

**TESTIMONY OF MICHAEL BLAUGRUND, CHIEF OPERATING OFFICER OF
THE NEW YORK STOCK EXCHANGE**

**U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES
MARCH 17, 2021**

Chairwoman Waters, Ranking Member McHenry and distinguished members of the Committee, thank you for the opportunity to testify today on the evolution of the U.S. capital markets and recent market events. My name is Michael Blaugrund and I am the Chief Operating Officer of the New York Stock Exchange. The New York Stock Exchange is the world's largest exchange, with NYSE-listed companies employing more than 43 million people worldwide and representing roughly 30% of the world's public market value.

The New York Stock Exchange's purpose is to help entrepreneurs raise capital so they can change the world. NYSE-listed companies access the capital markets to create jobs, develop new products, or weather unexpected challenges such as the pandemic. When a company issues shares, we facilitate trading of those securities so public investors can share in the growth of the company and the American economy. To that end, the NYSE's role in operating fair and orderly markets is clear: to promote continuous price discovery, to facilitate risk transfer, to regulate Exchange members' trading and compliance with NYSE rules and the federal securities laws, and to oversee listed companies' compliance with exchange listing standards.

The NYSE plays a central role in U.S. capital markets and we make significant investments in our trading platform technology and regulatory surveillance systems to be prepared for market swings at any time. These investments have been put to the test over the last year, beginning with last March's volatility and peaking this month when NYSE Group processed more than 350 billion order and market data messages on March 4th. At each of these times of stress, market participants have been able to depend on NYSE's infrastructure and well-established volatility controls. In short, the markets worked.

That being said, the events of January 2021 raise valid questions as to what, if anything, policymakers should seek to reform in the equity markets regulatory regime. The Securities and Exchange Commission ("SEC") has announced that it will study these events as it has studied others in the past, and Acting Chair Lee has gone on record to recommend that the Commission will-- prior to the completion of that study -- lead with regulatory action in a few areas, including retail investor suitability, enhanced short selling disclosures, and a review of the relationship between payment for order flow practices and best execution obligations.

Whatever conclusions the regulators reach about what ought (or ought not) be done, a key principle must hold true -- that public policy should build investor confidence in the markets. Investor confidence is built when individuals are armed with accurate information about public companies, when infrastructure operates with stability and resiliency, when markets function according to pre-determined rules, and when regulations are vigorously enforced.

The SEC's study will inform policy development, but NYSE believes at least four areas merit consideration for regulatory reform:

Modernizing Shareholder Disclosures

Section 13(f) was adopted by Congress as part of the Securities Acts Amendments of 1975 to create a central repository of historical and current data about the investment activities of institutional investment managers. Put simply, investment managers with at least \$100 million in equity securities holdings must file quarterly reports on Form 13F detailing their long positions in equities and listed options. These reports are due within 45 days of the end of the calendar quarter and are designed to provide the Commission, issuers, and the investing public with information to make more informed decisions about how to regulate, engage with shareholders, and invest in public companies.

At the NYSE, we sit at the nexus of issuers and investors, and both groups have strong feelings about 13F disclosures. Corporate issuers feel that the current limited frequency and lengthy lag time for 13F reporting prevent them from engaging productively and efficiently with their investor base. By contrast, institutional investors are concerned that more frequent or timely disclosures would erode the value of their fundamental research by allowing other investors to free-ride off of their investment decisions, particularly if they have not yet fully established their intended position in a given security at the time of their 13F disclosure.

We have facilitated joint discussions with representatives of both these groups in hopes of identifying a constructive middle ground. Based on this dialogue, we believe the SEC should consider shortening the delay for 13F reporting from 45 days after the quarter. Additionally, because issuers have a special interest in knowing who their owners are, the SEC should consider mechanisms to complement the public 13F filing process that enable direct disclosures to corporate issuers when a reportable position is established or fully divested. Potential information disparities could be addressed by leveraging blackout periods for corporate issuers when they choose to access the information.

Providing Transparency for Securities Lending

Short selling is an essential practice for liquidity, price discovery and risk management, but the securities lending market on which it depends is opaque and inefficient. Indeed, research from the Department of Treasury's Office of Financial Research has identified the potential for systemic stability risks associated with securities lending. FINRA collects equity short position information from its member firms twice a month, but this aggregate data is insufficient for market participants or regulators to understand how supply and demand are changing for stock loans in an actionable fashion.

By contrast, for decades investors have benefited from the real-time reporting of trades and quotes for securities transactions on the Consolidated Tape for the equities market. The Consolidated Tape provides a simple, low-cost mechanism for investors and issuers to understand the prevailing market dynamics for securities trading.

