

**OVERSIGHT OF AMERICA'S STOCK
EXCHANGES: EXAMINING THEIR
ROLE IN OUR ECONOMY**

HYBRID HEARING
BEFORE THE
SUBCOMMITTEE ON INVESTOR PROTECTION,
ENTREPRENEURSHIP, AND CAPITAL MARKETS
OF THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
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OVERSIGHT OF AMERICA'S STOCK EXCHANGES: EXAMINING THEIR ROLE IN OUR ECONOMY

Wednesday, March 30, 2022

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INVESTOR PROTECTION,
ENTREPRENEURSHIP, AND CAPITAL MARKETS,
COMMITTEE ON FINANCIAL SERVICES
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:03 p.m., in room 2128, Rayburn House Office Building, Hon. Brad Sherman [chairman of the subcommittee] presiding.

Members present: Representatives Sherman, Himes, Vargas, Gottheimer, Axne, Casten; Huizenga, Wagner, Hill, Emmer, Mooney, Davidson, Gonzalez of Ohio, and Steil.

Ex officio present: Representative Waters.

Chairman SHERMAN. The Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Also, without objection, members of the full Financial Services Committee who are not members of the subcommittee are authorized to participate in this hearing.

Today's hearing is entitled, "Oversight of America's Stock Exchanges: Examining Their Role in Our Economy." This will serve as the formal hearing on eight bills or discussion drafts that have been circulated to Members, and copies of each bill or discussion draft will, without objection, be part of the record of this hearing.

I usually thank our witnesses. Today, I am going to thank them profusely, because we are going to be interrupted by eight votes, during which time those of you who are here in person, but not those of you who are appearing virtually, will hopefully get some refreshments and otherwise be entertained, while we will be voting.

I now recognize myself for 4 minutes for an opening statement.

The U.S. Stock Exchanges are as old as our nation itself. For over 200 years, they have been a symbol of American capitalism, serving as drivers of economic growth. Since they play such a critical role in our financial system, they have long been recognized as self-regulatory organizations (SROs) under the Securities Exchange Act of 1934, giving them responsibility for creating regulations that oversee the securities exchanges. For most of the life of the exchanges, they have operated as member-owned, non-profit entities, but in the early 2000s, the New York Stock Exchange, NASDAQ,

and the Chicago Board Options Exchange (CBOE), the three largest exchanges, transitioned to becoming publicly-traded, for-profit companies.

Over recent years, the SEC has raised concerns about the potential conflicts of interest from acting, on the one hand, as a quasi-governmental regulatory entity, and on the other hand, as a for-profit entity. This arises, first, in the area of selling and providing data. The exchanges sell the basic information, sometimes called the tape, at a modest cost, for a higher cost. They provide proprietary information, which is both delivered more quickly and is more complete.

In 2020, the SEC issued rules to reform this system, requiring the public data to be more detailed and basically allowing broker-dealers, the users of the information, to have more voting seats on the National Market System (NMS) boards that oversee the status sales. The exchanges sued and blocked that regulation.

One of the bills before us today is the Securities Exchange Reform Act, which would clearly give the SEC the authority to adopt that regulation. We saw with the Facebook offering in 2012, a breakdown of the system. Investors lost as much as \$500 million. They were compensated chiefly by broker-dealers. The exchanges used their authority as SROs to establish rules that capped their liability. And we will explore here whether it is reasonable for them to use their authority as self-regulatory organizations to block or limit the liability, and to what degree they should limit the liability that they incur in operating their for-profit businesses.

The exchanges have performed well over the last several years, and these have been difficult years for everyone in our economy. Our hearing will focus on the data-providing process of the exchanges and the Regulation National Market System (NMS) oversight thereof. We will focus on the liability limitations that they have imposed. We hope also to deal with the governance standards for those stocks listed on exchanges, particularly whether those companies are, for example, overseen in their audits by the Public Company Accounting Oversight Board (PCAOB), something that Chinese companies have refused.

In addition to looking at those that are designated as exchanges, we should keep in mind that we had our GameStop hearings, which focused on the recent trading activity taking place off the exchanges, both in the somewhat regulated alternative trading systems and the relatively unregulated dark pools. And, of course, an increasing part and a large part of our trading is taking place there.

So we look forward to hearing from our witnesses, but first, we get an opportunity to hear from the ranking member.

I now recognize the ranking member of the subcommittee, Mr. Huizenga, for an opening statement.

Mr. HUIZENGA. Thank you, Mr. Chairman. Today's hearing, entitled, "Oversight of America's Stock Exchanges: Examining Their Role in Our Economy," I unfortunately believe is another example of how off track we have gotten here in this subcommittee and in the full committee.

So, why are we here this afternoon? What even prompted this hearing with this timing? Our equity markets have served both in-

vestors and businesses, powering economic growth and expanding wealth that has benefited investors, savers, and businesses. But instead of focusing on areas that expand opportunities for retail investors, promoting capital formation for small businesses, or even a discussion of recent SEC actions, the Majority has decided that this is a timely hearing.

In the 117th Congress, this subcommittee has held 5 hearings to date, this being the 6th, and the first one in over 5 months. Since the last time we met as a subcommittee, Committee Republicans have highlighted several issues that warrant further attention and oversight.

In October of 2021, Ranking Member McHenry sent a letter to SEC Chair Gensler, asking for clarification on the SEC's authority to regulate the digital asset ecosystem. The subcommittee has taken no action to clarify these statements.

In November of 2021, Ranking Member McHenry and I called on Chairwoman Waters to join Republicans' investigation into the Biden Administration's attempt to politicize the PCAOB, the Public Company Accounting Oversight Board. To date, Committee Democrats have been silent.

In December, Congressman French Hill sent a letter to Chair Gensler with several of our colleagues, sharing concerns over new, "staff guidance," on shareholder proposals submitted to publicly-traded companies under SEC Rule 14a-8. This guidance comes from staff at the SEC who have become arbiters of social policy for our financial markets.

In January, Committee Republicans demanded answers from the SEC, raising serious concerns with Chair Gensler's decision to limit outside input on rulemaking by providing unreasonably-short public comment periods. Yet, these 30-day comment periods continue to be the norm.

In February, Congressman Steil and I sent a letter to the SEC regarding proposed changes to the 2020 proxy rule, advisor rule, a rule, by the way, that was proposed and finalized under former SEC Chairman Clayton, that wasn't even allowed to take effect before the proposed amendments were put forth.

And finally, just last week, Republican Members of this subcommittee sent a letter to Chair Gensler expressing concerns about the upcoming meeting on climate-related disclosure for investors. Of course, Republican concerns were ignored in the meeting, and the proposed rule went forward.

Time and time again, subcommittee and Democrat leadership have chosen to focus on issues that fail to shine a light on the SEC and its Chairman, who is embarking on an aggressive rulemaking agenda, and, I might add, leaving us constitutional players in this whole system by the roadside. It is unacceptable that we have not had the full Commission before the committee in 3 years. I hope Chairman Sherman will see the importance in this hearing, of having all of those Commissioners here, and will join me in requesting its prioritization.

And finally, today we are having a hearing where no exchange is here to testify. Let me remind you, the hearing is entitled, "Oversight of America's Stock Exchanges: Examining Their Role in Our Economy." So, I am perplexed why we are having a hearing

that does not include the viewpoint from one of the exchanges, or all of them, as was proposed by them, is my understanding. I would hope my Democrat colleagues would want to have a productive hearing focused on the issues that matter to American investors and that includes all parties involved.

We as lawmakers should be working to create an atmosphere that helps promote more capital formation to allow the free flow of capital, strengthen job creation, and increase economic growth, and Committee Republicans look forward to discussing how to do that today. But I, again, will note that this is not a fulsome conversation, and I have been assured by at least the participants that they would like to have a fulsome conversation. We are missing some key elements, and I am not sure what final outcome the Chair plans with his proposed discussion language, and where these bills are going to go. There is a lot more work to be done before there are any kind of markups, and I hope that is going to be taken into consideration.

And with that, I yield back.

Chairman SHERMAN. Thank you. I would like to clarify a couple of things about the hearing. The first is this that is the Capital Markets Subcommittee, so, it seems in order to have a hearing overseeing our capital markets, and any question dealing with our stock exchanges is within the scope of this hearing.

The second is that the ranking member decries the absence of representatives from the New York Stock Exchange and from NASDAQ. I join with him in that. They both refused to come. We were able to get a representative from the International Xchange Organization.

Mr. HUIZENGA. Mr. Chairman?

Chairman SHERMAN. Yes?

Mr. HUIZENGA. Parliamentary inquiry. What time are you taking to opine about all of this?

Chairman SHERMAN. The need to clarify the purpose of the hearing so that Members understand what questions are in order.

Mr. HUIZENGA. So, you will be, of course, offering equal time, then?

Chairman SHERMAN. If you have comments about which questions are in order, you can bring them up.

Mr. HUIZENGA. Mr. Chairman, it just seems that you could deal with that on your time. We know that we have votes. If you would like to take this time, and grant us equal time, we can have that debate. This needed to be pointed out.

Chairman SHERMAN. Sir, in your opening statement, you criticized me for not inviting two relevant witnesses. It is appropriate for me to inform you that those witnesses were invited.

I now recognize the Chair of the full Financial Services Committee, Chairwoman Maxine Waters, for 1 minute.

Chairwoman WATERS. Thank you very much, Mr. Chairman, for holding this hearing.

In the United States, there are thousands of companies and exchange-traded funds (ETFs) traded on our stock exchanges, representing \$47 billion in market capitalization. Stock exchanges have a dual role of helping businesses raise funds to support their business and creating transparent opportunities for people to in-

vest their funds. Unfortunately, despite being invited to testify, the major exchanges, as the Chair has said—the New York Stock Exchange, NASDAQ, and CBOE—are not here today to describe their role in our economy or to help us assess how to reform them. That said, I am very pleased that we are considering, among other reforms, proposals to strengthen corporate governance and limitations on exchange legal immunity.

Thank you very much, Chairman Sherman.

Chairman SHERMAN. Now, I will introduce our first witness. We have Professor Robert J. Jackson, Jr., a professor of law at New York University School of Law, and a former Commissioner of the SEC.

STATEMENT OF ROBERT J. JACKSON, JR., PROFESSOR OF LAW, NEW YORK UNIVERSITY SCHOOL OF LAW, AND FORMER SEC COMMISSIONER

Mr. JACKSON. Thank you, Chairman Sherman, and Ranking Member Huizenga, for the opportunity to testify about the oversight of the nation's stock exchanges today. For someone like me, our stock exchanges are a symbol of how investing can change the lives of American middle-class families. You see, I was born in the Bronx, New York, to a big Irish Catholic family. My mother is one of nine kids, my father is one of five, and the day I was born, none of them had been to college. So my parents plowed their paychecks into the stock market every week, confident that their savings could give their son the chance to go to school.

Forty years later, my parents sat behind me at my Senate confirmation hearing to be a Commissioner of the Securities and Exchange Commission. So, to me, our stock exchanges are not only to encourage investment, and entrepreneurship, and growth; they make it possible for two middle-class parents to change their son's life. Our stock exchanges are at the core of the American Dream, and that is why it is so crucial that our exchanges give investors a level playing field and that is why today's hearing is so important.

When I served as a Commissioner, I was fortunate enough to give two speeches, one hosted by George Mason University and the Healthy Markets Association, and the other by the Open Markets Institute, on what I think is the uniquely American solution to the problems that plague our exchanges: competition. Both institutions are very different ideologically, but they reflect strong bipartisan support for ensuring that exchanges compete, like all American businesses should, by adding value, not leveraging their market power and legal status.

During my time at the SEC, my office led a series of initiatives designed to achieve just that. Unfortunately, exchanges have responded with litigation and lobbying to stall important progress on these issues. Several of the bills you are considering today would leave no doubt that the SEC has the authority it needs to make our exchanges more than just symbols of competition instead of businesses that thrive based on innovation, not litigation, and I will address two issues in those bills shortly.

When I first took office at the SEC, I asked our staff to explain a puzzling fact. Even though we had 13 public stock exchanges at

the time, 12 of them were owned by just 3 companies. Now, I have worked on mergers and acquisitions as an investment banker and a corporate lawyer, so I am familiar with the economies of scale that justify acquisitions, but I rarely come across an industry where conglomerates buy and then continue to run identical businesses.

So, I asked the SEC staff, why are our markets structured this way, and the answer lies in who decides what data investors get on stock prices. We have a two-tiered system of stock price information in this country: a lower-quality public feed; and generally higher-quality private ones. The key is we allow the exchanges to run them both while profiting from private feeds. The more exchanges a company owns, the more private data feeds they can charge for, even if doing so conflicts with overall market efficiency. As a result, the public feed is lower and less reliable than the private feed the exchanges sell. That is because exchanges have understandably underinvested in the public feed. It is a product they compete with. As I said before, it is like letting Barnes & Noble run our public libraries. Nobody could be surprised to find out that our libraries don't have enough books.

And as I said, during my tenure, the SEC took two key steps to address exchanges' power over stock price data. First, we adopted rules requiring exchanges to upgrade the public feed by including additional information that has become essential to trading in modern markets. Second, we adopted rules requiring the exchanges to propose reforms to the governance of the feeds so other stakeholders have a say in the quality and price of the information available to investors.

Unfortunately, as I mentioned, exchanges responded by suing, exercising the free option our courts had given regulated entities to block changes to market structure. The result is that much of the market structure reforms that we pursued while I was a Commissioner still haven't happened. And that is why the Securities Exchange Reform Act of 2022 is so important. Among other things, the Act would leave no doubt about the SEC's authority to require exchanges to give stakeholders a say about the pricing and quality of the public feed. The Act ensures that Congress, rather than the exchanges' lawyers, will determine when these key reforms arrive.

The Act would also address another vestige of our outdated regulatory structure. Although exchanges are now private, profit-making entities, when they are sued, they seek the shield of government immunity. Generally, market participants expect to be held liable for the harm that they cause, and this expectation gives them incentives to take care when dealing with others. Government actors, by contrast, are usually held harmless from liability so that their decisions reflect optimal policy.

Exchanges claim that they are regulatory entities, so they should be immune from liability when their profit-maximizing decisions harm investors. Now, back when I was a corporate lawyer, that was a better argument. Back then, exchanges actually developed meaningful corporate governance rules that gave investors a chance to hold insiders accountable. But today, exchanges' profit motive leads them to pursue listings, not investor protection. And since exchanges have exited the business of corporate governance,

they can't have it both ways, pursuing profit when it suits them, and the shield of regulatory immunity when it doesn't.

We have learned through hard experience that extending the government's protections to profit-making actors gives them a reason to take excessive risk, since they privatize gains from their actions, but don't bear the losses. Moreover, exchange rule books impose low liability limits, even when exchanges are found liable for investor losses. Both of these are inconsistent with the accountability we see in truly competitive markets and both put investors at risk of losses from decisions that are shielded—

Chairman SHERMAN. Professor, your time has expired. Perhaps one more sentence to summarize?

Mr. JACKSON. Of course. Let me just say that while it is understandable that market participants seek legal advantage where they can, we owe it to investors like my mom and dad to give them confidence that the biggest participants in our markets compete on a level playing field. Thank you again for the opportunity to testify today.

[The prepared statement of Mr. Jackson can be found on page 44 of the appendix.]

Chairman SHERMAN. Witnesses are reminded their oral testimony should be limited to 5 minutes. You should be able to see the timer that will indicate how much time you have left.

And without objection, all of the witnesses' written statements will be made a part of the record. It is the Chair's intention to hear from two more of our witnesses, and then adjourn so that we can vote.

We will now hear from, Mr. Michael Piwowar, who is the executive director of the Milken Institute Center for Financial Markets, and a former Commissioner and acting Chairman of the SEC.

STATEMENT OF MICHAEL S. PIWOWAR, EXECUTIVE DIRECTOR, MILKEN INSTITUTE CENTER FOR FINANCIAL MARKETS, AND FORMER COMMISSIONER AND ACTING CHAIRMAN, SEC

Mr. PIWOWAR. Yes. Thank you, Chairman Sherman. You can just call me Mike. It is easier to pronounce than my last name. And thank you for inviting me here today. Ranking Member Huizenga and members of the subcommittee, it is great to see you, many of you in person. It is great to see so many familiar faces in person today.

For those of you who don't know me, as Chairman Sherman mentioned, I am the executive director of the Milken Institute Center for Financial Markets. Over the course of my career, most relevant to today's hearing, I spent 9 years serving at the U.S. Securities and Exchange Commission. Earlier, I spent 4 years there as a visiting academic scholar and a senior financial economist. More recently, I had a 5-year term as a Commissioner, and also served as acting Chairman. During my SEC tenure, I always appreciated the thoughtful work of this subcommittee to help ensure that the SEC remained focused on its noble mission to ensure that capital markets work, and to make sure that they work well for everyone.

The U.S. capital markets are the envy of the world, due in large part to the role that our stock exchanges play. America's stock ex-

changes list the thousands of public companies that millions of Americans invest in. They trade literally billions of shares every single day, representing more than trillions of dollars every single year.

As this subcommittee evaluates various legislative proposals to change regulatory policies affecting U.S. stock exchanges, my written testimony contains details that I won't cover now, but I thought I would mention two broad areas. One is guiding principles that I use when thinking about general market structure policy, and then also, some comments on some of the specific policy proposals listed for this hearing. I am happy to provide more information about any of them during today's hearing.

Our capital markets help make America's future bright for everyone. For some, that future is to take their entrepreneurial spirit and put it into action, take a risk, start a company, raise capital from investors, hire workers, and bring a product or service to market, thereby improving the standards of living of the customers they serve, the employees they hire, and the investors who share in their success.

For others, that future is to take their hard-earned savings and invest in the job-creating entrepreneurs, and to take the proceeds from those investments and provide for retirement and security investments in their children's education, and then reinvest some of those proceeds into other job-creating entrepreneurs in their community and throughout our great nation. So, when all is said and done, our capital markets help all Americans invest in America's future by investing in each other.

Mr. Chairman, thank you for bringing attention to the critical role that exchanges play in our capital markets, our economy, and America's future. Thank you again for the opportunity to testify here today. I look forward to answering all of the questions that you and your colleagues have.

[The prepared statement of Mr. Piwowar can be found on page 69 of the appendix.]

Chairman SHERMAN. Thank you for your brevity.

We now move to Ms. Ellen Greene, who is the managing director at the Securities Industry and Financial Markets Association (SIFMA).

STATEMENT OF ELLEN GREENE, MANAGING DIRECTOR, THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION (SIFMA)

Ms. GREENE. Chairman Sherman, Chairwoman Waters, Ranking Member Huizenga, Ranking Member McHenry, and distinguished members of the subcommittee, thank you for the opportunity to testify today on behalf of the Securities Industry and Financial Markets Association (SIFMA). I commend you for bringing transparency to the urgent need to modernize the self-regulatory system underpinning the U.S. equity markets. SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers. Our members' combined businesses represent 75 percent of the U.S. broker-dealer sector by revenue, and 50 percent of the asset management sector by assets under management.

It is an honor to testify on behalf of our industry's 1 million employees and the hundreds of millions of Americans they serve, whose retirement, education, and personal savings are invested in the capital markets. This puts me in the privileged position of being the only witness today who represents communities in every district served by members of this subcommittee: the former school-teacher whose pension allows her to retire comfortably; the working parent saving to send their kids to college; the recent graduate who invests a portion of her paycheck each month; and many more like them. Those are your constituents, they are our clients, and it is the financial future that should be our focus for today's discussion.

Our equity markets facilitate the capital formation that is the lifeblood of our economy. Government's primary objective is to protect the interests of the investing public. Most securities laws meet that standard, but there are features of the self-regulatory system that fall short and need to be updated.

In the Securities Exchange Act of 1934, Congress codified exchanges as self-regulatory organizations known as SROs. As such, each exchange is required to enforce compliance with both its own trading rules and Federal securities laws. This includes the power to examine, investigate, and bring disciplinary actions against broker-dealers. This system made sense in 1934 when exchanges were organized as non-profit cooperatives owned by their broker-dealer members who operated them like utilities. But starting in the early 2000s, America's exchanges became for-profit entities, and many are part of publicly-traded companies.

Driven by their duty to maximize profits, exchanges now sell market data and other products to broker-dealers who compete against them for order flow and execution services. In other words, the institutions upon which our self-regulatory system was built no longer exist. Like other for-profit companies, exchanges act in the best interest of their shareholders, but there is a fundamental conflict of interest between that duty and their regulatory duties to protect the interests of the investing public. This conflict is made worse by special privileges granted to the exchanges prior to them becoming for-profit entities. For example, exchanges have historically been exempted by courts from private liability for damages they cause while performing their regulatory duties, but have sought to expand this immunity to damages caused while acting as for-profit entities.

Exchanges also impose non-negotiable, unreasonably low limitations on their private liability for damages they cause. In fact, the exchanges try to impose a \$500 limitation of liability on broker-dealers in the event of a cyber breach of the Consolidated Audit Trail, known as CAT. Exchanges have the unique right to sell their data products, and monopolistic power to set their prices, while broker-dealers and others are captive customers with no alternatives. Exchanges exclude their competitors from fully participating in but require them to comply with and help finance major initiatives developed as NMS plans. And exchanges' overlapping regulatory jurisdictions give them access to broker-dealers' highly-valuable trading data through their access to CAT. In sum, the powers that for-profit exchanges have to regulate and set the costs

for their customers and competitors make our equity markets less fair, competitive, efficient, transparent, and inclusive. This harms the investing public.

My written testimony discusses five reforms targeted at these unfair privileges. Enacting them will modernize our self-regulatory system and make our equity markets fairer and more efficient. They offer a rare chance for bipartisan cooperation to serve the interests of individual investors. We stand ready to work with anyone who shares this goal. We have a unique opportunity to make a positive difference in the lives of hundreds of Americans in every State and congressional district in the country whose financial futures are invested in the capital markets. We should not let it pass.

Thank you, and I look forward to answering your questions.

[The prepared statement of Ms. Greene can be found on page 30 of the appendix.]

Chairman SHERMAN. Thank you. The Chair notes that over 300 Members have yet to vote, and, accordingly, we will recognize at least one more witness.

I now recognize Nandini Sukumar, the CEO of The World Federation of Exchanges, and our one witness who is willing to come before us representing the exchanges, both here in the United States and elsewhere. Ms. Sukumar, you are recognized for an oral presentation of your testimony.

**STATEMENT OF NANDINI SUKUMAR, CEO, THE WORLD
FEDERATION OF EXCHANGES (WFE)**

Ms. SUKUMAR. Good afternoon, Chairman Sherman, Ranking Member Huizenga, and members of the subcommittee. It is a pleasure to be here, and I'm happy to do it anytime. We represent not only U.S. exchanges, but exchanges around the world. Our U.S. members have a solid history with the WFE. We are an old trade association founded in 1961. So, U.S. exchanges here today have indeed been active participants engaged in leadership roles across the world in the world of exchanges.

As I mentioned, the WFE is the global trade body for regulated exchanges and clearinghouses. Since the beginning, we have focused on improving markets. We now represent over 300 pieces of market infrastructure, exchanges, and CCPs. All of them are highly-regulated businesses.

As a preliminary point, I would like to note that exchanges work very hard to ensure robust infrastructure, including cybersecurity and operational resilience, more generally. They demonstrated this extensively through one of the most testing times for financial markets during the pandemic, of course, a period when broker-dealers by contrast very clearly faced operational difficulties.

In all cases, WFE member exchanges fulfill a function that we see as critical to capital markets and price formation. Without clear, unbiased, authoritative, and up-to-the minute information about the ever-changing value of financial assets, markets would simply struggle to serve society. This is why it is one of the key criterion of membership of the WFE that an exchange performs such a role, ensuring a properly-structured setting for establishing the consensus price of financial assets at any given moment.

At the same time, the modern exchange has to be a dynamic and competitive business, constantly investing in new capacity in order to meet the ever-increasing demands of investors, of issuers, of securities, and of financial service companies globally. The exchange, therefore, performs a valuable role from which financial service intermediaries benefit particularly greatly, and which has broader public benefits serving the businesses that need capital to grow and the investors whose savings can be put to worth.

Our members have many things in common, but the deeper, more fundamental shared characteristic is that they are the core of capital markets in their respective jurisdictions. Supporting fair and transparent trading is their purpose and, in our view, an essential component of public trust in the financial system. Our members recognize that the central role has always come with significant responsibility and will continue to do so.

There are many ways in which this responsibility manifests itself, including setting the rules for who can participate and how, ensuring surveillance of the trading process and overseeing everything from listing requirements to trading halts to stock splits. These functions relating to the operation and oversight of their markets are highly regulated and complex and are all conducted in furtherance of fair and orderly markets and protection of investors.

I want to stress that the exchange really creates the marketplace and flow of price information, but it does not participate in it. In other words, the great strength of the exchange model is that they act as an impartial facilitator of business, ensuring that transactions can take place in a safe and efficient manner while staying at arm's length from the back and forth that characterizes the typical trading day. This is a very important distinction, and just as importantly, it applies whatever the ownership and governance structure of the exchange. The very nature of the exchange role is to be a trusted third party that must fulfill considerable statutory obligations every single day. The U.S. securities exchanges are not only very highly regulated, but incredibly transparent. All rules and charges are filed with the SEC and publicly available, something that cannot be said for many other entities in capital markets.

I started by talking about the exchange business being modern in outlook, but it is built on well-established principles, much longer than the WFE's own history. It is a blend of these well-established principles and state-of-the-art operations that makes exchanges so effective for the full range of market participants, including everyday investors as well as Wall Street.

In summary, exchanges take their role and responsibility seriously because this is what makes them effective and valuable. Thank you.

[The prepared statement of Ms. Sukumar can be found on page 76 of the appendix.]

Chairman SHERMAN. Thank you. I am now going to recognize our fifth witness, with the warning that if we get down to only 70 Members not voting, I may ask you to suspend.

We have with us Manisha Kimmel, who is the chief policy officer of MayStreet.

**STATEMENT OF MANISHA KIMMEL, CHIEF POLICY OFFICER,
MAYSTREET, INC.**

Ms. KIMMEL. Thank you for holding this hearing and for offering me the opportunity to appear before you today. My name is Manisha Kimmel. I am the chief policy officer at MayStreet, and throughout my 25-year career, I have worked at the intersection of regulation and technology. At MayStreet, I focus on the policy issues that impact market data and our business model.

MayStreet is a fast-growing fintech. Our software processes market data from hundreds of trading venues across multiple asset classes worldwide. Market data from the U.S. stock exchanges is a big part of what we do. We are active in the market structure through our comment letters and membership and industry associations, including the Healthy Markets Association and the Financial Information Forum. I look forward to offering our view on the important role American exchanges play in our capital markets and on how Congress can improve oversight of the national market system.

