375 (Nov. 19, 2018) ("At the same time, in light of market structure changes since the Rule 606 Predecessor Adopting Release, among other things, the Commission continues to believe that disclosure of any terms, written or oral, that may influence a broker-dealer's order routing decision would be useful for customers to assess the potential conflicts of interest facing broker-dealers when implementing their order routing decisions and would provide more complete information for customers to better understand and evaluate a broker-dealer's order routing decision.").

[106] Rule 605 Proposing Release, 88 Fed. Reg. at 3858.

[107] *Id.* at 3797.

[108] *Id.* at 3797, 3887 tbl.13. The 85 broker-dealers that would be subject to Proposed Rule 605's reporting requirement handle approximately two-thirds of customer transactions, meaning a third of customer transactions would not even be covered. *Id.* Notably, the Equity Market Structure Advisory Committee recommended that Rule 605 be expanded to cover all broker-dealers except those with de minimis order flow "aligning scope of Rule 605 reporting with Rule 606." Equity Market Structure Advisory Committee, SEC, *Recommendations Regarding Modifying Rule 605 and Rule 606* (2016), https://www.sec.gov/spotlight/emsac/emsac-recommendations-rules-605-606.pdf.

DocuSign Envelope ID: 7AEE8AE5-7F97-46F5-9B18-D2936E9AEE94

as customers who use larger broker-dealers.[109] The limited application of the rule would also create an information gap about new entrants to the retail broker-dealer space where there may be a greater need to see data about execution quality since there is no history on which to evaluate their execution quality and performance. By choosing to exclude a large population of broker-dealers from the proposed order execution disclosure requirements, the SEC is embarking on rulemaking that denies any benefit to fully one-third of customer orders.[110]

B. Certain Of The SEC's Proposed Changes May Create Misleading Or Confused Reports Of Execution Quality.

Regardless of whether the SEC adopts the preferred approach of updating Rule 606 (rather than requiring an additional category of broker-dealers to publish both Rule 605 and 606 reports), it should make important modifications to Proposed Rule 605, at a minimum for market centers, to avoid misleading or confused reporting of execution quality. As a preliminary matter, there are several data-enhancement aspects of Proposed Rule 605 that Robinhood supports. For example, the Proposal would expand the scope of Rule 605 to include several categories of orders that are not currently included in market centers' Rule 605 reports. Robinhood supports the increased visibility and transparency that adding these new categories will bring to the Rule 605 reports, i.e.:

- Nonmarketable limit orders that are submitted outside of regular trading hours to the extent they become "executable" and are executed during regular trading hours.

- Orders with stop prices (execution quality will be measured as of the point in time at which the order becomes "executable").

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[109] *Cf.* Rule 605 Proposing Release, 88 Fed. Reg. at 3885 ("Lowering this threshold would increase the total costs of the proposed amendments, as more broker-dealers would be subject to the costs of preparing Rule 605 reports; however, lowering the threshold may also be beneficial if more broker-dealer customers are able to benefit from the proposed modifications to reporting entities.").

[110] *Id.* at 3887 tbl.13 (85 broker-dealers introducing or carrying more than 100,000 customer accounts are responsible for 66.6% of customer transactions).

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- Short sale orders that are (i) not marked "exempt" and (ii) not in symbols subject to a Reg SHO circuit breaker.[111]

- Orders for less than one round lot and for 100 round lots or greater. Currently, fractional shares and odd lots are excluded from the definition of covered orders by rule, and orders of more than 9,999 shares are excluded via no-action letter.

Proposed Rule 605 also would add statistics and change the way certain existing statistics are reported. Robinhood similarly supports adding these statistics and/or making these changes because they will help investors and broker-dealers analyze the execution quality provided by market centers to customer orders. In our view, the key changes are:

- *Changes to metrics incorporating time periods.* Proposed Rule 605 calls for the average, median, and 99th percentile times to execution for the various categories of types and sizes, in increments of a millisecond or finer.[112] These changes will better reflect the speed at which orders are executed today rather than the slower time periods that currently apply under Rule 605.

