# WILLIAMS & JENSEN, PLLC

**Fr**: Alex Barcham and Rebecca Konst

**Re:** SEC Equity Market Structure Advisory Committee

**Dt:** April 26, 2016

**Summary**
On April 26, the Securities and Exchange Commission (SEC) convened a meeting of the Equity Market Structure Committee (Advisory Committee, or EMSAC) to discuss: (1) a framework for a potential access fee pilot; (2) recommendations relating to trading and venues regulation; and (3) Market Quality Subcommittee and Customer Issues Subcommittee status reports.

**Stephen Luparello, Director of the SEC Division of Trading and Markets,** asked the Regulation NMS Subcommittee to change its Access Fee Pilot framework into a full recommendation to be posted on the SEC website and circulated within the next one or two weeks. He suggested the Committee will have a vote in the next few weeks on the recommendation, either by phone or through another meeting. Regarding the Trading Venues Subcommittee recommendations, **Luparello** said the second recommendation is the most immediate. He stated they would work on a timetable to distribute a formal recommendation in a couple of weeks, with a public meeting to vote a couple of weeks after that.

**SEC Staff and Commissioners' Opening Remarks**
**Stephen Luparello, Director of the Division of Trading and Markets,** stated this is the fourth meeting of the EMSAC. He stated since the last meeting each of the Subcommittees have held meetings and gathered input from the public. He noted they have included consultations with other Advisory Committees such as the Investor Advisory Committee. He noted additional consideration on the recommendations discussed at today's meeting might be needed, and that an additional meeting could be held as early as next month.

**SEC Chair Mary Jo White** in a statement stated she is impressed with the engagement and progress of this Committee in tackling the issues that are central to optimizing equity market structure. She suggested the agenda for today and the documents made publicly available by the four subcommittees reflect thoughtful analysis and recommendations. She noted the Regulation NMS Subcommittee and the Trading Venues Regulation Subcommittee are both presenting recommendations for consideration by the full Committee today: (i) a proposed framework for an access fee pilot that would measure the impact of reduced access fees on current equity market structure; and (ii) several recommendations for changes to the current trading venue rules on self-regulatory organization (SRO) immunity, NMS Plan governance, changes in the SRO proposed rule process when technology changes are also required, and the centralization of common regulatory functions. **White** stated all of these recommendations follow independent analysis by SEC staff available on the Committee's webpage, presentations and advice from an array of panelists, and discussions at prior public meetings. She noted discussion and consideration of the subcommittees' recommendations are the next step, which will be well-informed by the thorough analysis by the subcommittee members, the full Committee's views, and by the views of the knowledgeable and diverse panelists invited to present at the meeting today.



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**White** expressed her commitment to pursuing market structure reforms that enhance the markets and are driven by data and careful analysis. She noted this Committee's current deliberations regarding an access fee pilot for the production of data that would inform more permanent market structure changes is consistent with that important principle and approach. She suggested implementation of any access fee pilot would require both Commission approval and the significant participation and cooperation of the SROs.

**Chair White** suggested a properly designed access fee pilot would be an appropriate step in furthering the collective assessment of the current market structure. However, she noted there are significant issues in any access fee pilot that require close scrutiny and thorough planning. She expressed interest in hearing more about the views on certain of the elements of the recommended pilot. First, she noted a "*de minimis* bucket" of securities subject to a two mil fee cap is included. She asked about: the possibility of having a group of securities for which access fees and rebates would be prohibited altogether; views about a *de minimis* approach versus a no fee and rebate approach; and whether the *de minimis* approach would compromise the goal of generating data to determine the impact of access fees on the market structure. **White** also expressed interest in hearing discussion about whether the pilot should apply to non-displayed liquidity and off-exchange trading venues, such as alternative trading systems (ATS). She explained that Rule 610 only imposes access fee caps on exchange displayed liquidity, as market participants are prohibited from "trading through" such quotes when they are protected. She asked what would be the relevant considerations for expanding a pilot program to quotes and venues that are not subject to the access fee cap today.

**White** stated the recommendation does not include a "trade-at" provision, noting that one purpose of the access fee pilot is to assess whether a "trade-at" provision is needed and further noting that "trade-at," while intertwined with access fees, concerns a different market structure issue. She expressed interest in hearing perspectives on this issue and more about the rationale for the recommended choice.

**White** asked what the optimal timing for an access fee pilot is. She noted the primary purpose of an access fee pilot is to generate data about impact on liquidity and market behavior. She asked in light of the fact that the tick size pilot is scheduled to begin on October 3, is there any concern that the utility of any data produced from an access fee pilot would be degraded if the two pilot programs were to run in tandem, or can the access fee pilot be designed to avoid that.

Regarding the trading venue regulation recommendations, Chair White expressed interest concerning the concrete measures proposed, including how they would mitigate inherent conflicts of interest. She noted that the Customer Issues Subcommittee and Market Quality Subcommittee will provide updates on their work, observing that both subcommittees have begun to coalesce around a number of potential recommendations. **White** stated among other topics, the Market Quality Subcommittee has been actively reviewing how the U.S. equity markets operated during the volatility of August 24, 2015 and what may flow from what was observed. She explained the Customer Issues Subcommittee is considering a range of potential enhancements to current rules requiring disclosure of execution quality and routing information, with a particular focus on retail investors. She suggested this work is both critical and timely, as the industry and regulators also continue to consider these issues and possible changes to existing practices.