The exchange world has changed. I would like to highlight a few of these changes. First, the major exchanges are now publicly-traded companies. Second, broker-dealers are not just customers of the exchanges; they are competitors to them. Third, exchanges sell their raw data and package it into a number of products. The sale of their own data as well as their allocation of sales from the public market data stream are significant sources of revenue. Fourth, exchanges seek to innovate in terms of order types, product offerings, and pricing models, and to support those business decisions, the exchanges filed over 1,300 rules in 2021 alone. Over 700 of those were immediately effective. Compare that to 20 years ago, when exchange filings numbered in the dozens.

In light of these market dynamics, we believe this subcommittee should take action in the following areas. Our first recommendation is that Congress give the SEC direct control over the public market data stream. Industry and investor groups have raised concerns that the current NMS plans structure that administers the public data stream is not serving investors. The SEC has tried to address these concerns through recent rules, specifically the CT Plan and the Market Data Infrastructure Rule, also known as the MDI Rule. The CT Plan, among other things, includes the industry and investors as voting members of the governance of the NMS plan. The MDI Rule would expand the content of the public data stream and bring competition to its production and distribution. Both of these rules are tied up in litigation between the SEC and major exchanges.

This conflict calls into question the value of operating the public data streams as NMS plans. Why? Because there is a fundamental misalignment of interests. On the one hand, the congressional mandate to ensure timely access to core market data at a reasonable price, and on the other hand, the commercial interests of the major exchanges seeking to maintain revenue, the over \$400 million in revenue from the public market data stream and revenues associated with the exchange's own data products that directly compete with that public data stream. While adding investors and brokers to the NMS plan governance is a step in the right direc-

tion, we believe that Congress should go further and give the Commission control of the public market data stream.

Our second recommendation is that Congress eliminate immediately effective exchange fee filings. Subjecting exchange fee filings to notice and comment would mean that fee changes cannot be retroactive, nor can they be effective until after the SEC reviews and approves them. Exchange fees matter to investors because they directly affect order routing decisions and the ability of broker-dealers to achieve best execution for their customers.

Market participants should be given a voice in how and when fee changes go into effect. To that end, MayStreet supports the discussion draft legislation posted in connection with today's hearing that would amend the Exchange Act to modernize the filing and approval requirements for these fee filings. Specifically, by requiring exchange fee filings to go through the regular Commission review and approval process, the proposed legislation will allow the SEC to discharge its statutory duty to affirm the Exchange Act standards are met, namely that exchange files are reasonable, equitably allocated, not unduly burdensome, and not discriminatory.

Our third recommendation is that Congress create a clear mechanism for the SEC to review and remand filings already on the books. The SEC attempted to summarily remand over 400 filings for review. Unfortunately, the SEC's efforts were overturned by the courts, so Congress should step in. Investors and others should not continue to pay fees that are inappropriate, given the application of the Exchange Act standard in today's environment.

Our fourth recommendation is that Congress and the SEC provide definitive guidance on the Exchange Act standard as it relates to exchange fee filings. While Congress has explicitly declared that exchange fees need to meet Exchange Act standards, it has not defined what that means. Having the exchanges and the Commission on the same page helps investors, because when you set expectations properly, the process is less time-consuming and more consistent.

Thank you for your consideration of our recommendations, and for the opportunity to share my thoughts on these important topics.

[The prepared statement of Ms. Kimmel can be found on page 55 of the appendix.]

Chairman SHERMAN. Thank you for your testimony.

The subcommittee will now stand in recess, and we will reconvene immediately following the conclusion of this series of votes.

[recess]

Chairman SHERMAN. The subcommittee is back in session.

I now recognize myself for 5 minutes for questions.

Ms. Greene, in your written testimony, you highlight that when NASDAQ was sued by market participants for mishandling Facebook's 2012 IPO, the exchange argued that it was immune from liability because it was also an SRO. However, handling the Facebook IPO is something they did in their proprietary capacity, and, in fact, they charged for it. My discussion draft, the Securities Exchange Reform Act, which has been noticed for this hearing, would clarify that exchanges are shielded by immunity only when carrying out their regulatory functions. Could you speak to how a clarification of this standard would help market participants?

Ms. GREENE. Certainly. A clarification of this standard would help clarify some of the judicial standings that we have today where exchanges have historically been exempted by courts from private liability for damages they cause while performing their regulatory duties, but have sought to expand this for damages caused while acting as for-profit entities. And making changes to this and having the exchanges be responsible for damages that are caused when they are acting in a for-profit capacity, we think is important, because we do see them increasingly hiding behind their regulatory shield. And that was adopted back in 1934, in the Exchange Act, and certainly, we have seen a lot of evolution in the exchanges in the early 2000s to for-profit companies.

So, it seems that some of these special privileges that they enjoy today really need to be addressed through some of the legislation that has been put forth so that they are more similar to other publicly-traded companies that don't enjoy immunity from commercial activities. And also, looking at things like limitation of liability, prohibiting the exchanges from setting an artificially-low cap so that when there are incidents like Facebook, there is adequate funding or the ability to sue them in court so that there is able to be compensation to cover investor losses.

Chairman SHERMAN. I would point out that my discussion draft provides that there would be or allows for some cap with the intention that we would set that cap at a level where the exchanges could get insurance. The goal here is not to endanger them, even if there should be something like what happened with Facebook, which some have said was a \$500 million item, but rather to make sure that we put liability where the negligence resides.

Ms. KIMMEL, as you know, data is the lifeblood of all financial markets. Through their control of the National Market System (NMS) plans, which govern the collection, aggregation, and distribution of public stock market data, the exchanges have control over what investors rely on that data in their market trading decisions. They have the, "public data, the tape," which is provided for one price, but then they simultaneously sell separate proprietary data to market participants, which is more detailed, and delivered more quickly than the public market data. Would you agree this creates a disincentive for the exchanges to improve the quality of the tape, the market public data, when they have a competing product that sells for more?

Ms. KIMMEL. I think it absolutely does, but just to explain it, the exchanges actually sell two types of proprietary feeds. One type is the top-of-book feeds, and the other type is the depth feeds. The depth feeds are the ones that you are talking about that are more expensive, have lower latency and every order of data. But it is important to understand that this top-of-book data they sell is less expensive, has less data, and is chosen by retail broker-dealers instead of the consolidated tape because of those reasons. Because of that, we think it is very important that this market data infrastructure rule proceed, which would expand the content on the tape.

Chairman SHERMAN. In my remaining seconds, I would note that of roughly 44 percent of stock trading happening off the exchanges, 70 percent of that was Citadel and Virtu. And I am going to ask

Professor Jackson for comments on the record regarding that as my time has expired.

And I now recognize the ranking member of the subcommittee, Mr. Huizenga.

Mr. HUIZENGA. Mr. Chairman, before I ask my questions, I ask unanimous consent that the testimony of Kevin Edgar on behalf of the Equity Markets Association be entered into the record.

Chairman SHERMAN. Without objection, it is so ordered.

Mr. HUIZENGA. Thank you. Ms. Greene, it is my understanding that this is your first time testifying in front of Congress. Well, welcome to the circus. I won't ask you to identify the clowns, but we try to be productive here. So, yes, that is looking in a mirror every day, right?

I wanted to take a moment to discuss Consolidated Audit Trail (CAT). This is something that we have discussed before. Currently, the SEC has it before it, and because I believe that this is an issue that is important for everyone represented in the room, I just wanted to touch on that. Frankly, it has been an issue we have been discussing for quite a while. In fact, in 2017, when I chaired this subcommittee, we had a hearing on that topic, and at the time, I discussed a proposal I had introduced that was meant to safeguard and govern the security of the information reported to, stored by, and accessed by the Consolidated Audit Trail.

Fast forward to August 2020, and the SEC proposed amendments to the National Market System Plan governing the Consolidated Audit Trail to bolster its data security. I think it is important to remember that the CAT will be the largest database of customer and institutional trading data ever created, and will include a lot of very sensitive information, to say the least. So given this, I think it is imperative for all market participants that the SEC get this right. They have to have the confidence of investors that their information is going to be safe and will not be at risk of a data breach. Would you mind sharing your perspective on: one, the SEC getting it right; and two, the SEC moving quickly to approve the proposal?

Ms. GREENE. Yes, of course. Thank you. SIFMA remains in full support of the CAT. We do agree with you that there remains a lot of data security issues and privacy concerns that haven't been addressed to this day. Certainly, the SEC proposal that was put forth by former SEC Chair Clayton was something that SIFMA supported. We did have minor modifications to it, yet we thought that the Commission's concept of keeping the data within CAT in a secure environment that they could work on was a big improvement to having them download the data out of CAT. And, in fact, we saw many of the exchanges file comment letters opposing that proposal and their ability to take data out of the CAT. When we do look at CAT, we really think that a breach is more of a win, and if, again, we continue—

Mr. HUIZENGA. And, in fact, it has happened.

Ms. GREENE. Yes, it has. And as I said, we continue to raise this issue with FINRA CAT, the SROs, and the SEC, as well as this committee. And we were very supportive of your legislation back in 2018, Congressman Huizenga, and we think that the American Customer Information Protection Act that would prohibit the collec-

tion of personally-identifiable information was something that was very important. SIFMA did work with the SROs to keep Social Security numbers out of CAT, but we do remain concerned about that data and think those changes are really long overdue.

Mr. HUIZENGA. I appreciate that. I have a minute-and-a-half left, and we can continue this discussion about how fast the SEC is moving or not.

Mr. Piwowar, you are a former Commissioner, as well as a former acting Chair of the SEC. There is lots of concern, at least on this side of the aisle, about the impact of the short comment periods that the SEC is giving market participants. Could you touch on that very quickly? And then, somewhat related to that, by the SEC's own admission, there are economic consequences and potential negative unintended consequences that are there. SEC's climate-related disclosures are estimated to cost \$10.2 billion in paperwork burden alone, and some estimates have it at greater than that.

So if you could couple those things, short comment periods and dramatic, huge moves like that coming out of the SEC?

Mr. PIWOWAR. No, that is absolutely right. When I was on the Commission, I was an advocate for 90-day comment periods, the longer, the better. Some people think it is a way to sort of keep special interests from weighing in during the comment period, but it has the opposite effect. The trade associations can hire lawyers to do this. It is everyday Americans who don't have time to read through these huge, long proposals—the climate proposals more than 500 pages. And the other thing is that there are so many proposals out at the same time, right? It is not that you have 30 days—

Mr. HUIZENGA. They are just flooding the zone at this point.

Mr. PIWOWAR. Flooding the zone. Chairman Gensler is very smart, and he has run an agency before. And when he was at the Commodity Futures Trading Commission (CFTC), he was very famous for putting something very important into Footnote 513 on a cross-border rule. So, folks have to read these rules very, very carefully, and they need the time to do that.

Mr. HUIZENGA. My time has expired. I appreciate it.

Chairman SHERMAN. Without objection, I would like to submit for the record a statement from Fidelity Investments, and a letter sent to the committee for this hearing from OTC Markets, American Securities Association, Insured Retirement Institute, and Public Citizen.

Without objection, it is so ordered.

I now recognize the gentleman from Illinois, Mr. Casten.

Mr. CASTEN. Thank you, Mr. Chairman. And thank you to the witnesses. I want to talk about something or ask questions on something that is off the topic here, but certainly top of news, and that's Russian money laundering. This is as much as just sort of background for me because I feel like, as a member of this committee, I should be smarter on this issue than I am. In 2017, there was the whole Deutsche Bank mirror trade scandal with folks buying on a Russian market a dual-listed security, and then selling it on a London market and essentially converting Russian assets into hard currency.

And I guess I want to start with you, Mr. Jackson. Just walk me through, if you can, from an exchange perspective, if you have a same party or a related party executing the same trade on two different markets that are obviously connected, do you, as the U.S. exchange, as a U.S.-domiciled exchange, have any obligation? Do you have the data? Do you have any monitoring of that trade, or is the only compliance on the trader in Deutsche Bank? And I realize this was 2017, so it was a lifetime ago in Russian money laundering, but I just want to understand what you are monitoring right now, and are we satisfied that barn door is closed?

Mr. JACKSON. Thank you, Congressman, and I certainly think it is a crucial issue. And I share the concern about the degree to which foreign money finds its way into U.S. companies and exchanges. I think on this front, the exchanges have done very well to collaborate internationally with exchanges all around the world about the flow of funds into various kinds of companies.

But, Congressman, I do want to highlight a concern about this. You might know that Congress just last year unanimously passed what I think is a very important statute, the Holding Foreign Companies Accountable Act, which requires the listing of firms, particularly those from China, that refuse to have auditors' books inspected. And to me, audit inspection of the company's books is the basic lifeblood. It is the most basic rule of the road that we have in American capital markets.

And a question that someone could ask, sir, and the question that I would like to ask is, why was it necessary for Congress to pass a law letting exchanges know that they shouldn't be listing companies that refuse to have their books inspected? Here, too, I would think that the exchanges, if they were going to take their regulatory role more seriously, would not require a Federal law to be more careful about the kinds of companies that Americans are investing in. So, I do think the concerns you have raised are quite serious. The exchanges face a serious problem, a serious challenge there. And they have done important and very hard work on questions around money laundering and foreign investment, but I think we have a long way to go.

Mr. CASTEN. Okay. Ms. Sukumar, same question for you, but from your vantage point of seeing a lot of different international markets that are all in somewhat different regulatory regimes. And I want to frame this question by saying, if your answer to this question is, we should talk off the record, that is fine. But are there gaps in regulatory structures between the reporting structures, the compliance between these markets, so that if you had a dual listed security, maybe I can't go straight from Russia to London anymore. But are there other international markets, are there areas where you are concerned about so that we can ensure that we are not using our markets to launder money?

Ms. SUKUMAR. Thank you very much for the question and the opportunity. I would start by saying that every exchange in the world, every public market in the world is incredibly focused on ensuring that there is integrity of their markets. So, money laundering is a key concern, I think, that every exchange, not just in America, but across the world, shares that focus, shares that drive,

that vision really of having clean money, and stringent standards across markets globally.

I have two things, really, at this point to offer you. One is that every member of the WFE has to pass membership criteria. So we do a kind of assessment, and a really important membership criteria for us is, do the members comply or conform? Do they recognize international money laundering standards, and the answer is a resounding, "yes."

And the second is that, among our membership criteria, almost the first rule is where we look at regulatory jurisdiction, and we say, is your regulator a member of the international regulatory association, the International Organization of Securities Commissioners (IOSCO). And the reason that is particularly important is because regulators internationally have a memorandum of understanding (MOU). So, they sign this agreement where there is information sharing that helps them crack down on international crime.

I would say to you, it is obviously a complex topic. It is obviously a topic that worries everyone. And I think the exchanges have been doing a remarkable job at keeping markets clean. It helps, of course, that in that DNA exchanges are transparent markets, right? We live by corporate disclosure. Thank you. I see I am out of time.

Mr. CASTEN. Now, I am out of time. And I guess I will just leave it at, I still don't understand whether this was Deutsche Bank that was not reporting information that the exchanges should have had access to, or whether the exchanges weren't monitoring that information. And I would be happy to continue with any of you offline should you have more to share. I yield back.

Chairman SHERMAN. Thank you. I now recognize the gentleman from Ohio, Mr. Davidson.

Mr. DAVIDSON. Thank you, Mr. Chairman. I thank our witnesses and appreciate the chance to talk to you about this. Frankly, Ms. Kimmel, when I heard your testimony, there are a lot of things I would love to go into, but we have a hard time in the Minority picking topics for hearings. So, I am going to stretch some of the experience that you have had, and Mr. Piwowar, in particular, with your time at the SEC.

While this hearing discusses regulatory proposals to enhance our current market structure, I would like to focus for a second on what we have learned from our existing structure and how that can help us craft a framework for the future with respect to crypto exchanges. It is inevitable that crypto exchanges will continue to expand and become accepted over the course of the next few years. We can probably all agree that they will need to be regulated by someone. And an inherent part of that regulation will include an adequate disclosure regime like we have in place today with respect to equity markets.

In your testimony, Mr. Piwowar, you do a good job of laying out the guiding principles for market structure for traditional equities markets. In your opinion, what are some of the principles or perhaps some of the aspects of Reg NMS that we could emulate for a future crypto exchange framework?

Mr. PIWOWAR. Yes, thank you, Congressman. The first thing to recognize is that the U.S. equity markets are very complex. As has

been mentioned here, it is not just exchanges, there are market makers, and there are alternative trading systems, and the like. We have the same thing in the crypto world. We have exchanges. We have wallets. We have all kinds of different things.

And so to recognize that this is a dynamic and changing environment, and you want to set down the rules of the road, so you sort of balance the two pieces of the sort of two of the three parts of the SEC's mission. On the one hand, you want to protect investors, but on the other hand, you want to facilitate capital formation and innovation, and the key is getting that right. And the way you do that is through economic analysis, cost-benefit analysis, and then continuing to look at it over time to see whether or not we need to make changes over time based upon when markets change and what type of technologies change.

Mr. DAVIDSON. Are long, drawn-out enforcement actions selectively applied effective, or is a clear rulemaking process more effective?

Mr. PIWOWAR. Yes, clear rulemaking, obviously. Throughout my entire term, I was against rulemaking by enforcement. It is not fair to the people who aren't parties to the enforcement action. Oftentimes, you have a settlement that is entered into by one party and the Commission. And then, there are undertakings that become de facto rulemakings, that were not put out for notice and comment, that were not put out for other people to weigh in on, and now, that becomes a de facto rulemaking with which they have to comply.

Mr. DAVIDSON. And investors are hurt when that happens, correct?

Mr. PIWOWAR. That is correct.

Mr. DAVIDSON. Yes. And I think that it becomes incumbent upon Congress at some point to really provide that clarity and not just for the investors, but for the innovators, and frankly, for the regulators, because then you know there is a bright line. You are on this side of it or that side of it. And if can I shift, Ms. Sukumar, on a similar note, how do you think we could effectively build a framework that prevents market fragmentation and promotes transparency? Obviously, the crypto market has inherent differences such as a global reach; 75 to 90 percent of the liquidity is offshore; and it runs 24/7. But here in the United States, how can we entice future exchanges to build their presence here in the United States versus offshore?

Ms. SUKUMAR. Thank you, Congressman. That is a great question. The crypto, I think, continues to preoccupy us all, partly because we do want that innovation to occur, but I would also say to you, innovation isn't innovation if it is breaking the rules. So, we have had a question on Russia, and I am really thinking, I wake up every morning, and there is a headline about crypto platforms. I can't think of any that are registered as licensed exchanges, crypto platforms, saying, we are not going to follow sanctions dictates. So, I think really what would be incredibly helpful in thinking about crypto, because crypto is an asset class, is it needs to be traded in a way the retail investors in the world—

Mr. DAVIDSON. Yes. Let me interrupt you there for a second, because if you are asking a foreign exchange to do something that

has Know Your Customer (KYC) provisions, that is a different question. If you are asking for something like a node to be able to do it, you don't even know the identity of who owns which wallet, and frankly, you can't do that and not try to kill the entire concept. So, I think there are a lot of people who don't really actually understand the space, which is a barrier to creating regulatory clarity. I do hope that we can have future hearings where we deal with these topics because we touch on a lot of topics with—

Chairman SHERMAN. The time of the gentleman has expired.

I now recognize the gentleman from West Virginia, Mr. Mooney.

Mr. MOONEY. Thank you, Mr. Chairman. SEC Chairman Gary Gensler assumed office on April 17, 2021, so we are approaching the 1-year anniversary of Mr. Gensler's tenure. Already, I have some concerns about the direction of the Commission under Mr. Gensler's leadership. Mr. Piwowar, you spent 5 years on the Commission, and you know the way it functions as well as anyone. So, Mr. Piwowar, in your testimony today, you wrote at length about pilot studies as a tool for the Commission to measure and test the impact of changes in policy before implementation. Can you further elaborate on the pilot studies and how they have helped the Commission avoid bad policy changes in the past?

Mr. PIWOWAR. Yes, thank you for your question. I am a big proponent of pilot studies. At the same time, I recognize there are limitations and we need to put some guardrails around them. One of the examples of a successful pilot study was the Tick Size Pilot program that the SEC did, and also the Reg SHO Pilot where it got rid of short sale restrictions.

The Tick Size Pilot, which they were proponents of for a long time, said if we increase the tick size for small cap securities, it would improve liquidity. Some people thought that it would increase analyst coverage. We did that pilot, and it showed that neither one of those happened. It wasn't a success in that it wasn't a success because it didn't help small cap companies, but it allowed us to sort of say, okay, that is not a problem. We can move on and look at other things to help improve the liquidity there.

In terms of limitations, I recognize that pilot studies can be costly for market participants to implement, so the SEC needs to do a robust cost-benefit analysis to make sure that it is proper. On that note, I will note that some pilot studies like the Tick Size Pilot were done through an NMS plan, and I know that NMS plans are a large part of this hearing. I would prefer the pilot studies be done through notice-and-comment rulemaking so that everyone has a chance to weigh in and can say what they believe in terms of the cost and the benefits of any particular pilot program.

Mr. MOONEY. Thank you. I have a general concern about the Administration, all levels of government making law, which is the rule of Congress, not the Administration. But at least if you are going to issue new rules and regulations, I think a pilot study and being cautious would make sense.

Mr. PIWOWAR. Yes. And if I may, one of the unfortunate things that came out of the access fee pilot was challenged in court, and the D.C. Circuit said in there that the SEC did not have the authority to conduct a pilot study. And I think what would be helpful, a great role for this committee, if I may, would be to clarify that

the Commission does, in fact, have the authority to engage in pilot studies, and maybe also put some guardrails around that where it should be done through notice-and-comment rulemaking rather than through an NMS plan.

Mr. MOONEY. Thank you. We will look into that. Second question, capital formation is a core part of the SEC's three-part mission if the Commission's current agenda does not include any capital formation proposals. So, Mr. Piwowar, can you speak to the importance of reducing burdens for companies seeking access to capital?

Mr. PIWOWAR. Yes. As a matter of fact, next week is the 10th anniversary of the hugely bipartisan JOBS Act. It was probably the most successful piece of bipartisan legislation during the Obama Administration. And what we saw there was that if you can do some tweaks around the edges, lessening some of the burden for companies going public—the IPO on-ramp was probably the most successful provision in that legislation—that works. So, I would encourage this committee and the Commission to keep looking at what are some new ideas, 10 years later, that we could continue to do while protecting investors, but to improve the formation of capital.

Mr. MOONEY. Fair enough. And I will just make some closing comments in the minute I have left, but I am concerned that the Commission's current leadership seems more interested in regulating broadly and asking questions later. Mr. Gensler has repeatedly said that digital assets are securities. Imminently, for Mr. Gensler, that legal interpretation could give the SEC broader authority to regulate the entire industry. On the issue of climate disclosure, the SEC has decided to play the role of social activist by requiring that Scope 1 and Scope 2 emissions be disclosed by all public companies, whether or not those emissions are material to investors. So, regardless of whether they are sought by the average investor, the SEC has decided that public issuers must provide them.

It is not at all clear how this climate requirement fits within the three pillars of the SEC's mission of protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation. Yet, Mr. Gensler has prioritized his agenda item over making any single rule related to the capital formation. So, unfortunately, the Commission's current leadership is not adhering to the restrained, measured approaches that characterize good government, and I wish he would look more carefully at your testimony instead of pursuing the priorities of climate change activists.

Thank you, Mr. Chairman. I yield back.

Chairman SHERMAN. Those watching the hearing will notice that we don't have as many Members as usual. They should be aware that there is now a classified briefing regarding Ukraine going on, and Members had a tough decision.

The gentleman from Ohio, Mr. Gonzalez, is now recognized for 5 minutes.

Mr. GONZALEZ OF OHIO. Thank you, Mr. Chairman. And thank you to our witnesses. Let me start by thanking you and Chairwoman Waters for attaching the bipartisan Registration for Index-Linked Annuities Act that I introduced with my friend, Alma

Adams. It is my hope that this committee can advance this common-sense legislation in the coming weeks. It has strong support from Members on both sides of the aisle. I look forward to debating that, hopefully soon.

Mr. PIWOWAR, I want to start specifically with you. You mentioned the JOBS Act's 10-year anniversary. I know you are very familiar with it. I want to give you some time to maybe comment on areas where you think we can go further to improve that IPO on-ramp, to make sure that there are more companies going public and that they can do so in an efficient manner. I would love any of your thoughts on that.

Mr. PIWOWAR. Sure, I have some. I see Congressman Emmer is here. We are going to get into his Venture Exchange Bill a little bit later. I think that could be a nice piece of the puzzle. What the JOBS Act showed was that we can make some differences around the edges. What it also showed was that there were a number of provisions in the JOBS Act that a lot of people ahead of time *ex ante* thought were going to be taken up and be used, and they weren't. But other ones, we didn't realize were going to be as important as they ended up to be. So, for example, the ability of companies to do confidential filings with the SEC has proven to be a huge success that allows companies to go through that process, and if they decide not to go through with the offering, it is not like there is some sort of stain on the company or whatever.

Mr. GONZALEZ OF OHIO. Yes.

Mr. PIWOWAR. Biotech companies really like that idea because it allows them to keep proprietary information from their competitors, but then that information becomes public in enough time for investors to move forward. So, just as a general matter, I would encourage this subcommittee, and the committee at large, and Congress to come up with as many different ideas as possible, because we don't know which ones are going to be used.

Now, having said that, I think venture exchanges are one potential way to go forward, but there are things you could do in that area. The other one is, I think, opening up the accredited investor definition to allow more investment in private companies is something—

Mr. GONZALEZ OF OHIO. I totally agree.

Mr. PIWOWAR. —that we could do. And then, just anything in the IPO. There are other types of burdens and regulations to take a look at. So, 10 years later, are there new things now that are burdening companies? There is what is called the, "pebbles in the stream," analogy in terms of regulatory accumulation.

The Commission does a good job of looking at, on an individual basis, cost-benefit analysis, but over time, those regulatory burdens can go over time. And they are like, "pebbles in a stream," where each individual pebble doesn't stop the flow of the stream, but cumulatively, they can, and you can't look back and say it was any one of those. So, I would encourage folks to look back and say, well, what has accumulated over the last 10 years that could potentially be scaled back for these smaller emerging growth companies.

Mr. GONZALEZ OF OHIO. Yes, I think the accredited investor rule, in particular, just by definition, shuts out so many Americans. And we know that the bulk of the returns or a lot of the returns of our

fastest-growing companies are now happening in private markets. So, we are excluding minorities, and we are excluding lower-income retail investors from being able to get involved at the ground level at some of these exciting companies. I think it is a horrible rule. I would love to see bipartisan support around coming up with something more sensible. Sure, we have to protect folks, but good God, let's give them an opportunity.

