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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

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[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 Americans[2] – 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.

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[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 sperate 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

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

[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.

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[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

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[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 refed 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

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[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.