- *Size improvement.* Proposed Rule 605 would require reporting the cumulative number of shares of the full displayed size of the NBB or NBO, as applicable, at the time of execution.[113] Size improvement is a substantial benefit offered by retail broker-dealers and market makers to retail orders in the current market

[111] Currently such orders are excluded from Rule 605's definition of "covered order" by SEC Staff guidance. Division of Trading & Markets, *Responses to Frequently Asked Questions Concerning Rule 605 of Regulation NMS*, SEC (Feb. 22, 2013), https://www.sec.gov/divisions/marketreg/nmsfaq605.htm.

[112] Currently, Rule 605 requires information on the number of shares of covered orders executed within certain timeframes. Current reporting is based on seconds, and the smallest time-to-execution category is 0 to 9 seconds. Proposed Rule 605 also would require reporting average realized spread by reference to the midpoint 15 seconds and 60 seconds after execution (as opposed to the current approach of five minutes after execution). We do not believe realized spread is a key execution quality metric for retail investors so do not comment on this aspect of the proposed change.

[113] Rule 605 Proposing Release, 88 Fed. Reg. at 3817-19. For each order, the share count would be capped at the order size if the full displayed size of the NBB or NBO, as applicable, is larger than the order. *Id.*

structure, and its absence in Current Rule 605 reports means that execution quality is significantly undercounted.[114]

That said, there are a handful of aspects of Proposed Rule 605 that the SEC should reconsider before implementation.

First, Proposed Rule 605 would require execution quality metrics relative to the "best available displayed price," which is defined as the lower of the best displayed odd lot price or the NBO for buy orders, or the higher of the best displayed odd lot price or the NBB for sell orders. Currently, execution quality metrics are measured only by reference to the NBBO. We think that having two sets of execution quality statistics, each using different reference points, will be confusing to retail investors. Further, using the best displayed odd lot price as a reference point presents a number of difficulties or opportunities for the statistics to be misleading. For example, these quotes may be flickering quotes that are generally not accessible. They may also be for a size substantially smaller than the order size (e.g., a 1-share quote), which would mean that for even a 100-share order (the current round lot size), a broker-dealer will be required to report that 99% of the order was executed outside the best displayed price.[115] These types of circumstances may make a firm's execution quality appear artificially poor.

Second, the SEC needs to update Proposed Rule 605 to provide sufficient clarity regarding certain proposed changes. There are some new elements of Proposed Rule 605 that are not fully fleshed out in the Proposal that the SEC needs to explain *prior to* adoption so that market participants can better understand and comment on the full requirements (and associated costs) that the Proposal will impose on them. For example, although Robinhood supports transitioning to smaller increments of time for Rule 605's "time-to-execution" metrics (milliseconds rather than seconds), we are concerned that the more granular a timestamp needs to be, the more subject it is to variances across reporting entities. Different firms might have different practices around when to mark the same event (e.g., time of order receipt) that, when time is measured in milliseconds or finer increments, have the potential to distort statistics. Similarly, depending upon where a broker is located, quotation information (e.g., NBBO) at millisecond or finer resolution

[114] *E.g.*, Douglas Chu, CEO, Virtu Financial, Measuring Real Execution Quality, Benefits to Retail are Significantly Understated 3 (Aug. 27, 2021), https://virtu-www.s3.amazonaws.com/uploads/documents/virtu-real-pi_20210827.pdf (adding size improvement to the price improvement statistics currently measured under Rule 605 adds a 210% benefit to retail investors); Rule 605 Proposing Release, 88 Fed. Reg. at 3856.

[115] The best displayed odd lot price might be a reasonable reference price for very small sized orders, such as fractional share orders, but, as the example in the text demonstrates, it is not reasonable for any order sized as a round lot or greater.