Mr. Piwowar, I am going to ask for your quick thoughts on another SEC rule that has been considered, which is to require U.S. private companies to disclose more information as if they were public, but without any of the benefits of accessing the public markets. Do you have any concerns with that approach? Do you think it is the right approach? And how do you feel about it with respect to capital formation?

Mr. PIWOWAR. Yes, I do have concerns. We obviously have a regime for public companies and a regime for private companies. And I worry about the unintended consequences from these. Obviously, if you overburden public companies, you are going to have more private companies. And I worry about the fact that these companies will just go overseas, and then U.S. investors won't have access to the potentially great growing companies and the entrepreneurs of the future.

Mr. GONZALEZ OF OHIO. I only have 30 seconds left, so I don't know if I can get this out, but it was a similar concern with the ESG disclosures, and I was talking to a friend of mine who works in the investment industry, and he said, look, this is a total giveaway to the private equity industry because what is going to happen is smaller companies, who aren't going to be able to make or don't want to make those disclosures, are going to have trouble making those disclosures. It is just going to be easier for them to sell. So, we'll see a wave of consolidation when I think we should be promoting more competition, and more capital formation. Hopefully, we will have a hearing on that. Hopefully, we can get Chair Gensler and others to come before our committee again.

With that, I yield back.

Chairman SHERMAN. The gentleman yields back.

Now, I recognize the gentleman from Minnesota, Mr. Emmer.

Mr. EMMER. Thank you, Chairman Sherman, and Ranking Member Huizenga. I was pleasantly surprised and proud to see my bill, the Main Street Growth Act, noticed for this hearing. The Main Street Growth Act would allow the Securities and Exchange Commission to provide for the creation of venture exchanges so that small- and medium-cap companies can go public through a more streamlined process. This bill passed out of this committee unanimously in the 115th Congress, and it passed the House as well. In fact, I would like to thank Chairman Sherman, Mr. Scott, Mr. Himes, Mr. Foster, Mr. Meeks, Mr. Gottheimer, and Mr. Gonzalez on this subcommittee for voting in support of this bill, and I hope to have your support again.

We have a capital formation problem in this country, and ultimately the compliance burden borne by government overregulation is making the initial public offering process unrealistic for a large segment of private American companies. This hurts everyday American investors the most, much like Mr. Piwowar and Rep-

representative Gonzalez were just talking about. Small, private companies that need capital are at a disadvantage today because the trading and listing environment is geared for much larger IPO companies than it was 25 years ago. How do we know? The participation in the IPO process has significantly declined since the 1990s.

Let's look at the facts. The number of IPOs declined more than 63 percent from the 1990s to the 2000s, and has stayed relatively flat up to 2020. At the same time, the United States has doubled the regulatory compliance costs the business has to take on for going public in a traditional IPO. Just to give you an idea, it costs an average of \$2.5 million for a company to achieve just the initial regulatory compliance for going public, and then, it is an additional . \$1.5 million on an annual basis thereafter. These are SEC estimates.

In the past 2 years, we have seen a surge in companies going public through alternative strategies, like Special Purpose Acquisition Companies (SPACs), indicating that the traditional IPO process is not feasible for emerging innovative companies. The small start-up IPO should not be on the superhighway designed for trading Apple and Microsoft. We need to move away from the one-size-fits-all SEC regulatory posture and allow the market to try new innovative strategies. After all, capital formation starts when a company can list its shares on a quality electronic venue plugged into the full force of America's investment potential.

I appreciate my colleagues' willingness to advance legislation that creates new exchanges tailored to small- and medium-cap companies because exchanges are integral in the capital formation process. And America's capital markets are the envy of the world. The broader discussion of this hearing, I worry, centers around making it harder for exchanges to operate, which could impose barriers on the new small competitors in the venture exchange space, and ultimately make our capital markets less competitive and accessible. When we set up structures that allow for more companies to go public, we give the American people more access to our capital markets. We give them more opportunities to build financial wealth.

Mr. Piwowar, do you believe that my legislation, the Main Street Growth Act, can eliminate some of the barriers currently deterring small emerging growth companies from going public?

Mr. PIWOWAR. Thank you, Congressman. Yes, you pointed out the streamlined IPO process, and those are for existing private companies that do want to go public. In addition, as you point out, it also addresses the fact that the exchanges, the trading system is set up for the larger public companies. And, frankly, the exchanges don't have the incentive to try to do innovative things, like you said, and experiment because of unlisted trading privileges. So, in your bill, you would give exclusive trading rights to the venture exchange.

The Commission is looking at that. It is going to look at that very, very carefully, and we need to be very careful about that. The reason for that is you want to encourage the experimentation by the exchanges to compete with one another, to make the market more conducive for that. It is my hope that would be the case—you

mentioned tick sizes and potentially doing call markets instead of continuous trading. But there are probably some other things the exchanges could do if they were granted that exclusivity.

Mr. EMMER. Great point. And on that note, with the majority of American companies searching for alternative avenues from the traditional IPO process to form capital, such as SPACs, as I referred to earlier, are simply staying private. Do you believe that there is a timely need for Congress to pass this legislation?

Mr. PIWOWAR. In a word, yes. Whatever you can do in Congress, and the SEC can do to encourage more companies to go public at the appropriate time—you mentioned SPACs, right? Another one is direct public listings, and those are instances where you have companies that have grown very large in the private sector. And the only reason why they are going public is to have a liquidity event. They don't even need to raise capital at that point, so the more, the better.

Mr. EMMER. Thank you. I appreciate it. Thank you, Mr. Chairman.

Chairman SHERMAN. Thank you. I now recognize the gentleman from Wisconsin, Mr. Steil.

Mr. STEIL. Thank you very much, Mr. Chairman. We have had a really interesting discussion today about the friction between exchanges, broker-dealers, investment banks, and asset managers on the liability question. And one of the things that I've been kind of pondering up here is, have there been any instructive kind of global examples that we could look at outside the U.S. structure? In many ways, the U.S. capital markets are significantly stronger, bigger, and different than the global markets, but I'm curious if that gives us any light into this conversation, and I will open it up to you, if I can, Ms. Greene, for a quick comment on that. And I would like to come to you, Ms. Sukumar, as well, if you have a brief comment on that.

Ms. GREENE. Sure. When we look at the markets, my understanding is, and we can certainly come back to you and confirm this, but that the regulatory structure in the U.S. is unique in these special privileges that it does provide to the exchanges, things like immunity, rules-based liability caps, and even on the SEC plans that we see, the exclusion of industry members, so clearly things that can be improved here in this structure. And I would defer to Nandini on her views on how the global markets are structured here.

Mr. STEIL. Thank you for that feedback. Ms. Sukumar, would you like to comment?

Ms. SUKUMAR. Yes, with pleasure. I would like to start perhaps by just saying that across the world, across our members, and we have 300-odd, this kind of regulatory immunity is the standard model. And why is that? It is because the exchange, by nature, the nature of its work, the nature of its business, needs to do things, counseling trades, invoking volatility mechanisms, all of these kinds of things, and these are often unpopular. So, they need to be able to do it. They are a neutral, trusted third party that operates markets, so they need to be able to have regulatory immunity.

Mr. STEIL. I appreciate that comment. So, you see certain consistency in that?

Ms. SUKUMAR. Yes, absolutely.

Mr. STEIL. Mr. Piwowar, do you see that as well, or are there any comments you'd like to offer on that?

Mr. PIWOWAR. No further comments on that.

Mr. STEIL. No further comments. Let me shift gears slightly, if I can, because I think we have had interesting conversations. I would like to go to you, Mr. Piwowar, if I can. You commented in your testimony, and particularly on an area that I have an interest in, that banning restricting dual class stocks would lead some companies to delist, I think was your testimony. I am always concerned about proposals that reduce retail investors' options, especially when the purported benefits are questioned. And as you may know, the vast majority of Americans can't invest in many companies because they are not accredited investors under our U.S. rules and our U.S. structure.

So, you have essentially made a large number of promising investment opportunities off limits to all but the rich, which seems a bit counterintuitive to me. We could get in the weeds if we had more time, but would any other bills attached to today's hearing lead to a reduction in the number of public companies, in your opinion?

Mr. PIWOWAR. I think anything that increases the burden on being a public company vis-a-vis a private company, creates incentives for either private companies to stay private or public companies to either go private or to simply move to other capital markets, right? What we forget is that there is not only a competition between the public markets and the private markets here, but Nandini's members are all competing to try to get listings around the world, and capital is truly global. So, I worry about not only companies going private, but then also companies leaving the U.S. markets altogether.

Mr. STEIL. Shifting more specifically to the accredited investor, do you think Congress should revisit the accredited investor standard?

Mr. PIWOWAR. Congress or the SEC has the ability to do it. They don't need additional authority. But I think potentially, from this committee's perspective, if you could direct the SEC to do something with that, to put the focus on it, I think that would be very helpful.

Mr. STEIL. Thank you very much. And thank you very much for holding today's hearing, Mr. Chairman. I yield back.

Chairman SHERMAN. Thank you for your brevity.

I now recognize the ranking member for a 1-minute closing statement.

Mr. HUIZENGA. Thank you, Mr. Chairman. And, yes, we are missing some briefings, and it is unfortunate that this was interrupted with votes. I appreciate the time, especially the additional time that all of the panelists have put forward.

To kind of underscore my point from earlier, with all of the things that are going on and Mr. Piwowar has highlighted, as we talked about SEC actions, the SEC came out with another rule-making today on SPACs. And it is like we can't even catch up to where we currently are or where they currently are. And the capacity and bandwidth of the SEC, much less everybody else who is

being affected by all of these things, is just getting stretched to the absolute limits, and we ought to be talking about that, not that this isn't an important issue. The structure of markets is very important. It is what guarantees we have the liquidity and the depth, and makes this the premier place to invest in the world. But we are killing the goose that lays the golden egg here, in my opinion, and we have to do better at tending to that.

My time has expired. I yield back.

Chairman SHERMAN. I recognize myself for a 1-minute closing statement, and then the obligatory housekeeping.

First, Mr. Piwowar, thank you for bringing to our attention that we may need legislation to provide for pilot studies by the SEC. The Republican side has constantly advocated to get poor and middle-class people the opportunity to make high-risk investments in low-information securities. I would point out that the vast majority of middle-class and poor people's investments in the markets is through their interest in pension plans, plus, of course, mutual funds and business development companies.

I thank Mr. Davidson, an advocate of cryptocurrency, for explaining it to us clearly that you ruin the whole purpose of cryptocurrency if you require them to adhere to Anti-Money Laundering and Know Your Customer (AML/KYC) rules. After all, cryptocurrency literally means, "hidden money." And if it can't be hidden money, why would anybody prefer it over the currency we have now?

And finally, Ms. Sukumar, I thank you for bringing to my attention the fact that crypto exchanges call themselves exchanges, but aren't regulated exchanges. You can't call yourself a bank if you are not a bank. I will ask you to comment on for that for the record.

My time has expired. I want to thank our witnesses for their testimony today.

The Chair notes that some Members may have additional questions for these witnesses, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is now adjourned.

[Whereupon, at 5:09 p.m., the hearing was adjourned.]

A P P E N D I X

March 30, 2022

Written Testimony of Ellen Greene

**Managing Director, Equity and Options Market Structure, Securities Industry and
Financial Markets Association (SIFMA)**

before the U.S. House of Representatives

Committee on Financial Services

Subcommittee on Investor Protection, Entrepreneurship and Capital Markets

**Hearing Entitled: “Oversight of America’s Stock Exchanges:
Examining Their Role in Our Economy”**

Wednesday, March 30, 2022

Chairman Sherman, Chair Waters, Ranking Members McHenry and Huizenga, and distinguished members of the Subcommittee: thank you for the opportunity to testify on behalf of the Securities Industry and Financial Markets Association (SIFMA). SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. SIFMA's members' combined businesses represent 75 percent of the U.S. broker-dealer sector by revenue and 50 percent of the asset management sector by assets under management.

On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. Together with our member firms, we are dedicated to driving strong economic growth and job creation and enabling Americans from all walks of life to safely invest and prepare for a financially secure future.

I want to commend and thank the Committee's leaders for convening this hearing and bringing transparency to the critical – but too often overlooked – role of America's stock exchanges in our economy. It is an honor to discuss the urgent need to modernize the self-regulatory system that underpins our equity market structure. Congress formally established that system under the Securities Exchange Act of 1934 (the Exchange Act) but has not updated it since 1975 despite the fundamental transformation of America's exchanges in the 21st Century.

Our equity markets exist to facilitate the capital formation that entrepreneurs, business owners, and companies need to create jobs, grow the economy, and serve their customers and communities. The central goal of the laws governing our equity markets is to protect the interests of the investing public. Most of our federal securities laws meet that standard today, but there are some features of our self-regulatory system that fall short and need to be updated.

In particular, federal securities laws give special privileges to America's exchanges that benefit the exchanges commercially but do not serve the hundreds of millions of Americans whose retirement, education, and personal savings are invested in the capital markets. I will focus my testimony on five such privileges:

1. The exchanges have historically been exempted by courts from private liability for damages they cause while performing their regulatory duties but have sought to expand this immunity to damages caused while acting as for-profit entities.
2. The exchanges impose non-negotiable limitations on their private liability for damages they cause while acting as for-profit entities, and they set the limitations so low as to have no relation to the financial losses an exchange could cause.
3. The exchanges have the unique right to sell – and monopolistic power to set the prices of – their proprietary data products and related infrastructure, which broker-dealers and other market participants are compelled to purchase for regulatory and competitive reasons.

4. The exchanges exclude their competitors from fully participating in – but require them to comply with and help finance – major market initiatives developed as Regulation National Market System (NMS) plans, like the Consolidated Audit Trail (CAT).
5. The exchanges have access to broker-dealers’ highly valuable intellectual property through the CAT as a result of their overlapping regulatory jurisdictions.

SEC Commissioner Allison Herren Lee summarized the upshot of these special privileges when she said, “Our regulatory regime currently places for-profit trading venues in the position of setting many of the rules and costs for how our markets function.”¹ As we have seen throughout history in other areas of our financial system, empowering one group of businesses with advantages granted by the government rather than earned through superior market performance leads to markets that are unfair and uncompetitive and higher prices for consumers.

To protect individual investors and promote the greatest benefits of fair competition, we must modernize the self-regulatory system at the foundation of our equity market structure. This will require Congress to amend the Exchange Act. To that end, this Committee should take up legislation that includes the following five reforms, which I describe in greater detail below:

1. Clarify the boundaries of the judicially created doctrine of regulatory immunity by providing that exchanges are not immune from liability for damages they cause while acting as for-profit entities.
2. Prohibit exchanges from imposing limitations on their private liability for damages they cause while acting as for-profit entities.
3. Require a public comment period and approval by the Securities and Exchange Commission (SEC) before any proposed new fees for proprietary market data, connectivity, and co-location services can become effective.
4. Require that entities subject to and involved in financing major market initiatives pursuant to plans adopted under Regulation NMS, like broker-dealers and asset managers, have representation and meaningful voting participation in the initiatives’ development and management, with equal access to information as that of the exchanges.
5. Limit each exchange’s regulatory jurisdiction to its own exchange in order to reduce regulatory duplication and mitigate the inherent conflict of interest between an exchange’s commercial business interests and its regulatory obligations.

These reforms will bring our equity markets much closer to the goal that I believe everyone on this Committee shares, which is to serve the interests of the individual investor. The former schoolteacher whose pension allows her to retire comfortably, the working parents saving to send

¹ Statement on Proposed Order for Creation of a New Consolidated Market Data Plan for Equity Market Data, SEC Commissioner Allison Herren Lee, Jan. 8, 2020, available at (https://www.sec.gov/news/public-statement/lee-statement-proposed-order-creation-new-consolidated-market-data-plan#_ftn4).

their kids to college, the recent graduate who invests a portion of her paycheck each month, and many more like them – these are whose financial futures will benefit the most from these reforms.

For this reason, modernizing the self-regulatory system at the foundation of our equity market structure is not a partisan issue. Members of Congress from both political parties, SEC Commissioners from all backgrounds, and experts from across the industry agree that the self-regulatory system is outdated and failing to protect the interests of the investing public. Enacting these targeted, commonsense reforms offers a rare opportunity for bipartisan cooperation to make a positive difference for the hundreds of millions of Americans² – in every state and congressional district in the country – who are invested in the capital markets.

To appreciate the magnitude of the problems and the urgent need for the type of reforms mentioned above and discussed in detail below, it is essential to understand the origins of the self-regulatory system and the fundamental transformation of America’s exchanges that began at the turn of the 21st Century. This history demonstrates that the rules governing our equity market structure today were established in the 1930s for institutions that no longer exist.

The Self-Regulatory System Is a Relic in An Age of For-Profit Exchanges Serving as SROs

A central feature of our equity markets is the role of America’s securities exchanges as self-regulatory organizations (SROs). The roots of the self-regulatory system date back over 200 years to the 1792 Buttonwood Agreement that led to the creation of the first organized stock market in New York. As the capital markets grew and developed into the 20th century, exchanges regulated themselves, establishing their own rules that they enforced on their broker-dealer members.

Federal regulation of exchanges began with the Exchange Act, which codified the exchanges’ self-regulatory role by requiring all existing securities exchanges to function as SROs and all broker-dealers to be members of an SRO. Congress also expanded exchanges’ self-regulatory role by requiring them to register with and carry out their regulatory functions under the supervision of the SEC. As a result, an exchange is required to act as SRO that enforces compliance on its members with both its own rules and federal securities laws. To that end, exchanges have the authority to enforce the rules of their own market as well as the federal securities laws with regard to their own broker-dealer members. This allows the SROs to establish and enforce rules governing their members business activities, conduct examinations of their members, and, where necessary, investigate potential rule violations and bring disciplinary actions against their members.

One of the primary reasons Congress codified this system in 1934 was the exchanges’ unique structure as mutualized cooperatives. At that time, each exchange was owned by its members – i.e., the broker-dealers that traded on that exchange – which they operated like a utility without independent commercial interests.

However, this central premise of the self-regulatory system that Congress established in 1934 fundamentally changed in the early 2000s when the exchanges began to demutualize with SEC approval. Today, America’s exchanges are for-profit entities, many of which are part of

² See, e.g., (<https://news.gallup.com/poll/266807/percentage-americans-owns-stock.aspx>).

publicly traded companies owned by independent shareholders, not mutualized members.³ As such, America's exchanges today have their own commercial interests that are separate from, and often in direct competition with, those of its broker-dealer members.

The conversion of America's exchanges from mutualized cooperatives to shareholder-owned for-profit corporations represented a sea change in the structure of our equity markets. It led the exchanges to expand their commercial activities, driven by their fiduciary duty to their shareholders to maximize profits. To that end, exchanges now sell a range of market data products and connectivity infrastructure and services to deliver that data (e.g., co-location, fiber connectivity, wireless connectivity) to broker-dealers and other market participants. Exchanges also compete directly with broker-dealers for order flow, execution, and order matching services.

The self-regulatory system's delegation of broad regulatory, adjudicatory, and prosecutorial quasi-governmental powers to non-government entities has always been unparalleled among American financial market regulations. But it has become untenable following the exchanges' demutualization. In no other industry would anyone defend the government empowering one group of businesses (i.e., the exchanges) to surveil and regulate the business activities of its customers and competitors.

The only thing more confounding is how long this arrangement has continued without reform. As early as 2004, the SEC recognized that the exchanges' transformation into shareholder-owned for-profit corporations created an acute conflict of interest between their commercial business interests and regulatory obligations. In a Concept Release Concerning Self-Regulation, the SEC stated,

SRO demutualization raises the concern that the profit motive of a shareholder-owned SRO could detract from proper self-regulation. For instance, shareholder owned SROs may commit insufficient funds to regulatory operations or use their disciplinary function as a revenue generator with respect to member firms that operate competing trading systems or whose trading activity is otherwise perceived as undesirable. Moreover, as with the inherent conflicts discussed above, this conflict can be exacerbated by increased intermarket competition.⁴

This conflict of interest is also exacerbated by the special privileges that were granted to the exchanges, as SROs, when they were member-owned cooperatives, but which have remained in place despite the exchanges' transformation to shareholder-owned for-profit corporations. Below, are summaries of the harm that these special privileges cause the markets, individual investors, and other market participants.

³ There are 24 registered U.S. securities exchange licenses, most of which are part of three major exchange groups (the New York Stock Exchange, Nasdaq, and Cboe). A number of these registered securities exchanges operate separate equity and options markets through their SRO registrations, so there are, in fact, 32 equity and options exchanges currently operating. On February 17, 2022, the SEC approved a BOX Exchange proposal to establish BSTX as a trading facility of the Exchange.

⁴ Concept Release Concerning Self-Regulation, Exchange Act Release, 69 Fed. Reg. 71,256, 71,257 (Dec. 8, 2004), available at (<https://www.sec.gov/rules/concept/34-50700.pdf>).

The Self-Regulatory System with For-Profit Exchanges Serving as SROs Harms the Markets, Individual Investors, and Other Market Participants

1. Exchanges attempt to apply their judicially-created regulatory immunity to damages they cause while acting in their own commercial interest as for-profit entities

The exchanges, under the judicially created doctrine of regulatory immunity, have been recognized by the courts to be insulated from private liability for damages they cause while discharging their regulatory duties. Because the SEC, as an agency of the federal government, is entitled to immunity with respect to its own activities, courts have held that an exchange should be entitled to similar immunity when it “steps into the shoes” of the SEC in performing the quasi-governmental regulatory functions delegated to it as an SRO under the Exchange Act.

This doctrine of regulatory immunity emerged when exchanges were member-owned cooperatives with limited commercial interests. However, following the exchanges’ demutualization and increased focus on their responsibility to maximize profits for shareholders, they have sought to apply regulatory immunity to all of their activities, including their commercial activities.

For example, Nasdaq claimed that its SRO status immunized the exchange from private liability stemming from its negligence during the initial public offering (IPO) and secondary market trading of Facebook shares on May 18, 2012. Investors in the highly anticipated IPO suffered material financial losses because of a design flaw in Nasdaq’s system to match buy and sell orders and what the SEC called “a series of ill-fated decisions” by the exchange’s leadership.⁵ Nasdaq’s failures in technology and decision-making caused orders to be stuck in its system, leading to significant monetary losses for investors, who were made whole by the broker-dealers through which they traded. Nasdaq’s negligence in its commercial business activities involved in matching orders led the SEC to charge the exchange with securities laws violations, which the exchange settled by paying a \$10 million penalty to the SEC. Yet for the damages borne by its broker-dealer members arising from those same commercial activities that led to the \$10 million settlement with the SEC, Nasdaq claimed immunity from liability. In connection with this episode, Nasdaq received special approval from the SEC to exceed its rule-based liability limitations to compensate its members in the amount of \$62 million for their losses, which was nowhere near the estimated approximately \$500 million in losses incurred by these firms and market participants.⁶

2. Exchanges impose non-negotiable, unreasonably low limitations on their private liability for damages they cause while acting as for-profit entities

Each exchange has incorporated into its rules non-negotiable limitations on its private liability for damages they cause while acting as for-profit entities, including their activity of operating markets. These limits are legally protected and strictly enforced because the SEC approves the exchanges’ rulebooks and the exchanges are obligated to comply with their own rules, and the exchanges set these limits at such low levels that they bear no relation to the financial

⁵ Available at (<https://www.sec.gov/news/press-release/2013-2013-95.htm>).

⁶ See (<https://www.latimes.com/business/la-xpm-2013-mar-26-la-fi-facebook-nasdaq-20130326-story.html>).

losses that an exchange could cause its member firms. As far as we are aware, this government-approved authority to limit one's private liability is not afforded to entities in other industries, and certainly not to the exchanges' broker-dealer members with which they do business and compete.

For virtually all commercial entities, like broker-dealers, that may seek to limit their potential liability, such arrangements must be negotiated with their counterparties. And if an agreement is reached, there are judicially recognized exceptions to contractual limitations on liability, such as gross negligence or intentional misconduct. By contrast, exchanges have the power to unilaterally set their liability limits and impose them on their broker-dealer members without recourse. And broker-dealers do not have the power to walk away from doing business with an exchange if they disagree with its liability limits. For example, under the SEC's Regulation National Market System (NMS), broker-dealers are not permitted to trade through the exchange displaying the best available quotation. Broker-dealers executing customer orders must establish direct connectivity to each exchange regardless of whether they would willingly accept that exchange's liability limits.

With such extraordinary government-approved power, it should come as no surprise that the exchanges set their liability limits extremely low compared to the potential damages that they could cause their member firms. Today, most exchanges limit liability to an aggregate of \$500,000 per month, whereas a failure at a single exchange have resulted in claims upwards of several hundred million dollars.

As SIFMA stated in a 2013 letter to the SEC, "Rules-based limits on liability effectively externalize the costs of an exchange's missteps onto its loss-suffering members." This arrangement made sense "when exchanges were actually utilities owned by those members," but it is incompatible with the realities of today's equity markets in which "exchanges are for-profit businesses competing against those members that are forced to absorb losses the exchange causes."⁷ Allowing the exchanges to limit their risk of liability for their failures while leaving broker-dealers at risk of unlimited liability is not only patently unfair – it could also harm individual investors. The effects of exchanges' rule-based limitations of liability may factor into broker decisions about the types and amounts of business they conduct on exchange, including potentially decisions about whether to serve as a market maker.

By protecting the exchanges from the consequences of potentially catastrophic loss, rules-based liability limits do not properly incentivize exchanges to take appropriate measures to mitigate or limit their exposures to losses. To address this gap, the SEC adopted Regulation Systems Compliance and Integrity (SCI) in 2015, which aims to ensure the exchanges remain diligent with their operations and resilient, however, this doesn't mean that systems issues won't arise in the future. Ironically, a common argument made in support of this government-granted privilege is that exchanges need to unilaterally limit their private liability in order to protect themselves from the risk of catastrophic loss, which could cause them to cease operations and potentially create systemic risk for the broader financial markets. Like the self-regulatory system today with for-profit exchanges serving as SROs, this "too big to fail" argument may have been reasonable at some point, but today it is simply outdated.

⁷ Available at (<https://www.sifma.org/wp-content/uploads/2017/05/sifma-submits-comments-to-the-sec-requesting-a-review-of-the-self-regulatory-structure-of-securities-markets.pdf>).

Today's equity markets are resilient, supported by 16 equity exchanges. Liquidity is dispersed among these and other trading venues, and market participants can easily send their order flow to other venues if one exchange experiences problems. Gone are the days when the lion's share of trading volume was concentrated in the primary listing market. Recent history has shown that when an individual market is forced to suspend operations because of a systems failure, market-wide trading can continue without interruption. Thus, it is difficult to maintain that the failure of an exchange would pose systemic risk.