The SEC should consider establishing an analogous Consolidated Tape for securities lending. A system that provided for publishing the quantity, fees and/or rebates, duration and other material terms for each stock loan without attribution would provide issuers, investors and regulators the necessary data to better assess the risk and return of

establishing a short position, while protecting the identity and intellectual property of any individual market participant. At a minimum, stock loan information should be collected by the Commission and considered for public dissemination in the future.

Section 984(b) of the Dodd-Frank Act provides a sensible framework for the SEC to tackle the issue of stock lending transparency. Section 984(b) of Dodd-Frank directed the SEC -- not later than 2 years from the date of enactment -- to promulgate rules that are designed to increase the transparency of information available to brokers, dealers, and investors with respect to the loan or borrowing of securities. The SEC advanced aspects of Section 984 in crafting requirements for certain investment funds but has yet to address requirements for broker-dealers in this area. Establishing a Consolidated Tape for securities lending is a common sense way to bring more transparency to this dark area of the market.

Eliminating Competitive Barriers for Public Investors

Transparent, public markets are critical to the success of the U.S. equity markets. Exchange quotations drive price discovery, and market participants bid at higher prices and offer to sell at lower prices when they have a reasonable expectation that their displayed price will attract a broad range of investors with different investment time horizons.

Because it is typically uncorrelated with other asset prices and held for the long-term, self-directed retail order flow represents one of the most sought-after classes of trading counterparty. Over the past year, retail flow has also been the fastest growing segment of the market. It is encouraging to see increased and broadening participation in investing, as public markets are a powerful mechanism for democratizing participation in economic growth and reducing economic inequality.

The vast majority of self-directed retail order flow, however, never makes it to the public market. Instead, retail orders are typically routed to a broker-dealer "wholesaler" for internalization, a process that guarantees an execution to the retail customer in exchange for granting the wholesaler an opportunity to trade with the order before other market participants. Internalization is beneficial to the individual retail investor if the execution results in meaningful price improvement relative to the public market, which it often does. However, internalization deprives investors in the public markets the opportunity to interact with those orders, resulting in "inaccessible liquidity" for large institutional investors.

Under today's regulatory framework, the proportion of trading on public exchanges is at an all-time low. In fact, at the end of last year, on some days more shares were executed in private, dark venues than on lit, public exchanges with displayed price discovery. Trading in securities with a higher level of retail participation may have 60-70% of their shares traded in the dark.

Investors trading on public exchanges, including the NYSE, have a limited ability to compete for much of the retail volume executed by wholesalers. In large part, this is due to the difference in the regulatory framework for broker-dealers and exchanges. For

example, unlike exchanges, wholesalers can offer privately negotiated terms for price improvement or payment for order flow, choose to interact only with a curated set of market participants, and accommodate clients in cases where there may be a dispute.

However, investors trading on exchanges are also on unequal footing in a more straightforward way: off-exchange trading is permitted at price increments as small as \$0.0001, while investors trading on exchanges are limited to price increments of \$0.01.

NYSE Research has recently demonstrated that 30% of market volume is artificially constrained by this penny-wide regulatory requirement. This results in inefficient price discovery and makes it more difficult for public, institutional investors to access the full liquidity of the market.

The NYSE believes that it is time to harmonize the on and off-exchange price increment regimes. From a public policy perspective, if sub-penny trading is allowed in private dark trading, we believe similar conventions should also be allowed on public lit exchanges. Reducing the minimum pricing increment on exchanges in active, low-priced securities would lower investor trading costs, improve market transparency, and provide an increased opportunity for investors trading on exchanges to interact with retail orders.

Accelerating Trade Settlement to T+1

NYSE supports the growing consensus to accelerate industry settlement cycles from two days (T+2) to one day (T+1) after the trade. Though a shorter settlement cycle increases the potential for an operational error, the capital efficiency to be achieved by the industry is likely worth the risk.

According to DTCC, netting trades and payments for intra-day activity reduces the value of payments that need to be exchanged by an average of 98% each day. Without intra-day netting, massive capital inefficiencies would reduce and inhibit the liquidity retail and institutional investors depend upon to buy or sell with immediacy. Future innovations, including any possible acceleration to real-time or T+0 settlement, should preserve the benefits of transaction netting currently enjoyed by the industry.

We believe that free enterprise is the greatest force in history to improve the human condition. NYSE-listed companies spur economic growth by investing and innovating, leading to a higher quality of life for Americans and global citizens. Smarter regulation of today's equity market structure will improve investor confidence, encourage entrepreneurs to access the capital markets and allow the U.S. to extend its leadership in the global markets.

We look forward to working with the new Congress, the SEC, the Biden Administration, and all our stakeholders on these matters and thank the Committee for the opportunity to participate today.