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may vary materially given geographic latency in market data. SIP data, which is more readily available to retail brokers, is likely to vary from exchange proprietary data feeds used by market makers and exchanges. Issues around race conditions and clock synchronization would be further exacerbated due to the substantial increase in flickering quotes and quote volatility anticipated with the $0.001 trading increments contemplated in the Tick Size Proposal, if these two proposals are adopted simultaneously. These potential issues are likely to affect firms differently depending upon their location, source of data and trading counterparties. This should all be addressed in Proposed Rule 605 to ensure that execution quality statistics for brokers are not misleading, biased, or inconsistent.

Also, although the SEC is asking for execution quality information regarding fractional share orders, it does not explain how such orders should be addressed in certain statistics. For example, the new size improvement statistic requires reporting of "the cumulative number of shares of the full displayed size of the protected bid at the time of execution," but "capped at the order size." If an order is for .5 shares, is a broker-dealer supposed to state that there were .5 shares displayed in the market, despite the fact that this is currently an impossibility? Further, what is the "time of execution"? The time at which the full-share order sent to the market is executed or the time at which the broker-dealer principally fills the customer's order for .5 shares? Is the leftover principal portion of a fractional share order meant to be included in the statistics in any way? If so, how should it be timestamped, given that it was not technically "received"?

C. Disclosure Enhancements Should Be Adopted And Implemented Before The SEC Considers More Intrusive Market Structure Rule Changes.

As described above, the Commission has proposed these Rule 605 amendments in conjunction with proposed rules about best execution and order-by-order competition. But it is unwise and impractical to pursue these rules without first updating order execution disclosures for the following reasons.

First, as described in our separate comment letters on each of the contemporaneous rule proposals, the Commission has relied on Rule 605 data to support its other proposals, especially the Proposed OCR.[116] But if Rule 605 data is as flawed or as incomplete as the Commission suggests it is in this proposal,[117] such data should not be relied on to support

[116] *E.g.*, OCR Proposing Release, 88 Fed. Reg. at 208-09 tbls.18-19 (SEC benefit calculation based in part on Rule 605 data).

[117] Rule 605 Proposing Release, 88 Fed. Reg. at 3861 (referring to "erosions to the information content of Rule 605 statistics due to changes in market conditions").

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rulemakings until it can be updated and re-analyzed. The data that Proposed Rule 605 would provide would permit the Commission to engage in more meaningful analysis of the potential impact of its other market structure proposals. If the Commission believes that this additional order execution quality information is important for investors, such data are no less important for the Commission to consider in the course of its rulemakings that would significantly alter U.S. equity markets. It is possible that the enhanced data required under Proposed Rule 605, especially the inclusion of data regarding execution quality for fractional shares and size improvement, could impact the Commission's analysis of retail order execution quality, as well as its analysis of transparency and competition. The Commission need not engage in potentially harmful speculation or experimentation in search of further potential enhancements without first obtaining the data necessary to understand how those changes would impact the market.

Second, the Commission posits that the Rule 605 amendments would address many of the issues the other proposals purport to address. For example, the Commission believes that Proposed Rule 605 "would serve to improve execution quality for both individual and institutional investors."[118] The Commission also believes that Proposed Rule 605 "would promote increased competition on the basis of execution quality, both in the market for brokerage services and in the market for trading services. This would result in improvements to overall levels of execution quality, as well as improvements to particular components of execution quality, such as execution prices, execution speeds, size improvement, and fill rates."[119] The Commission further posits this increased competition would occur because market participants can use the disclosed information to choose broker-dealers that provide better execution quality, which would incentivize broker-dealers to compete for customer order flow by offering better and better execution quality, for example, by "adjusting their routing practices to increase the extent to which they route orders to the market centers offering better execution quality and limit the extent to which they route orders for other potential reasons."[120] These improved routing practices may include executing orders at prices better than the NBBO.[121] Broker-dealers will be incentivized to provide more size improvement and

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[118] *Id.* at 3872.