3. *Exchanges have the unique right to sell – and monopolistic power to set the prices of – their proprietary data products and related infrastructure*

The exchanges have the unique right to sell their proprietary market data – at prices that they have broad power to choose – to broker-dealers and other market participants. The exchanges incur little costs in gathering the data, which is created by their broker-dealer members and their customers and reported to the exchanges. The exchanges aggregate the data and then turn around and sell it to their broker-dealer members and other market participants, who are compelled to purchase it due to various regulatory requirements and/or competitive reasons.⁸ In practice, this also means that broker-dealers also must purchase from the exchanges the most up-to-date infrastructure and services necessary to receive and transmit data to the exchanges at the fastest possible speeds. The exchanges also have monopolistic power to set the prices of their own data products and infrastructure, subject to only limited SEC oversight: because each exchange is the sole source of data related to the trading activity on that exchange, market participants cannot substitute one exchange's market data products for another's, and therefore the exchanges face no competitive forces to constrain their prices of data products and infrastructure.

In other words, the exchanges receive valuable market data at virtually no cost from their broker-dealer members and their customers, aggregate it, and then sell it back to broker-dealers and other market participants at prices that have no apparent connection to the costs of producing the data.

Market data is critical to make informed decisions about what and when to buy and sell. Individual and institutional investors are key purchasers and users of market data, either directly or through a broker-dealer, and are therefore significantly impacted by the fees that exchanges charge. Historically, a key to the strength of America's equity markets has been our market data systems that collect from different trading centers quotes and trades for every security and then disseminate to the public that information in a single stream. Yet our current equity market structure is compromised in this regard.

Driven largely by changes brought about by Regulation NMS, each exchange has a monopoly over its proprietary market data products and infrastructure, and broker-dealers are captive customers that have no alternatives. This was evident in an analysis of market data fees published in 2018 by SIFMA and Expand Research, a company of the Boston Consulting Group. The 2018 study showed that “the pricing of equivalent NYSE Integrated, NYSE Arca Integrated

⁸ On the competitive front, many investment managers require that the broker dealers handling their order flow subscribe to each exchange's proprietary feed.

and NYSE American Integrated product data increased from 2010 to 2018 by approximately 1,110%, 1,011% and 612% respectively.” And “depending on the size and usage” of the consumer, these price increases translated into “as much as a 3,000% increase in total spend” by broker-dealers in 2018 for the equivalent market data content that was received in 2010.⁹

As SIFMA wrote in a letter to the SEC accompanying the 2018 report, “In a competitive market, companies cannot significantly increase prices over cost because if a company earned excess profits, other companies would drive profits down through less expensive products.” By contrast, the market for equity market data is defined by the exchanges’ monopolistic pricing patterns.

Such pricing patterns also appear immune from the positive price effects of technological advances. As technology improvements drive down costs of data and connectivity, the prices that the exchanges charge for their data products and services continue to increase. As the Healthy Markets Association noted in a 2018 letter to the SEC,

Outside of the exchange connectivity context, pricing for data transmission is generally competitive and one finds little variation from one vendor to the next. Further, rather than double and triple digit fee hikes, actual costs in the sector have been falling for data delivery. While prices for connectivity for all areas outside of the exchange server room have fallen, they have been quite the opposite for the monopoly exchanges.¹⁰

Under the Exchange Act, exchange market data fees must be “fair and reasonable” and not unfairly discriminatory. The Court of Appeals for the District of Columbia Circuit recognized that the cost of producing the market data must be considered for market data fees to qualify as fair and reasonable.¹¹ However, transparency into those costs remains limited, even as the exchanges have gained the ability to impose market data fee increases immediately upon filing them with the SEC.

Prior to 2010, an exchange’s proprietary market data fee changes were subject to a public notice and comment process before approval or disapproval by the SEC. However, in 2010, the Dodd-Frank Act amended the Exchange Act to provide that exchanges’ market data fee changes become immediately effective upon filing. In contrast, the SEC in 2020 adopted requirements that proposed fee changes under NMS Plans – e.g., for consolidated market data products – are subject to a public comment period and approval by the SEC before the proposed fee changes can become effective.

However, changes in the fees that exchanges charge for their proprietary data products are still effective immediately upon filing, after which the SEC has 60 days to suspend the change. By

⁹ Available at (<https://www.sifma.org/wp-content/uploads/2018/10/File-No.-4-729-SIFMA-Comments-on-Roundtable-on-Market-Data-and-Market-Access-October-24-2018-002.pdf>).

¹⁰ Letter from Healthy Markets Association to Brent J. Fields, Secretary, Securities and Exchange Commission, Aug. 23, 2018, available at (<https://www.sec.gov/comments/sr-box-2018-24/srbox201824-4258035-173056.pdf>).

¹¹ See *NetCoalition v. Commission*, 615 F.3d 525 (D.C. Cir. 2010), but see *NetCoalition v. Commission*, No. 10-1421 (D.C. Cir. Apr. 30, 2013) (finding that amendment to Exchange Act precluded court from jurisdiction to hear challenge at particular procedural posture).

creating a presumption that the exchanges' data fee changes comport with the Exchange Act requirements, putting the onus on the SEC to prove otherwise within 60 days, and excluding a formal process for the public to comment prior to the fee changes taking effect, this arrangement facilitates a scenario in which the exchanges have engaged in a practice of increasing fees for their proprietary data and related products with no relation to the costs incurred in developing them.

Often exchanges will make a fee change filing with the SEC, wait just short of 60 days and then withdraw it, and at the same time refile the same fee change, all the while collecting the new fees because such filings are effective immediately upon filing. For example, the MIAX exchanges have filed and refiled with the SEC the same fee changes six times between July 2021 and March 2022.¹²

There are multiple methods by which the exchanges exercise their monopolistic power in pricing data fees, but in all cases the upshot is the same: trading costs increase for market participants and individual investors are worse off. In 2018, former SEC Commissioner Robert J. Jackson notably explained the disproportionate impact on the investing public:

The costs of buying and selling American stocks, and therefore participating in our Nation's growth, are often a fraction of what they once were. But it's far from clear whether those developments are attributable to the exchanges' for-profit status. What is clear is that their profit motive gives exchanges every reason to structure stock markets in a way that maximizes their rents. And every time exchanges raise prices, that money comes out of investors' pockets, who pay more to buy and sell stocks than they otherwise might.¹³

The SEC should be commended for unanimously adopting in 2020 a rule to update the governance of the SROs' current equity market data plans. The rule was designed to ensure that consolidated equity market data is distributed fairly and reasonably and provides the content needed to facilitate best execution in today's market. While this rule brings competition to the monopolistic structure of market data, continued holistic reform of the current system governing the distribution of equity market data is needed.

4. Exchanges exclude their competitors from fully participating in – but require them to comply with and help finance – major market initiatives developed as NMS plans

Under the Exchange Act, the exchanges and FINRA, as SROs, are authorized to work together to develop facilities of the national market system. And Regulation NMS authorizes two or more SROs, working together, to file with the SEC a national market system plan (NMS plan), which, if approved by the SEC, serves as the governing document for a national market facility. Pursuant to its authority, the SEC has directed the SROs to establish, among other things, the Consolidated Audit Trail (CAT), which is the world's largest securities transaction database, and the Securities Information Processor (SIP) utilities that provide consolidated equity market data to

¹² See, e.g., (<https://www.sec.gov/rules/sro/emerald/2022/34-94257.pdf>).

¹³ Remarks of Hon. Robert J. Jackson, Jr. before the Healthy Markets Association and George Mason University, Sept. 19, 2018, available at (<https://www.sec.gov/news/speech/jackson-unfair-exchange-state-americas-stock-markets>).

the marketplace. Pursuant to the CAT NMS plan, broker-dealers are required to report information on each of their securities transactions to the CAT database.

Recently, the SEC determined that the Exchange Act does not prohibit non-SRO market participants, such as broker-dealers and asset managers, from serving as fully participating members of the NMS Operating Committees. In this regard, the SEC recently approved a new governance structure for the new equity market data plan governing the distribution of consolidated equity market data, the CT Plan, that permits for the first-time non-SROs to participate as full members of the plan's operating committee. However, the exchanges have sued the SEC over the CT Plan's governance structure, challenging the SEC's authority to allow non-SRO participants on the operating committee, to block this rulemaking from taking effect, and the matter currently sits with the DC Circuit.

Indeed, prior to this recent SEC action, the SROs historically have excluded non-SRO market participants from joining NMS Plan Operating Committees. As a result, the exchanges and FINRA have had exclusive control over NMS Plans and the operations of the associated market facilities, like the CAT, even though broker-dealers are responsible for complying with NMS plans' requirements and financing their operations. Denying industry members equal representation on the NMS Plan Operating Committees and the opportunity to inform the governance of critical market facilities undermines the strength of our equity markets.

Relatedly, the SEC uses NMS Plans, rather than direct rulemaking, to implement significant changes to the equity markets. Compared to direct SEC rulemaking, this NMS process lacks meaningful industry input and has been controlled by the SROs through the NMS Operating Committees.

5. *Exchanges have access to broker-dealers' highly valuable intellectual property through the CAT as a result of their overlapping regulatory jurisdictions*

Under the Exchange Act, each equity and options exchange (currently there are 32) and FINRA, as SROs, are required to examine and enforce compliance by its broker-dealer members with both its own rules and federal securities laws. Given that many broker-dealers need to be members of multiple exchanges to conduct their businesses, this system of overlapping SRO jurisdiction leads to regulatory duplication.¹⁴ More importantly, it gives exchanges access to broker-dealers' proprietary trading strategies – i.e., intellectual property with high commercial value – by allowing each exchange to see, through the CAT, the trading activity of its broker-dealer members across all exchanges of which they are members.¹⁵ Prior to the staged implementation of CAT, the ability of an exchange to access their broker-dealer members' cross-

¹⁴ While efforts have been made over the years to centralize SRO regulatory functions in FINRA, these efforts have been eroding recently due to some large exchange groups taking back regulatory functions that they had previously delegated to FINRA.

¹⁵ In August of 2020, former SEC Chairman Clayton and senior Commission staff released an update on the implementation progress of the CAT that stated, "One of the outcomes of CAT implementation that has been discussed is the enhanced availability of cross-market order lifecycle data. This enhancement, as a matter of operational capability, will enable multiple SROs to have access to cross-market data previously unavailable to them." See "Update on the Consolidated Audit Trail: Data Security and Implementation Progress" available at (<https://www.sec.gov/news/public-statement/clayton-kimmel-redfearn-nms-cat-2020-08-21>).

market trading activity was constrained by a process in which as a general matter, one SRO's regulatory arm would request the data from another SRO's regulatory arm through the Intermarket Surveillance Group (ISG). However, at this stage of CAT implementation now allows an exchange to view the trading data from all the markets of which its broker-dealers are members without having to request data through the ISG.

Exchanges are permitted to access and use their broker-dealer members' cross-market trading data only for regulatory purposes, and the SEC's August 2020 CAT Data Security Proposal includes further clarifications of and limitations on the scope of regulatory purposes for which the exchanges can use this data, though this proposal has not yet been adopted and is being actively opposed by some exchanges.¹⁶ However, market participants are extremely concerned that the revenue pressures on for-profit exchanges could lead them to misuse the CAT data for commercial purposes, such as a new order types. Moreover, the use of any CAT data beyond the regulatory purpose for which an exchange seeks it, or even outside of a regulatory context, is a critical security concern for the CAT and the investors whose information is contained within the CAT database, as the SEC has recognized.

Legislative Reforms to Protect the Individual Investor and the Interests of the Investing Public

Legislation is needed to bring the rules governing America's exchanges in line with the realities of the markets today and to ensure the self-regulatory system serves the interests of the hundreds of millions of Americans who are invested in the capital markets. Toward that end, this Committee should take up legislation that includes the five reforms described below.

These reforms are consistent with recommendations made by the U.S. Department of the Treasury in its 2017 report, *A Financial System that Creates Economic Opportunities – Capital Markets*.¹⁷ In that report, Treasury recommended comprehensive reviews of the roles, responsibilities, and capabilities of SROs, as well as operational, structural, and governance improvements to the SRO framework. Importantly, these reforms do not infringe on the exchanges' important role in capital formation and would not disrupt the capital markets. To the contrary, these legislative recommendations are urgently needed to ensure that individual investors can fully benefit from participating in the markets.

1. Restrict Regulatory Immunity

Congress should amend the Exchange Act to provide that exchanges are not immune from lawsuits arising out of their commercial activities. This approach would codify the view taken by the SEC in a 2016 amicus brief, which stated that "absolute immunity is properly afforded to the exchanges when they are engaged in their traditional self-regulatory functions – in other words,

¹⁶ See Release No. 34-89632 (August 21, 2020), 85 FR 65990 (October 16, 2020). See also Nasdaq Comment Letter (December 2, 2020), available at (<https://www.sec.gov/comments/s7-10-20/s71020-8084827-226094.pdf>); Cboe Comment Letter (December 2, 2020), available at (<https://www.sec.gov/comments/s7-10-20/s71020-8088156-226116.pdf>); NYSE Comment Letter (December 2, 2020), available at (<https://www.sec.gov/comments/s7-10-20/s71020-8083358-226075.pdf>).

¹⁷ Available at (<https://home.treasury.gov/system/files/136/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf>).

when the exchanges are acting as regulators of their members” whereas “immunity does not properly extend to functions performed by an exchange itself in the operation of its own market, or to the sale of products and services arising out of those functions.”¹⁸

2. Reform Exchanges’ Rule-Based Limitations on Liability

Congress should amend the Exchange Act to prohibit exchanges from creating rule-based limitations on liability. This reform would strengthen market-based discipline on our equity markets, creating incentives for exchanges to make responsible decisions in operating their markets and to maintain financial resources to absorb the consequences of any failure without relying on other market participants.

3. Require Public Comment and SEC Approval Before Implementing Data Fee Changes

Congress should amend the Exchange Act to require a public comment period and approval by the SEC before any proposed new fees for proprietary exchange market data, connectivity and co-location services can become effective, similar to the SEC’s 2020 requirements for NMS Plan fee filings. This reform would ensure that impacted market participants are able to meaningfully voice concerns to the SEC about such fee changes.

4. Expand NMS Plan Governance

Congress should amend the Exchange Act to clearly and explicitly provide that industry representatives, such as broker-dealers and asset managers, have meaningful voting participation in the governance of NMS Plans, with transparent access to the same information that exchanges currently receive. Representation by market participants will expand the insight and value of the Operating Committees governing the various NMS Plans. This change would also be consistent with the current Exchange Act statutory requirement that broker-dealers have representation on the boards of the exchanges themselves. Further, the SEC should be encouraged to rely on their own, direct rulemaking, rather than using NMS Plans to impose significant changes on the marketplace – doing so would significantly reduce the conflicts created by allowing for-profit exchanges to develop NMS systems directly impacting their broker-dealer competitors.

5. Limit SRO Status of Exchanges

Congress should limit exchange SRO status such that each exchange can enforce only the rules of its own exchange, thus reducing unnecessary and inefficient regulatory duplication. One example of the beneficial effects of this reform is that it would place clear guardrails on the ability of exchanges to use CAT data in a manner designed to protect the investing public. This recommendation would not impact the ability of an exchange to set and enforce its own listing standards.

¹⁸ Brief of the SEC, Amicus Curiae, City of Providence, Rhode Island v. Bats Global Markets, Inc. et al. Available at (<https://www.sec.gov/litigation/briefs/2016/providence-bats-global-markets-1116.pdf>).

Conclusion

The commonsense SRO reforms outlined above would benefit individual investors by encouraging fair and balanced competition among market participants. While not a solution for all issues, these SRO reforms are a meaningful step in the right direction to modernize our outdated self-regulatory system and ensure that our equity markets once again protect the interests of the investing public.

Testimony of Professor Robert J. Jackson, Jr.
New York University School of Law

Before the
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
of the
Committee on Financial Services
United States House of Representatives

Hearing on
Oversight of America's Stock Exchanges: Examining their Role in our Economy

Wednesday, March 30, 2020
Rayburn House Office Building

Thank you, Chairman Sherman, and thank you, Ranking Member Huizenga, for the opportunity to testify before you today about the oversight of the Nation's stock exchanges. For someone like me, our stock exchanges are a symbol of how investing can change the lives of American middle-class families. You see, I was born in the Bronx, New York, to a big Irish Catholic family. My mother is one of nine kids, and my father is one of five. The day I was born, none of them had been to college. So my parents plowed their paychecks into the stock market each week, confident that their savings could give their son the chance to go to school. Forty years later, my parents sat behind me at my Senate confirmation hearing to be a Commissioner of the Securities and Exchange Commission. So to me, our stock exchanges not only encourage investment and entrepreneurship and growth. They make it possible for two middle-class parents to change their son's life. Our stock exchanges are at the core of the American dream. That's why it is crucial that our exchanges give investors a level playing field—and it's why today's hearing is so important.

While I served as a Commissioner, I was fortunate enough to give two speeches—one hosted by George Mason University and the Healthy Markets Association, the other by the Open Markets Institute—on what I think is the uniquely American solution to the problems that plague our exchanges: competition.¹ Those institutions are very different ideologically, but they reflect strong bipartisan support for ensuring that exchanges compete like all American businesses should: by adding value, not leveraging their market power and legal status. During my time on the Commission, my Office led a series of initiatives designed to achieve just that.² Unfortunately, exchanges have used litigation and lobbying to stall important progress on these issues. Several of the bills you are considering today would leave no doubt that the SEC has the authority it needs to make our exchanges more than mere symbols of competition—and instead businesses that thrive based on innovation, not litigation. I consider that legislation in further detail below.

¹ SEC Commissioner Robert J. Jackson, Jr., *Unfair Exchange: The State of America's Stock Markets* (remarks at George Mason University, Sept. 19, 2018); SEC Commissioner Robert J. Jackson, Jr., *Competition: The Forgotten Fourth Pillar of the SEC's Mission* (remarks at the Open Market Institute, Oct. 11, 2018).

² *Id.* (“[M]y office will work closely with [then-] Director Redfearn [on] market data.”).

I. THE LACK OF COMPETITION AT OUR STOCK EXCHANGES

When I first took office at the SEC, I asked our Staff to explain a puzzling fact: Even though we had 13 public stock exchanges at the time, 12 of them were owned by 3 companies.³ Because I've worked on mergers and acquisitions as an investment banker and corporate lawyer, I'm familiar with the economies of scale that justify acquisitions. But I have rarely come across an industry where conglomerates buy, and then continue to run, identical businesses. So I asked the Staff: why are our markets structured this way?

The answer lies in who decides what data investors get on stock prices. We have a two-tiered system of stock-price information—a lower-quality public feed and generally higher-quality private ones.⁴ We allow the exchanges to run both—while profiting from private feeds. The more exchanges a company owns, the more private data feeds they can charge for—even if doing so conflicts with overall market efficiency.⁵ As a result, the public feed is slower and less reliable than the private feeds the exchanges sell. That's because exchanges have understandably underinvested in the public feed—a product they compete with. As I've said before, it's like letting Barnes & Noble run our public libraries: nobody should be surprised to find that our libraries don't have enough books.⁶

³ Since then, new entrants to the market have brought welcome innovation to our market structure. But even those new entrants cannot resist repeating the rent-seeking approach of the incumbent exchanges. The reason, of course, is that our stock-market structure has arisen not from the problematic conduct of a particular exchange but instead the incentives the law gives them. MEMX, *MEMX to Charge for Market Data*, MARKETS MEDIA (Feb. 10, 2022) (announcing that MEMX, an exchange launched in 2020 “by a diverse group of participants to benefit all investors” will now charge for market data after achieving 4% market share).

⁴ As I have before, for ease of exposition I generally refer to the CTA/CQ plan and the UTP/OTC NMS plans, which most call the “two centralized Securities Information Processors (“SIPs”) to which all exchanges are required to report,” as the “public feed” for purposes of this testimony. Robert P. Bartlett, III & Justin McCrary, *How Rigged Are Stock Markets? Evidence from Microsecond Timestamps*, 45 J. FIN. MKTS. 37 (2019); see also Shenwei Ding, John Hanna & Terrence Hendershott, *How Slow is the NBBO? A Comparison with Direct Exchange Feeds*, 49 FIN. REV. 313 (2014).

⁵ Giovanni Cespa & Thierry Foucart, *Sale of Price Information by Exchanges: Does it Promote Price Discovery?*, 60 MGMT. SCI. 1 (2014) (pointing out that exchanges jointly price trading and market data fees, creating incentives to charge more at the cost of potential price discovery).

⁶ Jackson, *Unfair Exchange: The State of America's Stock Markets*, *supra* note 1.

During my tenure, the SEC took several key steps to address exchanges' power over stock-price data. Today, I'll emphasize two of them. First, the Commission adopted rules requiring exchanges to upgrade the public feed by including additional information that has become essential to trading in modern markets.⁷ Second, the SEC adopted rules requiring the exchanges to propose reforms to the governance of the public feeds, so that other stakeholders have a say in the quality—and price—of the information available to investors.⁸

Exchanges responded to these reforms as they almost always do:⁹ by suing, exercising the free¹⁰ option the courts have given regulated entities to block changes to market structure.¹¹ For the exchanges, such litigation has little downside, since they can continue to extract rents from investors while courts consider their claims. And the upside is significant: good lawyers sometimes persuade courts to second-guess financial regulatory decisions exchanges don't like.¹²

⁷ U.S. Sec. & Exch. Comm'n, Release No. 34-90610, File No. S7-03-20, Final Rule: Market Data Infrastructure at 24 (Dec. 9, 2020) (redefining “core” market data to include, among other things, odd-lot quotations, which are increasingly common in a market with high-priced stocks like Amazon; depth-of-book data, which is used to evaluate liquidity for larger trades; and auction information, which is used in determining the most important price of the trading day—the closing price).

⁸ U.S. Sec. & Exch. Comm'n, Release No. 34-88827, File No. 4-757, Order Directing the Exchanges and the Financial Industry Regulatory Authority to Improve Governance of Market Data Plans (May 6, 2020).

⁹ History teaches that Congressional intervention is often necessary to modernize equity market structure. Indeed, when the SEC sought to create a consolidated trade and quote system in the early 1970s, it was met with four years of “foot dragging” and constant threats of litigation. JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET* 503-506 (3d ed. 2003) (quoting my predecessor, A.A. Sommer, on the SEC's efforts to get the New York Stock Exchange to implement a consolidated tape). Only when Congress intervened by passing the 1975 Securities Act amendments did NYSE acquiesce, and the SEC was able to finalize Rule 11Ac1-1 to make consolidated quote information available to the public. Senate Rep. No. 93-865, 93d Cong., 2d Sess. (1974), 5-8 (finding that questions of SEC authority to establish consolidated data feeds created unnecessary delays in modernizing markets).

¹⁰ It's technically true, of course, that litigation is not free; the lawyers who make a living on these suits are not inexpensive. *See, e.g.*, Robert Schmidt, *Suing the Government? Call Scalia!*, BLOOMBERG NEWS (Jan. 26, 2012). But the expense of even exceptional attorneys is trivial compared to the loss of valuable rents, so the exchanges' economic decision whether to sue is usually straightforward.

¹¹ *See, e.g.*, Alexander Osipovich, *Nasdaq, NYSE Sue SEC to Block Market Data Overhaul*, WALL ST. J. (Feb. 9, 2021) (exchange litigation over the SEC rule requiring more detailed information in the public feed); *The Nasdaq Stock Market, LLC et al. v. SEC*, No. 21-1167 (Aug. 9, 2021) (same, over the SEC rule giving stakeholders a say over the construction and pricing of the public feed); *see also* Stacey Cunningham CEO, New York Stock Exchange, *We're Suing the SEC to Protect the Stock Market*, WALL ST. J. (Feb. 14, 2019) (you get the idea).

¹² *See, e.g.*, Robert J. Jackson, Jr., *Cost-Benefit Analysis and the Courts*, 78 LAW & CONTEMP. PROBS. 55, 64 (2015) (arguing that “federal judges and their law clerks are ill-suited to conduct or even to carefully review [regulatory decisions] in the area of financial regulation”).

So exchanges nearly always have incentives to sue. The result is that much of the market structure reforms I worked to implement as a Commissioner still haven't happened.

That's why the Securities Exchange Reform Act of 2022 is so important.¹³ Among other things, the Act would leave no doubt about the Commission's authority to require exchanges to give stakeholders a say about the pricing and quality of the public feed. Rather than litigation that is good for lawyers and lobbyists but not investors, our markets need common-sense reforms like those the SEC has adopted after years of careful consideration and consultation. The Act ensures that Congress, not exchange lawyers, will determine when those reforms arrive.

II. THE END OF EXCHANGES AS CORPORATE GOVERNANCE GATEKEEPERS

The Act would also address another vestige of our outdated regulatory structure: although our exchanges are now private, profit-making entities, when they're sued they seek the shield of governmental immunity.¹⁴ Generally, market participants expect to be held liable for the harm that they cause, and this expectation gives them incentives to take care when dealing with others. Government actors, by contrast, are usually held harmless from liability, so that their decisions reflect optimal policy. Exchanges contend that they are regulatory entities, so should be immune from liability when their profit-maximizing decisions harm investors.

¹³ H.R. _____, SECURITIES EXCHANGE REFORM ACT OF 2022, Section 4 ("Any self-regulatory organizations acting jointly [to] regulate a national market system (or subsystem thereof) shall include as voting members of such national market system non-SRO Voting Representatives" in the manner described" by the SEC in its August 2021 plan adoption order).

¹⁴ U.S. Sec. & Exch. Comm'n, Release No. 69655, File No. 3-15339, *In the Matter of The Nasdaq Stock Market, LLC and Nasdaq Execution Services, LLC* at ¶23 (in Facebook's infamous botched IPO on Nasdaq, the exchange failed to take steps to ensure that the IPO would run smoothly, opting to open trading despite being aware of potential technical problems). Nasdaq later claimed immunity from liability in a securities class-action suit against Facebook in which Nasdaq was named as a defendant for negligent management of the IPO. The court accepted some of those arguments, but cautioned that absolute regulatory immunity would create substantial moral hazard problems. *In re Facebook, Inc., IPO Sec. & Derivative Litig.*, 986 F. Supp. 2d 428, 453 (S.D.N.Y. 2013) ("While the doctrine of SRO [immunity] must continue to ensure regulatory independence, it cannot be applied to allow blanket protection for exchanges when they fail to exercise due care in their pursuit of profit."). See also *City of Providence v. BATS Global Markets, Inc.*, 878 F.3d 36, 47 (2d Cir. 2018) (noting that the exchanges attempted to invoke absolute immunity in a case that did "not involve any exchange conduct that [the court] could properly characterize as regulatory").

When I was a corporate lawyer—that is, before exchanges became for-profit entities—that was a better argument. Back then, exchanges developed meaningful corporate-governance rules that gave investors a chance to hold insiders accountable.¹⁵ But today, the exchanges' profit motive leads them to pursue listings, not investor protection. To see how those incentives influence exchanges, consider WeWork's withdrawn IPO. To attract the company's listing, the *Wall Street Journal* reported, the New York Stock Exchange offered to change the cups in its cafeteria, and Nasdaq offered to create a new index called the We Fifty.¹⁶ A regulator would have asked the hard questions about the company's business and governance that eventually led to the IPO's withdrawal; instead, exchanges followed their profit motive.

Exchanges that have exited the business of corporate governance want to have it both ways, pursuing profit when it suits them and the shield of regulatory immunity when it doesn't. But we've learned through hard experience that extending the government's protections to profit-making actors gives them reason to take excessive risk, since they privatize the gains from their actions but do not bear the losses.¹⁷ Moreover, exchange rulebooks impose low liability limits even when exchanges are found liable for investor losses.¹⁸ Both are inconsistent with the accountability we see in competitive markets—and both put investors at risk of losses from exchange activities shielded by government protection.

¹⁵ See, e.g., NEW YORK STOCK EXCHANGE LISTING STANDARDS § 303(A) (establishing, among other things, standards for director independence at publicly traded firms).

¹⁶ Maureen Farrell, Liz Hoffman, Eliot Brown & David Benoit, *The Fall of WeWork: How a Startup Darling Came Unglued*, WALL ST. J. (Oct. 24, 2019) (in order to attract the ultimately unsuccessful WeWork IPO listing NYSE, President Stacey Cunningham offered to eliminate plastic cups in the NYSE cafeteria, and Nasdaq CEO Adena Friedman one-upped the competition by offering to create a new index, the We 50, of companies committed to sustainability.)

¹⁷ SEC Commissioner Robert J. Jackson, Jr., Statement on Proposed Amendments to the Volcker Rule (June 5, 2018) ("Rolling back the Volcker Rule while failing to address pay practices that allow bankers to profit from proprietary trading puts American investors, taxpayers, and markets at risk.")

¹⁸ Merritt Fox & Gabriel Rauterberg, *Stock Market Futurism*, 42 J. CORP. L. 793, 802 (2017) ("[L]iability limits are most questionable when exchanges are providing functionalities identical to those of broker-dealers. Here, as many market participants have objected, the exchanges seem to be subsidized by law with their liability limits granting them an anti-competitive advantage when providing an identical service to a broker-dealer.")

That’s why the Securities Exchange Reform Act’s provisions on this subject are crucial to giving American investors the market structure they deserve. By making clear that exchanges cannot claim immunity for market activities, the Act would put to rest the idea that exchanges can avoid the accountability all market participants face for their actions.¹⁹ And by stopping exchanges from adopting rules that limit their liability, the Act would put market forces back to work in exchanges’ approach to risky decisions.²⁰ Rather than continue to litigate these questions at investor expense, the Act would force exchanges to compete for investors’ business.²¹

Because the exchanges have exited the business of corporate accountability, it’s also important that you are considering today bills on the use of dual-class stock at public companies. The exchanges of the past were gatekeepers, providing basic corporate-governance guarantees to investors. But, as the WeWork experience showed, today’s exchanges are racing to the bottom, attempting to attract the hottest listings despite their questionable corporate governance practices. That’s why the use of dual-class stock, which gives corporate insiders more votes than ordinary investors—and thus hammerlock control of their companies—has become so widespread.²²

¹⁹ H.R. ____, SECURITIES EXCHANGE REFORM ACT OF 2022, Section 2 (“A national securities exchange shall not be immune from the jurisdiction of courts of the United States or of the States in any case in which the action is based upon an activity carried on by such exchange in the operation of the exchange’s own market or the sale of products and services arising out of such activity.”).

²⁰ *Id.* Section 3 (“The rules of the exchange do not include any rules-based limitation on the liability of the exchange for any loss, expense, damages or claims that arise out of the use of enjoyment of the facilities of the facilities or services afforded by the exchange, any interruption in or failure or unavailability of any such facilities or services, or any action taken or omitted to be taken in respect of the business of the exchange.”).

²¹ I note, however, that the Act does not address the SEC’s choice to use the National Market System process, rather than direct rulemaking, in addressing the conflicts of interest in the governance of the public feed. That decision, in January 2020, was a mistake; indeed, I dissented from that choice, noting my concern that “[r]ather than give investors a real say over the data that drives our markets, [the SEC chose to] invit[e] for-profit exchanges to draft their own rules on these questions,” an approach that had “failed investors before.” Commissioner Robert J. Jackson, Jr., *Statement on Reforming Stock Exchange Governance* (Jan. 8, 2020). I predicted then that the decision would “impose months of additional delay.” *Id.* I was wrong: it is now more than two years later, and these badly needed reforms are still not in place.

²² Dhruv Aggarwal, Ofer Eldar, Yael V. Hochberg & Lubomir P. Litovd, *The Rise of Dual-Class Stock IPOs*, 144 J. FIN. ECON. 122 (2022) (documenting a rise in dual class stock due to greater availability of private capital, giving founders greater control).

It wasn't always that way. For decades, the New York Stock Exchange refused even to list companies with nonvoting shares.²³ But after lobbying from corporate insiders in the 1980s, NYSE reversed course, and today companies crucial to the American economy and society are controlled through dual-class structures. The practice has gone so far as to allow insiders to pass control of American public companies to their chosen heirs—America's own corporate royalty.²⁴ The Council of Institutional Investors and Blackrock, who together represent millions of American investors, petitioned the exchanges years ago to place some limit on the use of dual class. The exchanges have done nothing to address it.²⁵

That's why the bills before you establishing minimum listing standards for multi-class stock companies are so important. Since for-profit stock exchanges pursue listings, not investor protection, they cannot be expected to adopt such limits on their own. Putting to one side the optimal approach to this question, all should agree that exchanges have no economic incentive to limit the use of dual class.²⁶ The bill before you that would require an accountability vote at dual-class firms seven years after an IPO offers an attractive balance between accountability and the freedom visionary founders need to grow our most exciting young companies.²⁷

²³ NYSE's famous decision in 1926 to list nonvoting shares of Dodge Motor Company led to public debate about the implications of that structure for accountability, and in 1940 NYSE announced that it would not list firms with nonvoting common stock. Before then, restrictions on shareholder voting rights were more common—although, of course, that was before the SEC even existed. See Stephen Bainbridge, PROFESSORBAINBRIDGE.COM, *Understanding Dual-Class Stock Part I: An Historical Perspective* (Sept. 9, 2017).

²⁴ SEC Commissioner Robert J. Jackson, Jr., *Perpetual Dual-Class Stock: The Case Against Corporate Royalty* (Feb. 15, 2018).

²⁵ See Ken Bertsch, Amy Borrus & Jeff Mahoney, Council of Institutional Investors, *Petition to NYSE on Multiclass Sunset Provisions*, HARV. L. SCH. F. CORP. GOV. (Nov. 2, 2018); see also COUNCIL OF INSTITUTIONAL INVESTORS, INVESTORS PETITION NYSE, NASDAQ (Oct. 24, 2018) ("We encourage U.S. exchanges to show global leadership on voting rights by requiring companies to either automatically convert or give shareholders the right to extend a multi-class structure." (quoting Barbara Novick, Blackrock Co-Founder and Vice Chairman)).

²⁶ See Jill Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. L. REV. 1056 (2019) (contending that event-based, rather than time-based, sunsets may be preferable); see also NASDAQ STOCK MARKET COMPANY RULEBOOK 5900. COMPANY LISTING FEES (listing fees can provide tens or even hundreds of thousands of dollars of annual exchange revenue—per listed company).

²⁷ H.R. ____, TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 TO IMPROVE THE GOVERNANCE OF MULTI-CLASS STOCK COMPANIES. That bill reflects empirical evidence suggesting that value-enhancing effects of dual-class structures wane over time. See *id.* at 1073 (citing Martijn Cremers, Beni Lauterbach & Anete Pajuste, *The*

But exchanges' weak incentives to help investors hold corporate insiders accountable are now coupled with the explosive growth of our private capital markets. As my friend and colleague Commissioner Allison Lee has ably explained, the growth of private markets is not an accident, but instead a consequence of deliberate policy choices.²⁸ Those choices have created new sources of private capital, increasing founders' power,²⁹ and while sophisticated early-stage investors are able to bargain for contractual provisions that protect their rights, ordinary investors in initial public offerings do not have the same opportunities.³⁰ Thus, any changes to the balance between public and private markets should consider the effects of expanding private markets on investors' power to hold insiders accountable in public markets.

That's why I am skeptical of bills creating new exchanges for companies that are not yet public. Although I appreciate that founders, investors, and employees in startup companies need liquidity, I am wary about providing that liquidity at the cost of public-company accountability. At a time when private capital markets are larger than ever, it is hard to see why creating venues to produce even larger private firms, with even more power over their eventual public investors,

Life Cycle of Dual-Class Firms (ECGI Working Paper No. 550, 2018), and Lucian Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 631 (2017)). While the interpretation of that evidence is contestable, see Fisch & Davidoff, *supra* note 26, those who favor economic analysis in the design of securities law should engage with this evidence—not gesture towards the assumption that IPO markets are efficient.

²⁸ SEC Commissioner Allison H. Lee, *Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy* (Oct. 12, 2021) (“[T]he single most significant development in securities markets in the new millennium has been the explosive growth of private markets.”).

²⁹ Michael Ewens & Joan Farre-Mensa, *The Deregulation of the Private Equity Markets and the Decline in IPOs*, 33 REV. FIN. STUD. 5463 (2020) (finding that the adoption of the National Securities Markets Improvement Act of 1996 significantly increased the capital available for late-stage private startups, allowing them to grow larger prior to raising public capital).

³⁰ Will Gornall & Ilya A. Strebulaev, *Squaring Venture Capital Valuations with Reality*, 135 J. FIN. ECON. 120 (2020) (documenting that 56% of unicorn IPOs appear to be overvalued as they are based on the economic rights of investors in prior financing rounds, which common-stock investors in public markets do not receive). To be sure, public investors are increasingly able to access exposure to late-stage startups through mutual fund investments. Sergey Chernenko, Josh Lerner & Yao Zeng, *Mutual Funds as Venture Capitalists? Evidence from Unicorns*, 34 REV. FIN. STUD. 2362 (2021) (finding that “mutual funds are more likely to invest in late rounds, hot sectors, and larger firms”).

should be a priority. Instead, the Congress and Commission should focus on ensuring that our public companies and the exchanges they trade on can be held accountable by investors.

III. THE PATH AHEAD

Although exchange oversight has been debated for years, we are still at the early stages of understanding how the economic incentives of powerful intermediaries can distort public markets. Before closing, I want to highlight two challenges that are likely to arise for this Subcommittee, and for the SEC, because of the lack of competition in our stock markets.

First, the exchanges' power over listings also gives them control over how auctions are run to determine the closing prices of American public-company stocks. The closing price is the most important price of the trading day because it determines the net asset value of the funds that millions of Americans use to plan for their future. Yet important recent research finds that the New York Stock Exchange uses its considerable power over market design to favor its own floor brokers at the expense of price efficiency.³¹ These prices are too important to American savers to allow them to be determined by anything but a competitive and efficient market.

Second, the role of retail wholesalers in modern markets deserves lawmakers' attention. Two firms—Citadel Securities and Virtu—now handle more than 70% of all off-exchange retail trading, in part because payment for order flow to online retail brokers like Robinhood draws volume to them.³² Indeed, Citadel now handles more trading volume than the New York Stock

³¹ Edwin Hu & Dermot Murphy, *Vestigial Tails? Floor Brokers at the Close in Modern Electronic Markets* (working paper, October 2021); see also Matt Levine, *A Vaccine With a Poison Pill*, Bloomberg Money Stuff (May 22, 2020) (“NYSE without floor brokers is a better and more efficient *electronic* exchange, but if you like floor brokers that is not quite what you want. You want whatever mysterious advantage floor brokers provide.”). The New York Stock Exchange responded to this evidence not by suggesting that market structure might need further reform but by calling the study “flawed” the day it was issued, *id.*, without specifying the flaw.

³² See Katanga Johnson & John McCrank, *Analysis: U.S. Mulls Shaking Up Stock Trading Rules to Aid Small Investors*, REUTERS (March 28, 2022).

Exchange.³³ Remarkably, these firms are regulated not as exchanges or alternative trading systems, but as *brokers*, despite the fact that they are not only the most important off-exchange market makers, but also the most important *on-exchange* market makers. In response to the possibility that the Commission may soon regulate payment for order flow, the firms that make and receive those payments have said—you guessed it—that they’ll sue.³⁴

Should those legal challenges arise, Congress should stand ready to make clear that the SEC has all the authority it needs to ensure that its rules adequately promote competition in this space. Entities with exchange-like significance for ordinary investors should be subject to rules that put those investors’ interests first.³⁵ While it’s understandable that market participants seek legal advantage wherever they can, we owe it to investors like my Mom and Dad to give them confidence that the biggest participants in our markets compete on a level playing field. Thank you once again for the opportunity to testify before you today, and I would be delighted to answer any questions you might have.

³³ *See id.*

³⁴ *See* Paul Kiernan, *Wall Street Pushes Back as SEC Targets Business Practice That Generates Billions*, WALL ST. J. (Nov. 8, 2021).

³⁵ Entities of this size and scope may be able to take advantage of a particularly troubling regulatory arbitrage: although they have exchange-like importance, they are not regulated as exchanges. What’s more, when we increase the scrutiny that exchanges face in our market structure, we make trading with these firms even more attractive. For example, there is evidence that requiring significant price improvement from internalizers leads to better execution quality on exchanges. *See* Edwin Hu & Dermot Murphy, *Competition for Retail Order Flow and Market Quality* (working paper, March 2022). Exchanges should, of course, be held to the highest standards for their oversight of American markets. But we should only ask them to do so on a level playing field.



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Testimony of Manisha Kimmel

Chief Policy Officer

MayStreet, Inc.

Hearing on Oversight of America's Stock Exchanges: Examining Their Role in Our Economy,
Before the House Financial Services Committee, Subcommittee on Investor Protection,
Entrepreneurship, and Capital Markets

March 30, 2022



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Chairman Sherman, Ranking Member Huizenga, and other members of the Subcommittee, thank you for holding this hearing, and for offering me the opportunity to appear before you today.

My name is Manisha Kimmel, and I am the Chief Policy Officer for MayStreet¹, a leading market data and technology provider. Throughout my 25-year career, I have focused on the implementation of market structure regulation and its practical implications on investors and the industry. MayStreet is a fast-growing fintech that was founded on the principle that the more efficient the world's capital markets become, the greater the need for streamlined delivery of high-quality market data.

MayStreet is active in the U.S. market structure dialog through our multiple comment letters² on key market structure issues as well as our membership in industry associations, including Healthy Markets Association and the Financial Information Forum. I look forward to offering our perspective on the important role American exchanges play in our capital markets, and how the Committee and the Securities and Exchange Commission (SEC) may improve our markets by managing conflicts of interest, complexities, and costs.

Executive Summary

Well-regulated and competitive exchanges are essential for well-functioning capital markets. However, the regulatory structure for exchanges has not kept up with today's market structure.

- Exchanges are now publicly traded companies, so they have responsibilities to their shareholders, in addition to regulators and their customers.
- Broker-dealers were traditionally customers of the exchanges, but now they are also competitors because competition for order flow is split across exchanges, alternative trading systems and broker-dealer internalizers.
- Exchanges sell their raw data and package it in a number of forms. Proprietary data products and related services, as well as revenues from the public market data streams are a significant source of revenue for exchanges.
- The number of trading venues has increased and markets have become increasingly interconnected.
- While exchanges have regulatory obligations as part of their self-regulatory status, the

¹ MayStreet delivers the highest-quality, most complete global market data available. The firm's solutions – which include the highly accessible Market Data Lake feed repository and Bellport Enterprise feed handler – help market participants generate maximum value from exchange data by delivering it when, where and how they want to receive it. With MayStreet, clients are freed from the difficult and costly work of sourcing and processing market data, leading to lower total cost of ownership, improved decision-making and better performance. Visit www.maystreet.com for more information.

² See MayStreet comment letters at <https://maystreet.com/category/comment-letters/>.



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Financial Industry Regulatory Authority (FINRA) performs essential regulatory services for many exchanges.

- Exchanges seek to innovate in terms of order types, product offerings and price. To support those business decisions, exchanges filed over 1,300 filings in 2021. Brokers, data providers, and investors are directly impacted by these filings, often in the form of greater complexity and costs.

Securities laws and SEC rules should be cognizant of these realities. While the incentives, operations, and roles of exchanges in the markets have evolved over the past few decades, the regulatory framework for exchanges has remained relatively unchanged. The current regulatory framework for exchanges could be improved to maintain fair, orderly, and efficient markets, better protect investors, promote competition, and serve the public interest.

MayStreet recommends taking action in the following areas:

First, Congress should rescind the “effective upon filings” status for self-regulatory organization³ (SRO) fee filings. As described in greater detail below, the SEC is obligated to ensure that exchanges’ rules and fees comply with the Exchange Act⁴ and SEC rules. Fee changes should not be retroactive, nor should they be effective until after the SEC has affirmatively determined that those fees are reasonable, equitably allocated, not unduly burdensome on competition, and not discriminatory.

It is in the interest of the investing public that there be time for a review of these filings to understand the impact on products, pricing, investors and technology. Additionally, filings often necessitate system changes that must be implemented and tested prior to going into production. These fees matter to investors because they directly affect order routing decisions and the ability of broker-dealers to achieve best execution for their customers.

Second, Congress should create a clear mechanism for the SEC to review and remand filings already on the books in light of market and regulatory developments. The SEC needs Congressional help in potentially unwinding some of the existing fees and rules that are already in place. The SEC’s attempt to summarily reject over four hundred of them did not work. Given that the SEC’s effort failed, Congress should step in. Investors and others should not continue to pay fees that are inappropriate given today’s technology and market realities.

Third, in order to promote the review of new fee filings and a retrospective review of existing filings, Congress and the SEC should provide definitive guidance on the definitions for each of the requirements imposed by the Exchange Act, as they relate to SRO and NMS

³ U.S. exchanges are self-regulatory organizations (SROs). A list of SROs is available at <https://www.sec.gov/rules/sro.shtml>.

⁴ Securities and Exchange Act of 1934, 15 U.S.C. § 78a et seq.



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Plan⁵ fee filings. While Congress has explicitly declared that exchange fees need to be “equitably allocated,”⁶ “reasonable,”⁷ “not ... designed to permit unfair discrimination between customers, issuers, brokers, or dealers,”⁸ and not an undue burden on competition,⁹ it has provided no details on what that means in practice. In other contexts where for-profit entities have monopolistic pricing powers over important public functions, such as the energy markets, Congress and regulators typically have detailed processes to evaluate rules and fees to protect market participants, the markets overall, and the public interest.

Fourth, Congress should give the SEC direct control over the public market data stream.

This would further the goal of making market data widely available to the investing public as required by the 1975 amendments to the Exchange Act.¹⁰ Put simply, keeping exchanges in charge of the public market data stream when they sell products that directly compete with that data stream creates conflicts between their commercial interests and investors’ interests that may be simply too difficult to manage under the current construct.

The SEC has tried to address this issue through recent rules including its approval of the CT Plan which among other things includes non-SROs in the governance of the NMS Plan and the approval of the Market Data Infrastructure Rule, which would bring competition to the production and distribution of the public market data stream. The major exchanges have challenged both of these rules in the DC Circuit Court of Appeals.

Regardless of the outcomes of those cases, the NMS Plan structure will continue to be a major obstacle to the SEC addressing the evolution of technology, business models and incentives currently at play with respect to the public market data streams. If Congress intends to fulfill the National Market System (NMS) mission of ensuring the timely provision of essential market information, then the NMS Plan structure for the public market data stream should be rescinded, and the SEC should take direct control of the rules and costs of this valuable public good.

⁵ National market system plans (“NMS Plans”) are established under 17 CFR 242.608 (Rule 608) of Regulation NMS. NMS Plans currently govern the collection, consolidation, processing, and dissemination of the public data stream including (1) the Consolidated Tape Association Plan, (2) the Consolidated Quotation Plan, and (3) the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis.

⁶ 15 U.S.C. § 78f(b)(4).

⁷ 15 U.S.C. § 78f(b)(4).

⁸ 15 U.S.C. § 78f(b)(5).

⁹ 15 U.S.C. § 78f(b)(8).

¹⁰ Securities Act Amendments, Pub.L. 94-29, (1975), *available at* <https://www.govtrack.us/congress/bills/94/s249/text>.



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Exchange Background & Evolution

Before reviewing each of our four recommendations in more detail, we would like to focus first on the role of exchanges in the national market system. Historically, exchanges have performed at least four key functions that promote fair, orderly, and efficient markets, including:

- Establishing listing standards and oversight for issuers of securities;
- Providing a centralized place for price discovery and trading of securities in the secondary markets;
- Providing access to essential market data, including prices for quotations and trades; and
- Policing market participants' trading for manipulation and other misconduct.

Exchange Fee Filing Approval Standards Outlined in Exchange Act

Because of their central roles in our capital markets, Congress has mandated that exchanges file changes to their rules and fees with the SEC. The SEC, in turn, is obligated to review exchange filings and determine that those filings are consistent with the law,¹¹ including that they:

- are an equitable allocation of reasonable dues, fees, and other charges;¹²
- are “not . . . designed to permit unfair discrimination between customers, issuers, brokers, or dealers”;¹³ and
- do “not impose any burden on competition not necessary or appropriate in furtherance of the purposes of” the Act.¹⁴

Exchange filings also have to be consistent with the protection of investors and in the public interest.

Under the SEC's rules, exchanges have the “burden to demonstrate that a proposed rule change is consistent with the [Exchange Act] and the rules and regulations issued thereunder.”¹⁵ In 2010, Congress created a process to make several types of exchange filings, including those related to fees, effective upon filing with the SEC.¹⁶

¹¹ See *Susquehanna Int'l Grp., LLP v. SEC*, 866 F.3d 442 (D.C. Cir. 2017).

¹² 15 U.S.C. § 78f(b)(4).

¹³ 15 U.S.C. § 78f(b)(5).

¹⁴ 15 U.S.C. § 78f(b)(8).

¹⁵ Rule 700(b)(3), Commission Rules of Practice, Sec. and Exch. Comm'n, 17 CFR 201.700(b)(3).

¹⁶ Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 916, Pub. L. No. 111-203 (July 21, 2010).



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Impact of Demutualization on the Frequency & Focus of Fee Filings

While exchange business models and commercial priorities have shifted significantly, the oversight of exchanges has not addressed these dynamics. Congress has not changed the laws around SRO responsibilities or altered the dynamics of the public market data streams. And when the SEC explicitly permitted exchanges to demutualize over two decades ago,¹⁷ we do not believe they fully appreciated how changes within the exchanges' business models would impact both their business and regulatory priorities. To be clear, we do not take issue with the evolution of exchanges, we simply believe that the regulatory framework needs to evolve as well to protect investors and promote fair and orderly markets.

In the years since exchanges demutualized, changes to the exchanges' business models have led to growing concern from market participants and the SEC that the regulatory framework needs to adapt. As exchange revenues from trading fees have been squeezed, they increasingly have sought to monetize the market data stream. Revenues from trading fees are generally capped at 30 cents per 100 shares, and there is fierce competition between trading venues (including both on-exchange and off-exchange). In some cases, exchanges now pay their largest customers to trade,¹⁸ and even lose money on some trades.¹⁹

Conversely, exchanges have increased revenues through sales of proprietary data products and related services. Exchanges have also profited from the public market data stream, which they also collectively control.²⁰

Access to Audit Trail Data Raises Regulatory Coordination Questions

In addition to market data, developments over the last several years have changed the role of order data in the marketplace. Through the Consolidated Audit Trail (CAT), exchanges have access to equity and options orders sent to and executed on other markets. We share the SEC's belief²¹ that this raises questions as to how best to achieve regulatory coordination. While an exchange's role in policing trading on their own exchange makes sense given their expertise and current surveillance capabilities, it's unclear what the appropriate regulatory framework for

¹⁷ Regulation of Exchanges and Alternative Trading Systems, SEC, Exch. Act Rel. No. 34-40760, Dec. 8, 1998, available at <https://www.sec.gov/rules/final/34-40760.txt>.

¹⁸ Remarks of Chris Concannon, Cboe Global Markets, before the SEC Roundtable on Market Access and Market Data, Oct. 25, 2018, Transcript at 74-75, available at <https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102518-transcript.pdf>.

¹⁹ See, e.g., Fee Schedule Update, MEMX, <https://info.memstrading.com/trader-alert-22-06-fee-schedule-update-effective-march-1-2022/> (published Feb. 28, 2022, and effective Mar. 1, 2022).

²⁰ See *supra* n.2.

²¹ See *Staff Paper on Cross-Market Regulatory Coordination*, SEC, Dec. 15, 2020, available at <https://www.sec.gov/tm/staff-paper-cross-market-regulatory-coordination>.



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exchanges and FINRA is in order to improve both the efficiency and the efficacy of cross-market surveillance while being mindful of data security considerations.

Recommended Reforms

In light of the current market and regulatory environment under which exchanges operate, we make the following recommendations.

Recommendation #1 - Rescind “Effective-on-Filing” Procedures for SRO Filings

All new exchange products and services and fees are implemented with filings.²² Each of these filings are supposed to provide sufficient information for the SEC to conclude that the filing meets the qualifications of the Exchange Act. It hardly seems possible for the SEC to review all of these filings with the attention they deserve, given that the SEC has similar resources dedicated to that task today (with well over 100 filings per month to review) as it did twenty years ago (when there were well under 100 filings per year).