[119] *Id.* at 3872; *id.* at 3832 ("One academic study examining the introduction of Rule 605 found that the routing of marketable order flow by broker-dealers became more sensitive to changes in execution quality across market centers after Rule 605 reports became available. The authors attribute this effect to broker-dealers factoring in information about the execution quality of market centers from Rule 605 reports when making their order routing decisions.").

[120] *Id.* at 3873.

[121] *Id.* at 3874.

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speed.[122] The SEC even contemplates that execution quality driven competition might cause broker-dealers to reduce or give up practices that create conflicts of interest, such as PFOF.[123] The SEC should implement a requirement for non-market center broker-dealers to make public execution quality data (preferably via adding data to existing Rule 606 reports), and wait to see if these anticipated effects materialize before determining whether other changes are needed to address the same issues.

Indeed, there is precedent in the Commission's history for adopting disclosure rules, observing the effects post-implementation, and only then considering whether prescriptive changes to market structure are required. Rules 605 and 606 were initially adopted in 2000. At the time, the Commission noted that it was not convinced that enhanced disclosure would solve all the market structure problems that the SEC attributed to market fragmentation.[124] The Commission's solution was not to simultaneously and hastily adopt a number of experimental rules that would upend equity market structure. Instead, the Commission stated that it "intend[ed] to monitor closely the effects of the disclosure rules on trading in the coming months."[125] It also noted that it would observe the then-pending move to decimalization, which could also potentially address fragmentation concerns.[126] Only "[a]fter assessing the impact of [Rules 605 and 606] and decimals" would the Commission "consider whether additional action is necessary to address market fragmentation and further the Exchange Act's objectives for a national market system."[127] And the SEC then followed this roadmap it set out for itself. Rule 605 was gradually phased in over the course of 2001. Regulation NMS was not proposed until 2004. The proposing and adopting materials for Regulation NMS's order protection rule discuss Rule 605 data in analyzing the basis for that rulemaking.[128]

In light of this history, the Commission knows—or should know—that rulemaking should be based on observable facts and data. Consistent with this time-honored approach, the

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[122] *Id.* at 3875.

[123] *Id.* at 3873.

[124] Adopting Release, Disclosure of Order Execution and Routing Practices, 65 Fed. Reg. at 75,417.

[125] *Id.*

[126] *Id.*

[127] *Id.*

[128] Proposing Release, Regulation NMS, Exchange Act Release No. 49325 (Feb. 26, 2004), 69 Fed. Reg. 11,126, 11,128 n.3 (Mar. 9, 2004); Final Rule, Regulation NMS, 70 Fed. Reg. at 37,512 nn.113-114.

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Commission should make its proposed order execution disclosure changes, whether that be by amending Rule 605 or Rule 606, *before* contemplating any of the other market structure proposals. Trying to implement all of the other proposals at the same time introduces a high probability of unforeseen and unintended results that could create significant market disruptions that harm investors. Updating execution quality disclosure requirements is the least invasive method—of all the rule proposals proffered by the Commission—of achieving the goals that are common across all those proposals: more transparent, better prices for customer orders (including more prices closer to the NBBO midpoint); more competition on the basis of execution quality; and more visibility into whether conflicts of interest affect order routing practices.

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Robinhood appreciates the opportunity to comment on Proposed Rule 605. Transparency drives investor education and confidence. Investors' informed decisions drive competition. And competition drives innovation and efficiency. Each of these factors is a key component of a healthy market. Robinhood therefore supports updating execution quality-related disclosures, with the suggested modifications set forth in this letter. We also urge the Commission to withdraw Proposed Reg Best Ex and the Proposed OCR pending the implementation and meaningful analysis of the MDI Rules, amendments to Rule 605 (or Rule 606), and the Tick Size Proposal (as modified to allow for half-cent pricing increments).

Please contact Robinhood's Deputy General Counsel, Lucas Moskowitz, at lucas.moskowitz@robinhood.com if you have any questions or comments.

Sincerely,

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