Complexity of Fees and Fee Filings Should Not Be Underestimated

Many exchanges compete with each other and other trading venues through changes to their trade pricing that can occur on a monthly basis. In response, brokers are constantly updating their order routing logic, not solely on where they can get their customers the best prices, but also where they can get themselves a larger rebate or lower fee. If brokers and investors do not pay attention to the changes that sometimes need to be implemented overnight, they can be materially harmed.²³

To give you a sense of how many different prices there are on exchanges, in 2018, a study by RBC Capital Markets found “at least 3,762 separate pricing variables across the exchanges – that

²² Notably, the New York Stock Exchange family of exchanges recently challenged the SEC, arguing that its Wireless Connectivity services need not be filed with the SEC or be subject to SEC review. On January 21, 2022, the U.S. Court of Appeals for the DC Circuit sided with the SEC, and found that these services were part of the “facility” of an exchange, and therefore subject to SEC oversight. *Intercontinental Exchange, Inc., et al., v. SEC*, No. 20-1470, (D.C. Cir. 2021), available at [https://www.cadc.uscourts.gov/internet/opinions.nsf/83FBB6E695A3FAE0852587D100546647/\\$file/20-1470-1931643.pdf](https://www.cadc.uscourts.gov/internet/opinions.nsf/83FBB6E695A3FAE0852587D100546647/$file/20-1470-1931643.pdf). (“We hold that the Wireless Bandwidth Connection and the Wireless Data Connection are subject to the SEC’s jurisdiction as ‘facilities’ of an exchange. The SEC therefore correctly concluded that the fee schedules for the Wireless Connections had to be filed with the Commission as ‘rules of an exchange.’”).

²³ See, e.g., Letter from Jaffray Woodriff and Michael Ledwith, Quantitative Investment Management, to Brent J. Fields, SEC (Dec. 21, 2018), available at <https://www.sec.gov/comments/sr-cboe-edga-2018-017/srcboe-edga2018017-4827803-177046.pdf>.



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is, 3,762 factors that ultimately determine the fees charged and rebates offered by exchanges.”²⁴ That study concluded that the sheer number and complexity of these pricing paths “strongly suggest[s] that exchange prices are tailored and offered on a bespoke basis.”²⁵

Hundreds of filings are made effective, and customers are charged the fees, before the SEC and most market participants have even had the opportunity to read them. Several of these new fee levels may even apply retroactively.

Notably, while the SEC sends these filings out for public comment, only a tiny fraction of them receive comments, typically from industry associations like Healthy Markets Association and SIFMA. In some cases, those objections have led to action. For example, following an objection by Healthy Markets Association, the SEC abrogated a market data fee filing associated with the public market data stream in May 2018. While concerns have been raised on other filings, the SEC’s record for intervention is not consistent.

Potential Impact on Competition Must Be Addressed

We would expect the SEC to assess the impact of fee filings on smaller firms and new market entrants to ensure that fees are not unduly burdening competition²⁶ and are provided on “reasonable” terms.

As Healthy Markets explained in 2018:

To the extent that different competitors fall into different pricing tiers, it will directly impact the competitive balance between those firms.²⁷ As a result, pricing tiers not only impact the competition between venues for execution, but also the competition between brokers and other market participants.

...

²⁴ Letter from Rich Steiner, RBC Capital Markets, to Brent J. Fields, SEC, Oct. 16, 2018, *available at* <https://www.sec.gov/comments/s7-05-18/s70518-4527261-176048.pdf> (“RBC Study”).

²⁵ RBC Study, *supra* n.17, at 1.

²⁶ Remarks of Joe Wald, Clearpool Group, before the SEC Roundtable on Market Access and Market Data, Oct. 25, 2018, Transcript at 198, *available at* <https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102518-transcript.pdf>.

²⁷ Remarks of Joe Wald, Clearpool Group, before the SEC Roundtable on Market Access and Market Data, Oct. 25, 2018, Transcript at 198, *available at* <https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102518-transcript.pdf>. *Accord* Remarks of Tyler Gellasch, Healthy Markets Association, before the SEC Roundtable and Market Access and Market Data, Oct. 26, 2018, Transcript at 280-281, *available at* <https://www.sec.gov/spotlight/equity-market-structure-roundtables/roundtable-market-data-market-access-102618-transcript.pdf>.



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Those without market power (e.g., smaller firms or those with less order volume) are likely to obtain the worst deals. Further, over time, as order flow has aggregated to the largest firms, this has increased their ability to negotiate even better rates; further expanding the gap between themselves and the smaller firms.²⁸

Issues of whether such pricing meets the “equitable” standard must consider the different fees for small participants particularly in light of exchange’s fair access obligations and the Exchange Act’s requirements that fees be equitably allocated, non-discriminatory, or not unduly burdensome on competition.

Expand on 2020 SEC Rule that Rescinded Effective Upon Filing for NMS Plan Fee Filings

Where the SEC has the statutory authority over NMS Plan fees, it has already rescinded the ability of the SROs to make them “effective on filing”.²⁹ All of the reasons cited by the SEC in taking that action extend to fee filings from individual SROs as well. Specifically, commenters raised key issues including the need for time to review in order to assess the impact of fees on market participants, the mandatory nature of paying those fees given how the national market system operates, as well as potential conflicts of interest that may be inherent given marketplace competition.

Recommendation Summary/Investor Impact

Notably, unlike the fees for NMS Plans, the SEC has limited statutory authority to rescind “effective on filing” status for individual SRO fee filings. Exchange filings that are immediately effective leave little time for review much less for implementation of system changes. Complicating matters, these filings can include changes that apply retroactively. We recommend mandating that no SRO fee filing may be effective until after a notice and comment period and SEC approval. By doing so, investors and their broker-dealers will have adequate time to review and implement exchange changes. Further, those fees should not be permitted to apply retroactively.

²⁸ Letter from Tyler Gellasch, Healthy Markets Association, to Brent J. Fields, SEC, at 4, Nov. 13, 2018, available at <https://www.sec.gov/comments/sr-ny-se-2018-49/srnyse201849-4640899-176435.pdf>.

²⁹ See *Rescission of Effective-Upon-Filing Procedure for NMS Plan Fee Amendments and Modified Procedures for Proposed NMS Plans and Plan Amendments*, SEC, 85 Fed. Reg. 65470 (Oct. 15, 2020) available at <https://www.govinfo.gov/content/pkg/FR-2020-10-15/pdf/2020-18572.pdf>.



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Recommendation #2 - Create Mechanism to Review & Remand Current SRO Fees That May be Inconsistent With the Exchange Act and SEC Rules

Since 2010, the vast majority of changes to exchange and FINRA rules – including those related to trading and market data fees – were implemented after being filed pursuant to “effective upon filing” procedures. Issues with that process are discussed extensively in the prior section.

In 2018, the SEC attempted to remand and reconsider more than 400 filings that had been adopted over a few of the preceding years; that effort was reversed by the U.S. Court of Appeals for the D.C. Circuit on technical grounds.³⁰ As a result, today, there are over 1,000 data and fee filings that have gone into effect and remained over just the past several years.

The goal of a review and remand process is not because a determination has been made that fees are inconsistent with Exchange Act standards. Rather, the fees need to be considered against those standards. The markets have dramatically changed with the advent of electronic trading, the implementation of Regulation NMS,³¹ the proliferation of trading venues and the applicability of Moore’s Law. Are existing exchange rules and fees consistent with the requirements that fees be “equitably allocated” and “reasonable” today?

Recommendation Summary/Investor Impact

In light of market and regulatory developments including technological developments, we recommend creating a mechanism to review existing fee filings addressing the issues the SEC raised and sought to address in 2018.³² By doing so, investors will be able to benefit from developments that may drive costs down in order to meet Exchange Act standards.

Recommendation #3 - Provide Definitive Guidance on Exchange Act Obligations, Including What is “Reasonable” and “Equitably Allocated”

In 2019, in recognition of the lack of clarity as it relates to how to assess Exchange Act standards in a fee filing, the SEC staff released guidance (“2019 SEC Staff Fee Filing Guidance”) on the information needed to make that determination for fee filings.³³ Unfortunately, since then, many exchanges appear to not consider the guidance while making their filings, and have nevertheless been able to continue to collect new fees.

³⁰ See, e.g., *NASDAQ Stock Mkt., LLC v. SEC*, 961 F.3d 421, 424 (D.C. Cir. 2020) (vacating and remanding the Commission’s 2018 decision to remand approximately 400 SRO filings).

³¹ See Regulation NMS - Regulation of the National Market System, §§ 242.600 - 242.613.

³² See Statement on Market Data Fees and Market Structure by Chairman Jay Clayton, Oct. 16, 2018 available at <https://www.sec.gov/news/public-statement/statement-chairman-clayton-2018-10-16>

³³ *Staff Guidance on SRO Rule Filings Relating to Fees*, SEC, May 21, 2019, available at <https://www.sec.gov/tm/staff-guidance-sro-rule-filings-fees>.



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Consider Direct & Indirect Costs When Pricing Market Data Fees

Beyond the actual price point, Congress must consider the complexity of the pricing terms. Exchanges charge different rates for market data, depending upon who is using it and for what. This forces purchasers of market data from exchanges to have complex and costly systems to keep track of all these usage details.

Exchanges often “audit” their customers’ usage, which often leads to the exchanges demanding additional payments and details.³⁴ Worse, we have seen instances where exchanges have sought information about their customers’ customers through this audit mechanism, and then tried to sell their own, competing products to those customers.

The direct costs of all these connections, data streams, and data management systems – across all exchanges – can easily exceed several hundred thousand dollars per month. There are also significant indirect costs of managing reporting and compliance risks. These costs are incurred before even a single order is sent to an exchange.

The successful implementation of the Market Data Infrastructure Rule,³⁵ recently approved by the SEC in December 2020, has the potential to increase the amount of market data available to investors at an affordable price with simplified administration. However, this rule is currently being litigated, and the related Plan fee filings submitted in November 2021 do not meet the standards required of the Exchange Act, much less achieve the benefits intended by the rule.³⁶ Without guidance on what the terms “reasonable,” “equitably allocated,” “non-discriminatory,” and undue burden on competition actually mean, particularly in the context of the public market data stream, we are concerned that investors will not benefit from the timely provision of essential market data at a reasonable price.

Recommendation Summary/Investor Impact

Establish definitive guidance on how SRO and NMS Plan fee filings should be reviewed, identifying objective criteria for determining whether a fee filing should be approved consistent with the Exchange Act. Investors should benefit from the unconflicted determination of fees focused on expanding availability to essential market data.

³⁴ See, Letter from Tyler Gellasch, Healthy Markets Association, to Brent J. Fields, SEC, Oct. 23, 2018, available at <https://www.sec.gov/comments/4-729/4729-4554022-176182.pdf>.

³⁵ SEC, [SEC Adopts Rules to Modernize Key Market Infrastructure Responsible for Collecting, Consolidating, and Disseminating Equity Market Data](#) (Dec. 9, 2020)

³⁶ For a detailed discussion of the Plan fee filings, see MayStreet’s [comment letter](#), submitted March 23, 2022



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Recommendation #4 - Eliminate the NMS Plan Structure as it relates to Equity Consolidated Market Data

One benefit of being an SRO is that the exchanges acting individually or jointly³⁷ effectively establish the rules and costs for all access to essential market data - their own proprietary data as well as the public data streams.

In order to understand the state of the market, broker dealers, investors, and other market participants need to buy market data. At this point, the public market data stream does not include odd-lot quotations, depth of book information, or auction information – all of which is essential to understanding the markets. The public market data streams are also slower than the exchanges' own proprietary data streams. As a result, market participants buy exchange-provided proprietary data. These data streams – from each exchange – often run over \$10,000 per month.

Exchanges' efforts to compete with the public market data stream – which they also control – also directly harms investors. For example, some brokers use exchange-provided top-of-book proprietary feeds as benchmarks for their customers' trading prices. This practice often deprives retail traders and smaller investors of a complete view of all available market prices, and may lead to them receiving prices that are not the best. According to Cboe's U.S. Equities Market Volume Summary, no single exchange has even 25% market share based on either notional or share volume.³⁸ And yet, the exchanges sell their top-of-book feeds as alternatives to the public market data stream. While these products may be cheaper, and easier to administer for customers, they are also facially inferior. None of these feeds provides a full view of the markets.

Put another way, when a retail broker uses an exchange's top-of-book feed for its customers, reference prices may not be the best available prices across all exchanges and trading venues. If the broker was using the public data stream, it would have the actual national best bid and offer for all listed stocks.

Additionally, the current public data stream does not include odd-lot quotations, depth of book information, or auction information. Without this information, investors do not have access to essential market prices. Specifically with respect to odd-lot data, a recent study by professors at several major universities found that “using information only on round lot quotes has the

³⁷ The CTA/Q and Nasdaq UTP Plans that oversee the provision of the public market data streams are overseen by an Operating Committee that includes the exchanges and FINRA. The SEC has attempted to add additional members to the Operating Committees, but those reforms have been mired in litigation and uncertainty. Nevertheless, it is worth noting that Congress has explicitly authorized the SEC to adopt rules to ensure “prompt, accurate, reliable, and fair collection, processing, distribution, and publication of information with respect to quotations for and transactions in such securities and the fairness and usefulness of the form and content of such information.” 15 U.S.C. 78k-1(c)(1)(B).

³⁸ See Cboe U.S. Equities Market Volume Summary *available at* https://www.cboe.com/us/equities/market_statistics, accessed March 16, 2022 based on a review of month to date and 5 day average volumes.



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potential to lead to erroneous conclusions, especially for high-priced stocks.³⁹ Because execution quality statistics allow brokers to ignore odd-lot quotations on exchanges in their calculations, these statistics are rendered largely irrelevant to retail investor's actual trade execution quality.

The SEC has tried to remedy some of these issues with two recent rules. The CT Plan which among other things includes non-SROs in the governance of the Plan and the Market Data Infrastructure Rule, which would expand the content of core data and bring competition to the production and distribution of the public market data stream. With the implementation of both of these rules still uncertain due to pending litigation between the SEC and major exchanges, the value of operating the public data streams as NMS Plans is called into question.

There is a fundamental misalignment of interests - the Congressional mandate to ensure timely access to essential market data at a reasonable price, and the commercial interests of the major exchanges seeking to maintain (1) the over \$400 million revenue stream generated by the public market data stream and (2) the revenue stream associated with the exchange top-of-book proprietary feeds that compete with the public data stream. In the interest of treating public market data as a public good, we believe that the Commission should take control of the public market data stream and disband the current NMS Plan structure.

Recommendation Summary/Investor Impact

The SROs have not demonstrated their ability to price the public market data stream in a manner that will promote its availability among investors. We recommend eliminating NMS Plan governance for the public data stream and have this public good be regulated directly by the SEC. Investors would benefit from the unconflicted approach to pricing that focuses on fees that promotes the timely access to essential market data at a reasonable price, rather than profitability.

Conclusion

We believe the potentially competing interests of exchanges and investors need to be managed to ensure that the markets work for all investors. While we are not opposed to exchanges evolving in terms of business models, our regulatory framework must reflect these changes to ensure fair, orderly, and efficient markets.

Exchange rule changes have dramatically shaped, and are continuing to shape, the market structure landscape. Their rule filings merit careful review and consideration.

We recommend that you modernize the oversight of exchanges to ensure that investors have warning on changes to exchange fees, changes are not retroactive, and they do not go into effect

³⁹ See Bartlett, Robert P. and McCrary, Justin and O'Hara, Maureen, The Market Inside the Market: Odd-Lot Quotes (February 1, 2022). Available at SSRN: <https://ssrn.com/abstract=4027099> or <http://dx.doi.org/10.2139/ssrn.4027099>.



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until after the SEC affirmatively determines that those fees are reasonable, equitably allocated, not unduly burdensome on competition, and not discriminatory.

Further, we recommend that you consider how the SEC might unwind some of the existing fees and rules that are already in place that are not in keeping with market and regulatory developments. The SEC's attempt to summarily reject many fee filings did not work. Congressional action is required.

Additionally, providing definitive guidance for both new and existing fee filings is essential to promoting consistent and objective review of filings in a timely manner. We believe the 2019 SEC Staff Fee Filing Guidance would be instructive in Congress' considerations.

Finally, we urge you to consider whether the exchanges' interests in overseeing the provision of market data through the NMS Plan process are irreconcilable with their interests in selling their own market data and related services. While adding non-exchange stakeholders to the oversight of NMS Plans might limit the skyrocketing costs and complexity of these public utilities, we are concerned that the underlying misalignment between exchange's interest and the Congressional mandate to ensure availability of quotes and trades will remain unaddressed.

Exchanges are incredibly important components for fair, orderly and efficient markets particularly as it relates to promoting lit price discovery. The markets and the dominant exchange business models have evolved dramatically over the past several decades, now is the time for the regulatory apparatus designed to ensure they continue to perform their essential functions to do the same.

Thank you for your consideration and for the opportunity to share my thoughts with you on this important topic for our markets.

Written Testimony of

Michael S. Piowar
Executive Director of the Milken Institute Center for Financial Markets

Before the U.S. House Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets

“Oversight of America’s Stock Exchanges: Examining Their Role in Our Economy”

March 30, 2022

Good morning. Thank you Chairman Sherman, Ranking Member Huizenga, and Members of the Subcommittee for inviting me to testify today.

My name is Mike Piowar, and I am the Executive Director of the Milken Institute Center for Financial Markets.¹ I had the pleasure of serving as a Visiting Academic Scholar, Senior Financial Economist, Commissioner, and Acting Chairman of the U.S. Securities and Exchange Commission (“SEC” or “Commission”). I am testifying today on my own behalf.

* * *

The U.S. capital markets are the envy of the world due, in large part, to the role that our stock exchanges play. Competition among exchanges, alternative trading systems, and market makers has led to the best market quality environment for publicly traded securities in history.² Transaction costs are low, market depth is high, and execution speeds are fast.

America’s stock exchanges list the thousands of public companies that millions of Americans invest in. Our stock exchanges execute billions of trades every day, representing trillions of dollars traded every year.

The U.S. stock exchanges are incredibly resilient. When most of the U.S. (and the world) economy was shut down in March 2020, America’s stock exchanges remained open. In fact, when the New York Stock Exchange closed its trading floor due to Covid restrictions, it moved seamlessly from its hybrid model of floor trading and electronic trading to fully electronic trading.

¹ The Milken Institute is a nonprofit, nonpartisan think tank that promotes evidence-based research that serves as a platform for policymakers, industry practitioners, and community members to come together in catalyzing practical solutions to challenges we face both here in the U.S. and globally. The Center for Financial Markets conducts research and constructs programs designed to facilitate the smooth and efficient operation of financial markets—to help ensure that they are fair and available to those who need them when they need them.

² See, e.g., A Century of Stock Market Liquidity and Trading Costs, Charles M. Jones (May 23, 2002), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=313681; Equity Trading in the 21st Century, James J. Angel, Lawrence E. Harris and Chester S. Spatt, Quarterly Journal of Finance, Vol. 1, No. 1 (2011); and Equity Trading in the 21st Century: An Update, James J. Angel, Lawrence E. Harris and Chester S. Spatt (May 23, 2013), available at <https://www.q-group.org/wp-content/uploads/2014/01/Equity-Trading-in-the-21st-Century-An-Update-FINAL.pdf>.

During that time, America's stock exchanges provided liquidity for retail investors who had to sell shares to meet cash needs. They provided large institutional investors, many of which invest on behalf of retail investors, with the ability to pursue new investment opportunities and manage risk. America's stock exchanges also provided price discovery for government policymakers to help them craft targeted fiscal, monetary, and regulatory responses to the pandemic-induced economic crisis.

Mr. Chairman, thank you for calling this oversight hearing to examine the role of America's stock exchanges in our economy. As this Subcommittee evaluates various legislative proposals to change regulatory policies regarding U.S. stock exchanges, my comments today will be in the following areas:

- I. Guiding principles for market structure policy,
- II. Select policy proposals, and
- III. Investing in America's Future.

I. Guiding Principles for Market Structure Policy

There Are No Solutions; There Are Only Trade-Offs³. The regulatory framework of the U.S. equity markets is complicated; it reflects a complex system of legal and regulatory decisions that have been made over decades. The markets have evolved within this framework into a highly interconnected system. U.S. stock exchanges compete with alternative trading systems and market makers for trading volumes. Moreover, the U.S. equity markets are part of a larger global capital markets system where U.S. stock exchanges compete with international competitors for listings and trading volumes.

As a result, any change to market structure policy, including the regulation of stock exchanges, in one area will likely affect other areas.

Economic Analysis Is a Particularly Useful Tool. The lens of economic analysis is well-suited for evaluating tradeoffs. While serving as an SEC commissioner, I found my economics training was a valuable tool for virtually every regulatory and enforcement decision I made.

In 2012, the Commission recognized the importance of going beyond statutory obligations and mere quantitative exercises to incorporate comprehensive economic analysis in the rulemaking process by adopting "Current Guidance on Economic Analysis in SEC Rulemaking" ("Current Guidance").⁴ The Guidance was adopted under SEC Chairman Mary Schapiro. It has been followed on a bipartisan basis by Chair Mary Jo White, myself as Acting Chairman, and Chairman Jay Clayton.⁵ I was glad to see that SEC Chairman Gary Gensler committed to following the Current Guidance in response to a question during his nomination hearing.

³ This phrase is often attributed to Thomas Sowell.

⁴ Current Guidance on Economic Analysis in SEC Rulemaking (Mar. 16, 2012), available at http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

⁵ The Commission has not proposed or adopted any new rules under current Acting Chair Allison Herren Lee.

The SEC's Current Guidance requires the Commission to evaluate a rule's likely economic consequences, including potential negative unintended consequences. It requires the Commission to compare a proposed regulatory action with reasonable alternatives, including the alternative of not adopting a rule.

Because U.S. equity markets and their regulatory framework are so complex, the SEC's Current Guidance is a particularly useful tool for evaluating potential changes to market structure and market infrastructure policy.

Frequent Retrospective Reviews of Existing Rules Are Necessary. The only constant in financial markets is change. Markets and technologies are continually evolving. If we want our capital markets to remain the envy of the world, our regulatory framework needs to evolve with them.

Throughout my tenure as an SEC commissioner, I was an outspoken advocate of retrospective reviews of Commission rules.⁶ I believe it is a fundamental best practice of good government to observe how the Commission's regulations work in the real world. Armed with this information, the Commission can propose thoughtful improvements to its rules to advance the Commission's essential work to protect investors, maintain fair, orderly, and efficient markets, and promote capital formation.

I am not alone in this view. For example, the Regulatory Flexibility Act of 1980 requires agencies such as the Commission to perform a periodic review of rules that have or will have a significant economic impact upon a substantial number of small entities within ten years of the publication of such rules as final rules "to determine whether such rules should be continued without change, or should be amended or rescinded."⁷ The Regulatory Flexibility Act identifies the following factors for analysis: (1) the continued need for the rule; (2) the nature of complaints or comments received concerning the rule from the public; (3) the complexity of the rule; (4) the extent to which the rule overlaps, duplicates, or conflicts with other federal rules, and, to the extent feasible, with state and local governmental rules; and (5) the length of time since the rule has been evaluated or the degree to which technology, economic conditions, or other factors have changed in the area affected by the rule.⁸

⁶ See, e.g., Advancing and Defending the SEC's Core Mission, Speech by Commissioner Michael S. Piowar at the U.S. Chamber of Commerce (Jan. 27, 2014), available at <https://www.sec.gov/news/speech/2014-spch012714msp>; Remarks to the Securities Enforcement Forum 2014, Speech by Commissioner Michael S. Piowar (Oct. 14, 2014), available at <https://www.sec.gov/News/Speech/Detail/Speech/1370543156675>; Statement Regarding Publication of List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act, Public Statement by Commissioner Michael S. Piowar (Sept. 15, 2016), available at <https://www.sec.gov/news/statement/piowar-statement-list-of-rules-regulatory-flexibility-act.html>; Remarks at FINRA and Columbia University Market Structure Conference, Speech by Commissioner Michael S. Piowar (Oct. 26, 2017), available at <https://www.sec.gov/news/speech/speech-piowar-2017-10-26>; and Statement of Commissioner Piowar at Open Meeting Regarding Amendments to the Commission's Whistleblower Program Rules, Commissioner Michael S. Piowar (June 28, 2018), available at <https://www.sec.gov/news/public-statement/statement-piowar-whistleblower-062818>.

⁷ 5 U.S.C. 610.

⁸ 5 U.S.C. 610(b).

In 2011, President Obama signed an Executive Order to enhance the Regulatory Flexibility Act's goals by directing independent agencies such as the SEC to develop and implement a plan to conduct ongoing retrospective analyses of existing rules.⁹ The stated goal is "to determine whether any such regulations should be modified, streamlined, expanded, or repealed so as to make the agency's regulatory program more effective or less burdensome in achieving the regulatory objectives."¹⁰

Because markets and technologies are continually evolving, frequent retrospective reviews of market structure rules by the Commission are necessary to ensure that they are not outdated, obsolete, or overly burdensome.

II. Select Policy Proposals

SEC Pilot Studies. Pilot studies can be useful tools for the Commission. SEC pilot studies involve applying a new rule only to a group of securities while maintaining the existing rule for another group. This allows the SEC to more accurately measure and analyze the effects of a rule change by comparing the two groups. Based upon the results of the pilot study, the SEC can choose to make the new rule apply to all securities or to revert all securities back to the old rule.

One successful example is the SEC's 2016-2018 Tick Pilot Program.¹¹ The program was designed to study and assess the impact of wider tick sizes on certain small-capitalization stocks. Some proponents hoped that wider tick sizes would result in greater liquidity and analyst coverage. However, researchers found that the larger tick size led to a substantial deterioration in market quality. Investor transaction costs increased, volatility increased, and price decreased.¹² Moreover, wider tick sizes did not lead to greater analyst coverage. As a result, the Commission reverted all securities back to the old tick size rule.

Unfortunately, in June 2020, the United States District Court for the District of Columbia ruled that the SEC did not have the authority to implement a pilot program to analyze the effects of exchange transaction fee and rebate pricing models.¹³

As this Subcommittee considers legislative changes to the SEC's authority, I suggest that you consider legislation that would explicitly grant authority to the Commission to conduct pilot studies. As a starting point, you might consider Section 912 of the Dodd-Frank Act, "Clarification of Authority of the Commission to Engage in Investor Testing."¹⁴ Because pilot studies are not

⁹ See Executive Order 13579 – Regulation and Independent Regulatory Agencies (July 11, 2011), available at <https://obamawhitehouse.archives.gov/the-press-office/2011/07/11/executive-order-13579-regulation-and-independent-regulatory-agencies>. See also M-11-28 – Memorandum for the Heads of Independent Regulatory Agencies (July 22, 2011), available at <https://obamawhitehouse.archives.gov/sites/default/files/omb/memoranda/2011/m11-28.pdf>.

¹⁰ *Ibid.*

¹¹ See "Tick Size Pilot Program" at <https://www.sec.gov/ticksizepilot>.

¹² See, e.g., Edwin Hu, Paul Hughes, John Ritter, Patti Vegella, and Hao Zhang, Tick Size Pilot Plan and Market Quality, DERA Working Paper (Jan. 31, 2018), available at https://www.sec.gov/dera/staff-papers/white-papers/dera_wp_ticksiz_pilotplan_thresholdanalysis.

¹³ New York Stock Exchange LLC, et al. v. SEC, No. 19-1042, available at [https://www.cadc.uscourts.gov/internet/opinions.nsf/BE5AD5AD3C0064408525858900537163/\\$file/19-1042-1847356.pdf](https://www.cadc.uscourts.gov/internet/opinions.nsf/BE5AD5AD3C0064408525858900537163/$file/19-1042-1847356.pdf)

¹⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act, § 912, Pub. L. No. 111-203 (2010).

always the most appropriate way to engage in evidence-based rulemaking,¹⁵ you might consider adding limitations to this authority. Since pilot studies can be very costly for market participants, you might also consider requiring the SEC to engage in pilot studies through notice-and-comment rulemaking (which requires cost-benefit analyses) and prohibiting the SEC from using NMS Plans (which do not require cost-benefit analyses).

Dual-Class Share Structures and the SEC's Accredited Investor Definition. If dual-class share structures were banned, restricted, or phased out, some public companies listed on U.S. stock exchanges would likely delist. Some would go private, and some would list on a competing international stock exchange that allows dual-class structures. In addition, some private companies would delay or cancel their public offerings.

These outcomes will disproportionately harm low-income households because they are effectively prohibited from investing in private companies. The SEC's accredited investor definition essentially divides the world of private company investors into two arbitrary categories of individuals—those persons who are accorded the royalty status of being an accredited investor and those who are not.¹⁶ In short, if you make \$200,000 or more in annual income or have \$1 million or more in net worth, then you are “investor royalty” and can choose to invest in the full panoply of investments, whether public or private.¹⁷ If not, the SEC has decided that, for your protection, you are restricted access to invest in private companies.

As an SEC commissioner, I took my investor protection mandate extremely seriously. However, I challenge the SEC's investor protection rationale for prohibiting non-accredited investors from investing in high-risk companies. Here, I appeal to two well-known concepts from the field of financial economics. The first is the risk-return tradeoff. Because most investors are risk-averse, riskier securities must offer investors higher expected returns. As a result, prohibiting non-accredited investors from investing in high-risk securities is the same as prohibiting them from investing in high-expected-return securities.

The second economic concept is modern portfolio theory. By holding a diversified portfolio of securities, investors reap the benefits of diversification; that is, the risk of the portfolio as a

¹⁵ See, e.g., Statement on Evidence-Based Regulation and the Limits of Pilot Studies, Financial Economists Roundtable (October 2019), available at <https://www.financialeconomistsroundtable.com/statements/statement-on-evidence-based-regulation-and-the-limits-of-pilot-studies>; Lawrence Harris, Charles M. Kahn, Robert L. McDonald, and Chester S. Spatt, The Role of Pilot Studies in Financial Regulation (Dec. 1, 2021), available at <https://ssrn.com/abstract=3979297>.

¹⁶ See, e.g., Remarks at the Meeting of the SEC Advisory Committee on Small and Emerging Companies, Public Statement by Commissioner Michael S. Piowar (May 18, 2016), available at <https://www.sec.gov/news/statement/piowar-opening-remarks-acsec-051816.html>; Remarks at the “SEC Speaks” Conference 2017: Remembering the Forgotten Investor, Speech by Acting Chairman Michael S. Piowar (Feb. 24, 2017), available at <https://www.sec.gov/news/speech/piowar-remembering-the-forgotten-investor.html>.

¹⁷ The SEC recently expanded the definition of accredited investor to include, among other things, individuals “holding in good standing one or more professional certifications or designations or other credentials from an accredited educational institution that the Commission has designated as qualifying an individual for accredited investor status[.]” See Accredited Investor Definition, Final Rule, SEC Release Nos. 33-10824; 34-89669 (Aug. 26, 2021), 85 Fed. Reg. 64234 (Oct. 9, 2020), available at <https://www.sec.gov/rules/final/2020/33-10824.pdf>. However, the expanded definition is not likely to substantially increase the number of low-income individuals who qualify under the new definition.

whole is lower than the risk of any individual securities. The statistical correlation of returns is key. When adding higher-risk, higher-return securities to an existing portfolio, as long as the new securities' returns are not perfectly positively correlated with (move in exactly the same direction as) the existing portfolio, investors can reap higher portfolio returns with little or no change in overall portfolio risk. In fact, if the correlations are low enough, the overall portfolio risk could actually decrease.

These two concepts show how even a well-intentioned investor protection policy can ultimately harm the very investors the policy is intended to protect. Moreover, restricting the number of accredited investors in the privileged class can have additional adverse impacts. The accredited investors may enjoy even higher returns because the non-accredited investors are prohibited from buying and bidding up the price of high-risk, high-expected-return securities. Remarkably, by allowing only high-income and high-net-worth individuals to reap the risk and return benefits from investing in certain securities, the SEC is actually exacerbating wealth inequality.^{18,19}

Improved Disclosures for Index-Linked Annuities. The bipartisan bill H.R. 4865, "Registration for Index-Linked Annuities Act," would require the SEC to amend its rules and create a new form for annuity issuers to use when filing registered index-linked annuities (RILAs). The bill's purpose is to improve disclosures so that investors can make better-informed decisions about purchasing RILAs.

The bill correctly recognizes the Commission's important role as a disclosure regulator, and I like the factors the SEC must consider in improving RILA disclosures. I also like that the bill sets reasonable deadlines for the SEC to propose and finalize new rules to fulfill this mandate. Finally, I really like the bill's requirement that the SEC engage in investor testing and incorporate the results of such testing in the design of the form. The stated goal of this requirement is to ensure that key information is conveyed in terms that a purchaser can understand. As an SEC commissioner, I championed the role of investor testing to receive constructive feedback to ensure that SEC disclosures are understandable.²⁰

Venture Exchanges. The bipartisan bill H.R. 5795, "Main Street Growth Act," would amend Section 6 of the Securities Exchange Act of 1934²¹ to create a new type of national securities exchange ("venture exchange") to trade the securities of certain small companies, such as startups and emerging growth companies. The bill recognizes that many small-cap companies listed on stock exchanges suffer from a lack of liquidity.

The bill also recognizes that exchanges lack incentives to experiment with changing rules to improve the liquidity of small-caps because of unlisted trading privileges (UTPs). UTPs allow stocks to trade on venues other than the listing exchange. As a result, if a listing exchange

¹⁸ See Thomas Piketty, *Capital in the Twenty-First Century*, translated by Arthur Goldhammer (Cambridge MA: The Belknap Press of Harvard University Press, 2014).

¹⁹ Another unfortunate consequence of the accredited investor definition is that small businesses face higher costs of capital.

²⁰ See, e.g., Statement of Commissioner Piwowar at Open Meeting on Form CRS, Proposed Regulation Best Interest and Notice of Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Commissioner Michael S. Piwowar (Apr 18, 2018), available at <https://www.sec.gov/news/public-statement/statement-piwowar-041818>.

²¹ 15 U.S.C. 78f.

experiments with changing a rule, it is at risk of losing trading volume to other exchanges. The bill would prohibit stocks traded on a venture exchange ("venture securities") from being traded on a non-venture exchange. The bill includes examples of permitted experimentations, such as allowing venture exchanges to change the tick size of venture securities and allowing them to trade in periodic call auctions instead of continuous trading.

III. Investing in the America's Future

As everyone at this hearing knows, the SEC has a threefold mission: to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. Oversight hearings like this one ensure that the SEC remains focused on the second part of its noble mission so that capital markets work as intended and work for everyone.

Capital markets are the engines for economic growth. Stock exchanges are the pistons in the engine, capital provided by millions of individual investors is the fuel for those engines, and entrepreneurial firms are the vehicles.

Capital markets make America's future bright for everyone.

For some, that future is to take their entrepreneurial spirit and put it into action. Take an idea for a product or service and start a company. Raise capital from investors. Hire workers. Thereby raising the standards of living for the customers they serve, the employees they hire, and the investors who share in their success.

For others, that future is to take their hard-earned savings and invest in job-creating entrepreneurs. And then take the proceeds of those investments to provide financial security in retirement, invest in the education of their children, and re-invest in other entrepreneurs in their community.

So, when all is said and done, capital markets help all Americans invest in America's future by investing in each other.

* * *

Mr. Chairman, thank you for bringing attention to the critical role that exchanges play in our capital markets, our economy, and America's future. Thank you for the opportunity to testify here today. I am happy to answer any questions you may have.

Nandini Sukumar
Chief Executive Officer, World Federation of Exchanges
On
Oversight of America's Stock Exchanges: Examining Their Role in Our Economy
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets
Committee on Financial Services
U.S. House of Representatives
March 30, 2022

Good afternoon, Chairman Sherman, Ranking Member Huizenga and Members of the Subcommittee. The World Federation of Exchanges – or 'WFE' – is grateful to the Sub-Committee for the opportunity to engage in a discussion about the way that the modern exchange business is run.

The WFE is the global trade association for regulated exchanges and clearing houses, formed (actually quite a long time ago) in 1961. Since that beginning, our membership has included the major US stock exchanges that this subcommittee will be very familiar with, and now also encompasses their counterparts all around the world. All 300 of the pieces of 'market infrastructure' they run are highly regulated businesses.

As a preliminary point, I'd like to note that exchanges work hard to ensure robust infrastructure, including cybersecurity and operational resilience more generally. They demonstrated this extensively through one of the most testing times for financial markets, during the pandemic of the past two years – a period when broker dealers by contrast very clearly faced operational difficulties.

In all cases, WFE member exchanges fulfill a function that we see as critical to capital markets: price formation. Without clear, unbiased, authoritative and up-to-the-minute information about the ever changing value of financial assets, markets would quite simply struggle to serve society. This is why it is one key criterion of membership of the WFE that an exchange perform such a role, ensuring a properly structured setting for establishing the consensus price of financial assets at any given moment.

At the same time, the modern exchange has to be a dynamic and competitive business, constantly investing in new capacity in order to meet the ever increasing demands of investors; of issuers of securities; and of financial-services companies globally. The exchange therefore performs a valuable role, from which financial-service intermediaries benefit particularly greatly; and which has broader public benefits, serving the businesses that need capital to grow; and the investors whose savings can be put to work.

So, our members have many things in common but the deeper, more fundamental shared characteristic is that they are the core of the capital markets in their respective jurisdictions. Supporting fair and transparent trading is their purpose – and, in my view, an essential component of public trust in the financial system.

Our members recognise that this central role has always come with significant responsibility, and will continue to do so. There are many ways in which this responsibility manifests itself, including setting the rules for who can participate and how; ensuring surveillance of the trading process; and overseeing everything from listing requirements to trading halts to stock splits. These functions relating to the operation and oversight of their markets are highly regulated and complex and are all conducted in furtherance of fair and orderly markets and investor protection.

I want to stress that the exchange creates the marketplace and the flow of price information but does not participate in it. In other words, the great strength of the exchange model is that they act as an impartial facilitator of business, ensuring that transactions can take place in a safe and efficient manner, while staying at arm's length from the back and forth that characterizes the typical trading day.

This is a very important distinction and – just as importantly – it applies whatever the ownership or governance structure of the exchange. The very nature of the exchange role is to be a trusted third party that must fulfill considerable statutory obligations every single day. The US securities exchanges are not only highly regulated but incredibly transparent. All rules and charges are filed with the SEC and publicly available – something that cannot be said for many other entities in the capital markets.

I started by talking about the exchange business being modern in outlook but it is built on long-established principles – much longer than the WFE's own history. It is the blend of these well established principles and state-of-the-art operations that makes exchanges so effective, for the full range of market participants, including everyday investors as well as Wall Street.

In summary, exchanges take their role and responsibilities seriously, because that is what makes them effective and valuable.

Thank you.

Kevin R. Edgar
On behalf of the Equity Markets Association
On
“Oversight of America’s Stock Exchanges: Examining Their Role in Our Economy.”
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets
Committee on Financial Services
U.S. House of Representatives
March 30, 2022

Chairman Sherman, Ranking Member Huizenga, and Members of the Subcommittee. My name is Kevin Edgar; I am a Counsel at BakerHostetler and submit this written statement on behalf of the Equity Markets Association (EMA).¹ Established in 2015, the EMA provides federal policymakers, regulators, and investors with in-depth analysis on important issues that impact the U.S. capital markets. Its members -- Cboe Global Markets, Nasdaq, and NYSE Group -- each operate U.S. registered cash equity and options exchanges. They manage fair, orderly, and transparent markets that incentivize capital formation and ensure a robust secondary market for trading securities.

Summary:

U.S. exchanges are a source of strength, resilience, and confidence for America’s investors. The role performed by U.S. exchanges in our capital markets is vitally important, and the manner in which they perform that highly regulated role is sound. EMA members support incremental and thoughtful improvements to the well-functioning market infrastructure we have today and believe that it is valuable for the U.S. Securities and Exchange Commission (SEC or Commission) to focus anew on the issues impacting market participants, including the increasing share of dark trading, as it is currently doing through SEC Chair Gensler’s regulatory agenda. Strengthening displayed markets and the value of the public quote for investors are more laudable policy objectives than altering exchange limitations on liabilities or immunities, National Market System (NMS) plan governance or sending more executions to off-exchange platforms. EMA would welcome an opportunity for a vigorous, and balanced, debate of equity market structure before this Subcommittee. Unfortunately, today’s hearing is inapposite to that objective.

Despite the innocuous title of today’s hearing, several of the legislative discussion drafts put forth are direct assaults on U.S. exchanges. EMA questions how many of the legislative discussion drafts would improve the U.S. capital markets and the American investor experience. EMA further believes that several discussion drafts would violate the National Securities Markets Improvement Act of 1996 and its directive to the SEC when engaged in rulemaking, to consider “whether the action will promote efficiency, competition, and capital formation.” Unfortunately, notwithstanding multiple offers to provide this Subcommittee with a witness to

¹ For more information about the Equity Markets Association, please visit <https://www.equitymarketsassociation.org/>

testify on behalf of EMA on these matters, there are no witnesses testifying today who solely represent America's stock and option exchanges.

Unlike some who seek self-serving exchange reforms, our U.S. stock exchanges did not need a bailout from the Federal government in 2008, nor did they ask the Federal Reserve to use its extraordinary authority to make its counterparties whole or establish emergency lending facilities. Exchanges did not offer or create mortgages and mortgage-backed derivative instruments, nor did they rate those instruments during the financial crisis. Exchanges innovate on their own to build technology and operate a resilient trading infrastructure to benefit the entirety of the capital markets. Exchanges remained open to provide stability to the market during the COVID-19 pandemic and the historic volatility of January and March 2021. Exchanges are reliable, open for business to ALL investors, and serve as a model to the rest of the world for efficient capital allocation and price discovery.

Introduction:

Every trading day, America's registered stock and options exchanges deliver cutting-edge technological services to the world's capital markets and have well-established reputations for operating dependable, fair, and well-regulated markets for investors, public companies, and broker-dealers. Our U.S. capital market system is extremely efficient and reliable, delivering deep liquidity, investor protection, jobs, and economic growth to the American economy that is the envy of the world. Even as the exchanges have invested heavily in modernization and innovation, the costs to investors associated with trading on these markets have fallen over time. As has been noted in several hearings recently, retail investors now usually pay no commissions to trade in today's competitive marketplace.

Since the COVID-19 pandemic hit in March 2020, U.S. equity and options markets and their members have unquestionably demonstrated resiliency by seamlessly processing historic levels of message traffic amidst the market volatility caused by the pandemic. For the first time since 1997, market-wide circuit breakers were triggered on three occasions to halt trading as volatile market conditions warranted, with those mechanisms operated as designed and consistent with rules filed with the Commission. The U.S. exchanges' displayed markets — the reference prices for trillions of dollars of equities, options, mutual funds, ETFs, and derivatives — stood strong under severe pressure. Simply stated, our markets instilled confidence at a time when the American public was rightly scared about the pandemic and provided individual investors with the ability to exchange securities for cash before the Congressional legislative response to the pandemic.

More recently, in connection with market volatility in January 2021 from the GameStop "meme" stock events, and in reaction to the current events in Ukraine and Eastern Europe, U.S. exchanges have served as a strength to our capital markets. U.S. exchanges continue to perform a vital role for investors by operating the most fair, orderly, and efficient markets in the world with displayed prices that allow for robust price-discovery. When the markets are volatile -- and investor confidence is shaken -- U.S. exchanges provide a trusted harbor for market participants and investors to manage their risk.

Thus, the legislative focus for today's hearing, which seeks to diminish U.S. exchanges' immunity and liability protections and restrict their ability to incentivize transparent trading and price discovery, is confounding. Such legislation might benefit some business interests, but not the American public. Congress should not be called upon to entertain legislation that would inject poorly conceived legal uncertainty that could harm U.S. competitiveness, erode the credibility of our capital markets, and bring the prospect of legal action as an overhang to responsible regulatory considerations.

The History of Securities Exchange Self-Regulation and SEC Oversight:

U.S. equity and options exchanges have had a role in operating and regulating our nation's equity markets for more than 225 years. Federal regulation of exchanges, and their formal recognition as self-regulatory organization (SROs), followed the Great Depression and the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934, which created the SEC. The Exchange Act sets forth requirements for the registration and regulation of national securities exchanges. The requirements relating to rules of an exchange are contained in Section 6 of the Exchange Act and, the main provisions for the SEC's oversight of SROs are contained in Section 19 of that law. For example, exchange SROs are required to file any new rule or rule change with the SEC for review, and, in most cases, they must obtain SEC approval before the rule becomes effective. That detailed and often lengthy process includes filing with the SEC all proposed exchange rules and rule amendments that govern operations, including, among other things, listing and membership standards, order types and routing, trading conduct, and fees. All rule filings are published for a public comment, despite the assertions made by some, including the Committee Hearing Memo's omission of this fact when it discussed exchange market data practices. The SEC may consider in its reviews of proposed exchange rules whether they are just and equitable, protect investors, and serve the public interest.

In an increasingly complex and diverse market environment, SROs are a partner to the SEC and work to enhance the SEC's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. Each exchange is the closest and most experienced regulator of activity on its own market and is able to bring market-specific knowledge to bear. They investigate potential violations of exchange rules and federal securities laws, impose fines or other discipline on members who violate those rules, and routinely refer significant matters to the SEC for further inquiry. While these actions and decisions have no commercial or revenue-generating motivation, they are vital to the operation of efficient and well-functioning markets. Banks and broker dealers, by comparison, do not have this responsibility and perform no such functions.

U.S. exchanges perform a myriad of regulatory functions designed to protect investors. These functions include assessing whether a company or fund has met standards to list on a public exchange, determining whether a listed company fails to continue to meet those standards, determining whether to halt trading in a security for the protection of investors, and the maintenance of fair and orderly markets, and monitoring and enforcing member compliance with exchange rules.

The regulatory role of U.S. exchanges further extends to their function to develop, operate, and administer NMS Plans, which are approved by the Commission and must operate in a manner consistent with standards established by Congress. Among other things, these NMS Plans ensure delivery of reliable consolidated market data, provide for mechanisms to protect against extraordinary price volatility, and maintain a consolidated audit trail used for regulatory purposes.

Concerns Voiced About For-Profit Exchanges are Red Herrings:

Globally, the standard for competitors to U.S. exchanges in places like London, Hong Kong, continental Europe and elsewhere is the for-profit model. When the U.S. exchanges demutualized and became public companies in the early-to-mid 2000s, many understood and supported these actions.² The U.S. exchanges today are more highly respected, well-regulated, technologically advanced, nimble, and competitive than they have ever been, and they remain the envy of the global markets. U.S. exchanges have retained their solemn commitment and obligations to investors and quality markets because of, and not in spite of, their transformations to for-profit businesses.

For-Profit Exchanges Invest Heavily in Fulfilling their Public Mission:

Even as the U.S. exchanges have evolved their business models and operations, they have always fulfilled their core responsibilities to investors and the public. The exchanges continue to operate as genuine and effective SROs. Indeed, the exchanges have not engaged in a “race-to-the-bottom” on their listing and membership standards, as naysayers foretold when exchanges became for-profit enterprises. To the contrary, membership on national securities exchanges continues to be a privilege reserved only for qualified and scrupulous firms. The U.S. exchanges’ rules for listing public companies continue to be among the most rigorous in the world. A listing on a U.S. securities exchange continues to be a coveted mark of quality and status.

² See, e.g., David Greising, *Why It’s Time for Wall St. Inc.: If the Public Owned the Markets, Everyone Might Gain*, Chicago Tribune (Aug. 22, 1999) (noting that as publicly owned, for-profit exchanges, the Chicago and New York exchanges would stop focusing on meaningless internal feuds and launch a competitive new era of savvy tactical maneuvering, fair markets and a much improved long-term future”); Dustan Prial, *For-Profit Nasdaq, NYSE Raise Fears*, Associated Press (July 30, 1999) (noting that the “shift [to] for-profit status will help stock markets to move forward quickly with technological innovations that will lower trading costs and ultimately benefit investors” and that it will provide them with the extra capital they need to invest in new technology and introduce new products quickly); Craig Pirrong, *Electronic Exchanges are Inevitable and Beneficial*, Cato Institute (1999) (observing that “an electronic exchange can adopt for-profit ownership and tap equity markets to raise the substantial funds needed to build a state-of-the-art trading system” and to “adopt more efficient decision-making and governance procedures”; also noting that the “tension between regulation and profit is not unique to for-profit exchanges” and that the “interests of members of traditional nonprofit exchanges are not always perfectly aligned with the interests of institutional and retail investors” because “exchange members are in business to make a profit, not to do good works”).

Likewise, for-profit exchanges strictly enforce their rules and pursue disciplinary actions, even when doing so has impacted their bottom lines. The U.S. exchanges continue to bring disciplinary actions, collect fines, and delist companies at a pace that is on par with, if not greater than, prior years.

For-profit exchanges have defied critics' expectations by investing substantial capital and resources into developing highly sophisticated market surveillance tools that significantly augment their already robust regulatory capabilities. These tools enable the exchanges to monitor activity on their markets, both historically and in real time. The tools also employ cutting-edge technologies, including machine learning, to identify patterns of suspicious behavior that are hidden within terabytes of data and which human eyes would almost certainly overlook or require years to find on their own. Again, these surveillance tools are held in such high regard that some exchanges license them to both market operators and regulators around the world.

Additionally, despite assertions to the contrary, the U.S. exchanges have invested heavily in upgrading the technologies that run the public consolidated equities data feeds – the Securities Information Processors (SIPs) – including by increasing the SIPs' resiliency and redundancy while reducing median latency measured in the millionths of a second.

Finally, the exchanges have been thoughtful in proposing and assertive in advocating for sensible reforms when necessary to fortify the structure of the equity markets. EMA always stands ready to work with Congress on necessary reforms that would help listed companies and exchange-tradeable products trade better.

For-Profit Exchanges Are Innovators:

Most equity and options trading today occurs electronically – among racks of softly humming computer servers that neatly line vast data centers. The exchanges employ sophisticated matching engines that automatically prioritize, match, execute, and report billions of orders each day. Further, the exchanges have invested substantial resources to deploy cutting-edge telecommunications technologies that enable their members, if desired, to access the exchanges' systems almost instantaneously – in mere millionths of a second – so that they can keep pace with rapid market movements. The exchanges also have invested enormous resources into sifting through vast rivers of market data to develop products that offer deep and valuable insights into the market. None of these investments, innovations, or achievements would have been possible if the exchanges had not evolved with a focus on innovation.

Meticulous capacity planning, engineering talent, significant investments into their infrastructures, and deep client relationships have allowed EMA member exchanges to flawlessly handle the recent historical spikes in message traffic and volume. These outcomes were not by sheer luck: they are the result of intensive planning, system programming and vigorous testing that allowed the U.S. exchanges to handle extreme market turbulence, providing a forum for investors to manage their risk and in many cases access the cash they needed in the midst of challenging times. This outcome was also part and parcel of a robust and trusted relationship between the markets and the SEC built over many decades.

In addition, since 2015, U.S. exchanges have operated under Regulation Systems Compliance and Integrity, also known as Reg SCI. Reg SCI was designed to reduce the occurrence of systems issues, improve resiliency when system problems do occur, and enhance the SEC's oversight and enforcement of securities market technology infrastructure. These rigorous standards have worked. The proof is in the performance of U.S. exchanges during the last two years. U.S. exchanges have provided uninterrupted service during an extended period of continued and unprecedented elevated trading volumes and market volatility.

Exchange Regulatory Immunity Works as Intended:

Exchanges are recognized as components of critical infrastructure in the United States – particularly in performing the quasi-governmental role that they are statutorily mandated to perform in furthering the Congressional goal of ensuring an effective national market system for U.S. securities. Exchange immunity is neither infinite nor absolute.

The determination of SRO regulatory immunity is a court-derived measure directly related to the regulatory role that U.S. exchanges serve. Congress, and by extension the SEC, enshrined these regulatory functions as core obligations of U.S. exchanges. When an exchange is acting in furtherance of that goal, an unbroken line of federal court decisions holds that the exchange and its officers are immune from private lawsuits for damages.³ Exchanges are assigned quasi-governmental responsibilities over their markets under the Exchange Act, so the doctrine of SRO immunity has the same foundation as the immunity of officials of the legislative, executive, and judicial branches of the federal government: the power to establish, administer, and interpret rules governing private conduct cannot be effectively applied if the agencies and individuals exercising authority over such matters can be sued for monetary damages resulting from the exercise of that authority.

The judicial doctrine of regulatory immunity is narrowly tailored, appropriately applied and enforced by the courts. Immunity does not apply to all activities of an exchange, nor does it apply to non-exchange businesses operated by a company affiliated with an exchange.⁴ Rather, the determinative question in applying SRO immunity is whether an activity “relate[s] to the proper functioning of the regulatory system,” and whether “the conduct is ‘consistent with’ the exercise of power delegated to the SRO” under the securities laws.⁵

Only those SRO functions of a U.S. exchange are subject to court-derived regulatory immunity. All exchanges exercise SRO functions and do so only under the authority vested by Congress and the SEC. Among others, operating a fair and orderly market, including matching buy and sell orders in a manner consistent with rules filed with the Commission, is a regulatory function. Determining whether to bust a trade - which can be done only consistent with rules filed with the SEC - is a regulatory function. Assessing companies and funds to determine whether they meet

³ See, e.g., *In re NYSE Specialists Sec. Litig.*, 503 F.3d 89 (2d Cir. 2007); *DL Capital Grp., LLC v. NASDAQ Stock Mkt., Inc.*, 409 F.3d 93 (2d Cir. 2005); *D'Alessio v. NYSE, Inc.*, 258 F.3d 93 (2d Cir. 2001); *Sparta Surgical Corp. v. NASD*, 159 F.3d 1209 (9th Cir. 1998).

⁴ *City of Providence v. BATS Global Markets, Inc.*, 878 F.3d 36 (2d Cir. 2017) (immunity not applied to certain exchange products and services); *In re Facebook, Inc. IPO Securities & Derivatives Litigation*, 986 F. Supp. 2d 428 (S.D.N.Y. 2d 2014) (immunity not applied to technology used in Facebook IPO).

⁵ *NYSE Specialists*, 503 F.3d at 96, 99 (quoting *D'Alessio*, 258 F.3d at 106).

listing standards is a regulatory function. Determining whether to halt trading in one or more securities is a regulatory function. Determining whether to initiate delisting proceedings is a regulatory function. Acting jointly with other SROs, consistent with Section 11A of the Exchange Act and SEC Rules, to plan, develop, operate, and regulate national market systems is a regulatory function. Again, no bank or broker-dealer has any such regulatory responsibilities.

Regulatory immunity also furthers the Congressional goal of uniformity in the national market system by ensuring that the SEC, with its expertise, evaluates the regulatory performance of SROs. To allow suits by private litigants to challenge or dictate regulatory outcomes would result in an unstable and dysfunctional marketplace. Different judges or juries in different jurisdictions should not be deciding regulatory policy or market structure matters. Congress wanted exchanges to answer only to the SEC with respect to those issues. Regulatory immunity is not an absolute shield to liability if an exchange fails to properly perform its regulatory obligations. The SEC has enforcement authority over U.S. exchanges and through the years has exercised this authority. And if a U.S. exchange fails to operate in a manner consistent with its rules, the rules of the SEC or the Exchange Act, it is subject to regulatory jeopardy. Congress wanted to ensure uniformity by empowering the SEC with control over such issues, not courts and juries.

We believe the existing framework works well. The immunity doctrine applies to certain activities of an exchange -- and when an activity is in question, the courts decide. There is no reason to believe that our courts are not capable of determining the appropriate scope of regulatory immunity, as they have for decades, and as they do for members of the legislative, executive, and judicial branches. Because cases in which immunity is at issue often require a careful assessment of the allegations in a complaint to determine whether they pertain to regulatory activities, a court is the best forum to shape the immunity doctrine as a body of federal common law.

Arbitrary Congressional action could inhibit the courts from reacting to future changes in the capital markets. Freezing regulatory immunities in a statute prevents common-sense application of facts and circumstances to fit future scenarios. The prudent policy is to leave this to the courts and their judicious approach to setting precedents. U.S. exchanges execute hundreds of billions of dollars of transactions every day, and they are not capitalized to cover the risks potentially created by efforts to eliminate limits on liability for critical infrastructure.

Are the proponents of limiting regulatory immunity comfortable that a particular incident might bankrupt U.S. exchanges and the critical financial infrastructure they provide? Are proponents of changes to the current structure comfortable with the measures exchanges might need to take to boost their net capital or buy insurance to cover these additional risks? The degradation of SRO immunity amounts to an exchange-ending event and EMA strongly opposes the "Securities Exchange Reform Act of 2022" discussion draft.

Exchange Liability Rules Function Well:

Unlike dark trading venues, all material aspects of U.S. exchange operations must be filed with the SEC as rules that, among other things, promote just and equitable principles of trade, remove

impediments to and perfect the mechanism of a free and open market and a national market system, and in general, to protect investors and the public interest. The SEC disapproves or suspends any rule that does not meet those standards. Importantly, these filed rules include exchange limitations on liability.

The SEC, regardless of the Commission's makeup at the time, has always allowed exchanges registered under the Exchange Act to limit their liability:

- Cboe – 1991
- Nasdaq – 2006
- NYSE – 2007
- IEX – 2016
- NYSE Arca – 2017
- Long-Term Stock Exchange – 2019
- MEMX – 2020

When granting these liability limits the SEC uniformly found that the rules would protect investors and the public interest. These SEC-approved exchange liability caps function well. In fact, monthly use of the caps seldom approaches the limits in any meaningful manner. More to the point, the members of EMA are unaware of any recent instance where a claim against an exchange has not been satisfied by the monthly caps. And in one high-profile episode from a decade ago, claims against an exchange were satisfied via rule filings with the SEC and the courts.

The broker-dealers that seek to reduce limitations on liability for exchanges do not themselves perform regulatory functions. And while they may compete for the transaction services that exchanges provide, they are not subject to the same statutory requirements that U.S. exchanges have for providing those services. Remarkably, the broker-dealer proponents themselves also routinely limit their own liability to their customers through bespoke private contractual language such as: “Client understands and agrees that [the broker] will have no liability whatsoever for any claim, loss, cost, expense, damage or liability of Client arising out of or relating to a System Failure” or “In no event will [the broker] be liable ... for any direct, indirect, incidental, special, punitive, or consequential losses or damages of any kind with respect to the Services.” Further, these industry proponents have the flexibility to customize terms from client to client – something exchanges are statutorily prohibited from doing. EMA is deeply troubled by the implications of any proposal under which broker-dealers would have robust limitations on liability to individual investors but exchanges would have open-ended liability to those same brokers and the class-action trial bar.

The discussion draft known as the “Securities Exchange Reform Act of 2022” seeks to impose unlimited liability on exchanges in a way that would place the regulatory functions of U.S. exchanges at risk of heightened litigation.⁶ If enacted, this legislation would change the

⁶ Discussion draft, H.R. ____, “Securities Exchange Reform Act of 2022,” “To amend the Securities Exchange Act of 1934 to reform certain requirements with respect to the registration and operation of national securities exchanges, and for other purposes.”

fundamental structure of exchange liability for a hypothetical scenario without any regard to the real-world, negative impact such change would have on our capital markets, issuers and investors. EMA strenuously objects to this discussion draft.

SROs are Best Suited to Operate NMS Plans

NMS Plans originate from directives by the SEC to the SROs to work together in furtherance of a market-wide related objective. The SROs, whether they support the directive or not, are obligated to undertake the requirements and obligations associated with the NMS Plan.

The Commission designated SROs as the entities best suited to operate NMS Plans because, unlike broker-dealers or other industry participants, SROs have the obligation to enforce compliance with the Exchange Act, the rules promulgated under the Exchange Act by the Commission, and the SROs' own rules.⁷ Moreover, the 1975 amendments to the Exchange Act specifically required the Commission to rely on SROs to design and operate NMS Plans.⁸ That is why Rule 608 of Regulation NMS only authorizes two or more SROs acting jointly to file NMS Plans and is why the Rule goes on to require each SRO to comply with the terms of any effective NMS Plan of which the SRO is a sponsor or a participant.⁹

Broker-dealers or other industry advisors to the Plans simply have no such obligation. In fact, other than ensuring their own compliance with the securities laws and rules of SROs, broker-dealers and other industry participants are entirely free to and do act in their own commercial interests unfettered by statutory or public interest concerns. If the advisors to the NMS Plans were allowed to vote on the actions of the operating committees of the Plans, the advisors would be able to block changes the SROs felt were necessary to discharge their SRO statutory obligations.

The discussion draft legislation being considered today -- the topic of which has been at the top of SIFMA's advocacy agenda for years -- would provide broker-dealers, investment advisors, and investor advocates a vote on NMS Plan operating committee matters notwithstanding that they have no obligations under an NMS Plan. The Commission provided for advisors because NMS Plan participants benefit from having input from industry members. But there is nothing in the Exchange Act nor the Commission's regulations to suggest that the Commission ever envisioned advisors becoming the policymakers. Indeed, that would have been completely

⁷ See 15 U.S.C. §78f(b)(1).

⁸ See Section 11A(a)(3) of the Exchange Act states, "The Commission is authorized in furtherance of the directive in paragraph (2) of this subsection [the directive to facilitate the establishment of a national market system]—(B) ... to authorize or require self-regulatory organizations to act jointly with respect to matters as to which they share authority under this title in planning, developing, operating, or regulating a national market system (or a subsystem thereof) or one or more facilities thereof...."

⁹ We also note that in adopting Regulation NMS, the Commission balanced the need for public input with the regulatory nature of the NMS Plans by mandating that certain NMS Plans be amended to include a minimum of five advisory committee members. The NMS Plan advisory committee structure established by the Commission is working as intended and should remain in place.

inconsistent with the requirements of the Exchange Act and Regulation NMS. For this reason, EMA strenuously objects to this provision of the “Securities Exchange Reform Act of 2022.”

Conclusion:

By contributing to the capital allocation and formation and price discovery processes, U.S. exchanges serve as a vital component of our economy. During every recent and notable challenge to the U.S. economy, such as the reopening of the markets following the September 11, 2001, terrorist attacks, or the financial crisis of 2008-2009, exchanges provided all investors with an open, transparent and reliable venue to execute their transactions. With the recent challenges in our markets such as the COVID-19 pandemic, the volatility of January 2021 with GameStop, and the more recent volatility in response to historic inflation, rapidly increasing energy prices and the invasion of Ukraine by Russia, U.S. exchanges have been a constant source of stability and reliability in our nation’s financial infrastructure.

The legislative discussion drafts included in today’s hearing do not further the interest of investors. In addition to what is stated above, EMA notes that legislative initiatives that would prolong an already intensive SEC review process for exchange fee filings and hinder exchange rebates that incentive liquidity provision in the lit markets, are not beneficial to everyday investors.

EMA hopes that the Subcommittee will engage in a constructive, thoughtful dialogue with U.S. exchanges before advancing legislative proposals that would harm the U.S. capital markets and the American economy.

Thank you for the opportunity to provide this written statement for the record.

Question for the Record of Ellen Greene
Managing Director, Equity and Options Market Structure, Securities Industry and
Financial Markets Association (SIFMA)
before the U.S. House of Representatives
Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets
Hearing Entitled: "Oversight of America's Stock Exchanges:
Examining Their Role in Our Economy"
Wednesday, May 18, 2022

To all the witnesses:

If we were to start from scratch and design a regulatory regime for the markets of today, would we craft it the same way and grant the for-profit exchanges their SRO status along with all of the privileges/responsibility that come along with it?

The Securities Industry and Financial Markets Association (“SIFMA”) appreciates the opportunity to respond to the Committee’s question for the record. If we were to start from scratch and design a regulatory regime for our U.S. equity markets today, SIFMA does not believe the current self-regulatory model would be the best regime. Regulatory developments combined with innovations in business and technology have brought significant changes to the equity markets. As such, we believe a holistic review of the current regulatory structure of broker-dealers and exchanges is needed as we believe this model is outdated and in need of reconsideration and reform.

As we discussed in our written testimony¹, the largest U.S. securities exchange operators have evolved from member-owned utilities to for-profit business enterprises. At the same time, technological advancements have changed the way the securities markets and market participants operate, with securities exchanges and non-exchange venues operated by broker-dealers performing essentially identical functions in certain respects. Nonetheless, the status of exchanges as self-regulatory organizations has not changed, even as the exchanges have become active competitors with the broker-dealer members they are charged with regulating. This inconsistency has led to tensions, unfair competition, anomalies, and conflicts in the structure, operation, and regulation of the securities markets.

SIFMA supports effective regulation of the securities markets, and we believe that, properly structured, strong self-regulation must continue to be an integral part of the oversight of the market and its participants. However, the current self-regulatory structure is outdated and in great need of rethought and reform. SIFMA has long advocated for a holistic review of market structure and would direct the Committee’s attention to three previous letters submitted to the SEC in 2013, 2014, and 2017 providing recommendations for equity market structure reforms². Specifically, SIFMA wanted to highlight the following for the Committee’s consideration:

Competition:

Changes to the equity market structure spurred by Regulation NMS, along with the evolution of automation technologies for processing securities transactions, have changed the way all market participants operate, blurring the distinctions between services provided by an exchange and those provided by a broker-dealer. Combined with the transformation of exchanges into for-profit

¹ <https://www.sifma.org/wp-content/uploads/2022/03/220329-Ellen-Greene-Written-Testimony-Hearing-on-Oversight-of-Americas-Stock-Exchanges.pdf>

² <https://www.sifma.org/wp-content/uploads/2017/05/sifma-submits-comments-to-the-sec-requesting-a-review-of-the-self-regulatory-structure-of-securities-markets.pdf>;
<https://www.sifma.org/wp-content/uploads/2017/05/sifma-submits-comments-to-the-sec-with-recommendations-for-equity-market-structure-reforms.pdf>
<https://www.sifma.org/wp-content/uploads/2017/12/SIFMA-Letter-to-SEC-on-Near-Term-Priorities.pdf>

enterprises in search of ways to expand their business and grow, exchanges and broker-dealers have become direct competitors in many aspects of their businesses. Most prominent is the competition for order flow between exchanges and broker-dealers. In this regard, exchanges and many broker-dealers offer functionally equivalent securities transaction services and fiercely compete for orders to execute. In this respect, SIFMA is concerned that when exchanges compete with broker-dealers, the role of exchanges as SROs creates regulatory disparities and competitive anomalies. While we welcome competition since it ultimately benefits investors, it must be enabled through a common and equally applied rule set applicable to all market participants including the exchanges.

Judicially-Created Absolute Immunity

As SROs, exchanges are insulated from private liability for damages they cause, based on both a judicially-created doctrine of “absolute immunity” and limitations on liability codified in their rules. Broker-dealers performing similar services, of course, are subject to private liability. While these protections were understandable when exchanges were not-for-profit, member-owned utilities that actually performed regulatory functions, they have become less so as exchanges have outsourced most regulatory functions to FINRA. Additionally, as exchanges have converted into for-profit enterprises, most, if not all, of their activities have become commercial in nature and not deserving of immunity. Since the Commission cannot alter judicially-created doctrines, SIFMA recommends Congress amend the Exchange Act to provide that exchanges are not immune from lawsuits arising out of their commercial activities. This change is a “must have” to even the playing field.

Rules-Based Limitations on Liability

In addition to judicially-created absolute immunity from liability for regulatory activities, each exchange has adopted rules that limit its liability to members in any other circumstance. These limits are set at levels that bear no relation to the substantial costs that an exchange could impose on the public. In addition, these limits are legally protected and strictly enforced through the Commission’s approval of the exchanges’ rulebooks and through the statutory requirement that exchanges comply with their own rules. SIFMA believes Congress should amend the Exchange Act to prohibit exchanges from creating rule-based limitations on liability. This reform would strengthen market-based discipline on our equity markets, creating incentives for exchanges to make responsible decisions in operating their markets and to maintain financial resources to absorb the consequences of any failure without relying on other market participants.

Market Data Revenue

By virtue of their SRO status, exchanges receive substantial revenues from their unique right to sell market data to broker-dealers, information vendors, investors, and others. Rule 602(b) of Regulation NMS requires broker-dealers to report their bids, offers, and quotation sizes to an exchange or FINRA. The exchanges receive this valuable data for free, aggregate it, and then sell it back to broker-dealers and others for a profit. Congress should amend the Exchange Act to require a public comment period and approval by the SEC before any proposed new fees for proprietary exchange market data, connectivity and co-location services can become effective, similar to the SEC’s 2020 requirements for NMS Plan fee filings. This reform would ensure that

impacted market participants are able to meaningfully voice concerns to the SEC about such fee changes.

Exchanges as Designers of Market Structure

The status of the exchanges as SROs provides exchanges with an important but often overlooked competitive advantage over broker-dealers, the ability to design and implement market structure initiatives. In this regard, the Commission frequently turns to the exchanges—whether or not their actual regulation is outsourced—along with FINRA to design vital market structure reforms that will ultimately be binding on the entire marketplace, including broker-dealers. This places exchanges in a unique position to influence the outcomes on market structure, despite their own competitive interests as market participants.

Most critically, the Commission has largely delegated to the SROs the power to design and dictate the structure and functions of a new consolidated audit trail (the “CAT”), subject to Rule 613 of Regulation NMS under the Exchange Act and the Commission’s approval. The authority to decide how the CAT system will operate and how its costs will be allocated among market participants has been delegated to the exchanges. SIFMA has expressed significant reservations about this process. More broadly, SIFMA questions the public policy rationale behind the Commission’s decision to ask one group of competitors over another to direct such an important and costly project, with broad implications for the entire securities business.

Viewing exchanges as independent regulators that will design and implement the Commission’s market structure initiatives without considering their own competitive interests is no longer realistic. As for-profit businesses, exchanges should no longer be entrusted with such important public functions and expected to act as if they are disinterested parties acting in the public interest. The transparency of exchange procedures should be strengthened, particularly those designed to safeguard the separation of regulatory and commercial operations – with respect to use of funding (e.g., regulatory fees from fines) and use of information (e.g., CAT, market data). At a minimum, SIFMA believes Congress should amend the Exchange Act to clearly and explicitly provide that industry representatives, such as broker-dealers and asset managers, have meaningful voting participation in the governance of NMS Plans, with transparent access to the same information that exchanges currently receive.

SIFMA appreciates the Committee’s question and attention on a comprehensive review of the market and self-regulatory structure, and your consideration of our comments in connection with this matter. We look forward to continuing to engage with the Committee on this topic and would welcome the opportunity to further discuss these issues with you in greater detail.

QUESTIONS FOR THE RECORD OF REP. BILL HUIZENGA

House Financial Services Committee

Hearing on Oversight of America's Stock Exchanges: Examining Their Role in Our Economy

March 30, 2022

RESPONSES FROM MANISHA KIMMEL

To Nandini Sukumar:

1. The issue of the 2012 Facebook IPO was mentioned by witnesses and included in SIFMA's testimony. Could you please review those witness statements and provide the exchange perspective regarding Facebook's IPO and your reaction to that testimony?

To all the witnesses:

2. If we were to start from scratch and design a regulatory regime for the markets of today, would we craft it the same way and grant the for-profit exchanges their SRO status along with all of the privileges/responsibility that come along with it?

Manisha Kimmel, Chief Policy Officer, MayStreet Inc response:

I do not believe we would craft the SRO regulatory regime exactly the same way if the exchanges had been for-profit at the time the NMS-related rules were proposed and adopted. Areas where I believe privileges and responsibilities would be different include cross-market regulatory oversight, exchange fee oversight and market data plan governance.

While the exchange SROs are effective as the front-line regulators for their markets, and they have expertise in regulating unique aspects of their markets such as opening or closing auctions or floor-based activity, they should not be responsible for regulation across the markets. The responsibility to regulate trading across market venues and products (e.g., equities, options, futures, and swaps) should be with FINRA and the SEC, as they have the most comprehensive cross-market surveillance capabilities and expertise, combined with a mission consistent with the public interest that is free of conflicts of interest.

With respect to exchange fee rulemaking, I believe all fee-related rule changes should be posted well in advance of being effective with sufficient time for notice and comment. All fees should be forward-looking and subject to Commission review for compliance with the Exchange Act. Today, exchanges can change many of their rules -- including for trading and data fees -- essentially with little or no warning. Immediately effective on filing fee changes make it difficult to assess the impact of fee changes on order-routing and best execution.

Finally, with respect to market data plan governance, I do not believe that the use of NMS plans make sense when there is an inherent conflict between exchanges' commercial interests and the Congressional mandate to increase the availability of consolidated market data. The SEC should be in control of consolidated market data, and that data should be made commercially competitive with the exchanges' own data feeds. All data providers -- including those affiliated with the exchanges -- should have access to the same data, at the same time, in the same format, and at the same prices.

RESPONSES FROM MICHAEL PIWOWAR

House Financial Services Committee

Hearing on Oversight of America's Stock Exchanges: Examining Their Role in Our Economy

March 30, 2022

To Nandini Sukumar:

1. The issue of the 2012 Facebook IPO was mentioned by witnesses and included in SIFMA's testimony. Could you please review those witness statements and provide the exchange perspective regarding Facebook's IPO and your reaction to that testimony?

To all the witnesses:

2. If we were to start from scratch and design a regulatory regime for the markets of today, would we craft it the same way and grant the for-profit exchanges their SRO status along with all of the privileges/responsibility that come along with it?

Piwowar Response:

I do not believe that if Congress were to start from scratch and design a regulatory regime for the markets today, it would craft the exact same SRO model. When Congress first enacted the SRO model for exchanges, they were all non-profit organizations, mutually owned by broker-dealer members. Since then, they have demutualized, and, as you point out, they have become for-profit corporations owned by shareholders.

The demutualization of stock exchanges has led to conflicts of interests between exchanges and broker-dealers. If Congress were to consider redesigning the SRO regulatory regime from scratch, I recommend that the House Financial Services Committee and the Senate Banking Committee hold hearings to identify all the conflicts of interest, consider various alternatives to addressing those conflicts, and evaluate the qualitative and quantitative costs and benefits for each alternative. Committee witnesses should, of course, include representatives from the exchanges and broker-dealers. It should also include interested parties and experts such as academic financial economists.

In the meantime, if Congress were to consider incremental steps to address these conflicts of interest, I would recommend the following. One issue of contention between the exchanges and the broker-dealers is NMS Plan governance. Without weighing in on the merits of the arguments on either side, I have a recommendation that would address the vast majority of concerns. I believe the SEC has overused NMS Plans on initiatives, such as the Tick Size Pilot Program and the Consolidated Audit Trail, that should have been done through notice-and-comment rulemaking. Congress could simply limit the SEC's ability to use NMS Plans to initiatives with little or no conflict of interest.

Finally, I would be remiss if I did not point out a recent relevant development. In 2019, a group of financial service firms, including broker-dealers, founded a member-owned exchange aptly named The Members Exchange (MEMX). Congress could direct the SEC to study the extent to which the

existence of MEMX has (or has not) helped mitigate any of the issues related to the conflicts.

QUESTIONS FOR THE RECORD OF REP. BILL HUIZENGA

House Financial Services Committee

Hearing on Oversight of America's Stock Exchanges: Examining Their Role in Our

Economy March 30, 2022

To Nandini Sukumar:

1. The issue of the 2012 Facebook IPO was mentioned by witnesses and included in SIFMA's testimony. Could you please review those witness statements and provide the exchange perspective regarding Facebook's IPO and your reaction to that testimony?

Answer:

The SIFMA testimony contained dramatic inaccuracies, told none of the real story of that day and failed to give credit to Nasdaq for their efforts after the event to be accountable to their customers. The SIFMA claim that the industry lost \$500 million is simply not consistent with the facts. Recognizing the unique circumstances, Nasdaq voluntarily waived its SEC-approved limitations on liability through a special rule filing that raised the cap for liability to its members from \$500,000 to \$62 million. They enlisted the neutral arbiter of FINRA to oversee the claim and disbursement process. However, the actual value of claims that were submitted totaled only \$42 million, \$20 million less than the amount that Nasdaq was prepared to pay. In addition, Nasdaq was sued by a class of investors and, contrary to SIFMA's testimony, was found by the court *not to be immune* from lawsuit. Accordingly, Nasdaq paid out an additional \$26.5 million to settle claims under that lawsuit.

This event was 10 years ago and is often cited as a great example of a professional and investor-friendly handling of an event by a major exchange. Nasdaq, it should be noted, revamped its IPO opening process and is a trusted technology supplier for exchanges around the globe. In particular, its IPO opening process was battle-tested during the pandemic as 1069 companies went public over the two-year period – a record number of IPOs – without any technology concerns. SIFMA members enjoyed among the best trading environments on the globe and its member revenues during this time exceeded \$297 billion.

To all the witnesses:

2. If we were to start from scratch and design a regulatory regime for the markets of today, would we craft it the same way and grant the for-profit exchanges their SRO status along with all of the privileges/responsibility that come along with it?

Answer:

Unequivocally yes.

The operations of exchanges/SROs are highly regulated and complex and involve day to day decisions related to the furtherance of fair and orderly markets and investor protection.

All registered national securities exchanges are approved by the SEC and operate as self-regulatory organizations (SROs). The regulatory work done by SROs is important and beneficial to investors and is overseen by the SEC.

Exchange for-profit status has nothing to do with whether investors are getting quality markets or not. The statutory obligations are the same regardless of ownership structure. For-profit status is just a herring.

The SRO model is sound. The top line question for policymakers as it relates to market structure should be whether the investor experience is sound. The answer is a resounding yes – a major overhaul of what is working is not needed. These discussion draft bills do not advance the interests of investors in any way.

Courts have determined that national securities exchanges should be absolutely immune from suit when they are engaged in their self-regulatory activities and functions. Regulatory immunity is a judicial doctrine, which courts have recognized is applicable to exchanges because they perform quasi-governmental functions in the regulation and oversight of their markets delegated to them under the Act, just as if the government performed those tasks.

Courts have expressly noted that in performing these quasi-governmental functions, exchanges should be free from the fear of burdensome damage lawsuits that would inhibit the exercise of their independent judgment. It is also important to note that regulatory immunity is limited in scope and applies to functions that are regulatory in nature. The Courts police this line carefully.

Much of what the securities exchanges do on a day-to-day basis is regulatory in nature. “Regulatory conduct” does not just cover oversight of member trading and disciplining members. It also includes performing statutory obligations in many other contexts. Examples, which Courts have appropriately recognized, include actions by exchanges to: declare trading halts, cancel trades, make option contract adjustments, and interpret securities laws and regulations as applied to the exchanges or their members, etc.

To allow private litigants to bring lawsuits and dictate regulatory outcomes would result in an unstable marketplace and undermine the role of the SEC in evaluating the performance of SROs.

Regulatory immunity is as necessary now as it was 30 years ago. Being owned by a for-profit, public entity has not changed the rationale for regulatory immunity, as securities exchanges continue to have the exact same statutory obligations under the Exchange Act and perform the same regulatory activities as before.

The U.S. has a unique (and litigious) legal system. These exchange protections are critical. Lawsuits challenging market infrastructure are generally non-existent in other jurisdictions.

Putting critical market infrastructure out of business over routine but critical market decisions like trading halts is not only of no use to investors but harmful to them.

Limitations on Liability: Exchanges have rules that limit their liability in certain circumstances related to the operation of their markets, such as any interruption in or failure or unavailability of trading facilities.

These rules set forth in detail what activities are covered by their provisions, and importantly are SEC-approved (following public notice and comment period). We would note that rules limiting liability do not apply to losses resulting from willful misconduct, gross negligence, bad faith or fraudulent or criminal acts of the exchange.

These SEC-approved rules also provide that exchanges can compensate members for certain types of losses alleged to have resulted from the failure to process an order or quote correctly due to the acts or omissions of the exchange or due to the failure of its systems or facilities.

These limitations on liability rules are consistent with existing law, and international practice, and assist the exchange in fulfilling its role as a national securities exchange. This is done by avoiding the risk of tempering its critical regulatory functions and obligations to avoid the disruption and expense of unnecessary litigation or potential catastrophic loss, to the detriment of investors.

Unlike trading firms and ATSs, which can actually customize and negotiate liability provisions with their customers and disclaim liability altogether or force arbitration, exchanges are not allowed to do that. Rather, exchanges are required to apply these rules in a non-discriminatory basis.