**Chair White** expressed pleasure that the Market Quality Subcommittee is keenly focused on the events of August 24, 2015 and related issues. She noted the Commission last week extended the limit-up/limit-down (LULD) pilot period for one year, and she recognized the ongoing work being conducted by the LULD participants to further refine the plan's operation. She explained that work includes considering: (i) the harmonization of current clearly erroneous execution rules with the Plan; (ii) a review of exchange traded products (ETPs) to determine whether adjustments should be made to LULD to account for their particular trading characteristics; (iii) potential enhancements to the categorization of securities into different tiers; and (iv) a review of other issues that may have arisen during the events of August 24, including the impact of double-wide price bands during the opening period and the advisability of coordinated reopening procedures.

**Chair White** noted the Committee will also hear from the Customer Issues Subcommittee on issues related to execution quality and order routing disclosures. She noted Commission staff has been directed to focus on improvements to Rule 606 routing disclosures, with a particular focus on institutional order routing disclosures and discrete enhancements to the existing retail order routing information provided by broker-dealers today. She expressed an expectation that the staff's recommendation will be considered by the Commission in the very near future. **White** suggested today's agenda demonstrates the importance of gathering a diverse set of market participants to address complex, potentially very significant market structure issues. She stated while the SEC does not require perfect solutions, regulatory changes must be informed by unbiased and fact-based assessments of the likely impacts, positive and negative, on market quality for investors and issuers.

**Commissioner Kara Stein** noted tomorrow the SEC will consider issuing a public notice on the consolidated audit trail (CAT), which she suggested may be one of the most important market structure issues on the agenda of the SEC this year. **Stein** stated the idea of an access fee pilot has been "floating around" for years and she thanked the Subcommittee for putting forward a path forward. She asked how best to create a comprehensive data set; whether a trade-at should be included; how long it would take to develop and implement the pilot; and how long should the pilot run. **Stein** noted the recommendation related to trading venue regulation. She noted the markets are continually evolving and the SEC and SROs need to evolve as well. She stated as the markets change, the regulations need to change as well. **Stein** noted for some time the SEC's agenda has been focused on mandated rulemaking related on the financial crisis but she stressed the need to also be forward thinking. She expressed interest in the status reports of the Customer Issues Subcommittee and the Market Quality Subcommittee. She expressed appreciation for the EMSAC member's time spent on these issues.

**Commissioner Michael Piwowar** in a statement suggested the Regulation NMS Subcommittee's recommendation for an access fee pilot is "provocative," judging from the reactions heard in the last week. He expressed his "delight" to see that is the case, because it means the SEC can expect full engagement of market participants to help vet the framework. He noted anticipation that today's discussion will be "animated, to say the least." **Piwowar** noted the SEC has been told by many parties, including Senator Mark Warner (D-VA) and Senator Mike Crapo (R-ID), to act prudently with respect to an access fee pilot. He suggested because the key to the success of a pilot is the specifics of the design, he will be "keenly focused" on whether the design of the pilot is sound. **Piwowar** explained his preliminary view is that it lacks a key category for observation, namely, a zero access fee category, on the basis that the proposed bucket with the smallest access fee cap will itself result in a *de minimis* economic incentive. He stated while that may be true under the Commission's current minimum tick size regime, it may not be the case if the Commission decides to lower the minimum tick size in the future. He expressed his hope that the possibility of a "zero fee bucket" is something which can be further explored, and he encouraged public comment on that permutation.

**Piwowar** stated immunity for SROs is something that has been of significant interest in the marketplace, especially in light of several high-profile events in recent years. He noted the "much maligned" concept is certainly worth exploring. He suggested the Trading Venues Subcommittee's recommendation will give interested parties a single place to provide comment, rather than having views interspersed in and among various rule filings, which will facilitate consideration of this issue.
**Piwowar** noted the topics the Trading Venues Subcommittee has identified with respect to Advisory Committees are particularly timely. He noted tomorrow, the Commission will have an open meeting on the consolidated audit trail (CAT). He expressed hope that the Committee will recognize some of the Subcommittee's work incorporated into questions in the CAT notice for comment. He stated the information the SEC gathers in connection with the responses to the CAT NMS Plan can inform how to proceed on Plan governance generally, and vice versa. **Piwowar** stated CAT has the promise of creating new and powerful means of surveilling activity that is conducted on multiple markets. He stated the Trading Venues Subcommittee is suggesting that responsibility for such cross-market surveillance and similar common functions be centralized in a single regulator. He suggested it is worth considering whether, rather than centralizing common regulatory functions, there would be benefits to having SROs compete with one another for this purpose. He stated public comment will be particularly useful as the Commission thinks through this issue.

**Piwowar** noted the Market Quality Subcommittee and the Customer Issues Subcommittee have been hard at work analyzing issues, and have developed a few preliminary recommendations that will be presented at future meetings. He stated he looks forward to hearing those ideas, and he hopes the Subcommittees will provide previews. **Piwowar** noted at a prior meeting, he challenged the Committee to take ownership of the issues and generate forward momentum for an equity market structure review. He suggested the Committee's work has matured into detailed proposals that will spur much-needed public debate. He urged the Committee to keep bringing the Commission thoughtful recommendations and challenge the Commission to respond.

**<u>Regulation NMS Subcommittee Recommendations to the Committee: Framework for Potential Access Fee Pilot</u>**

**Kevin Cronin (Invesco, Ltd.)** stated over the years access fees have been an issue with "tentacles" into other issues such as order routing. He stated there is consensus that something needs to happen around access fees, but some might define that differently. **Cronin** stated what is needed is a data driven pilot to see if access fees are helpful or harmful. He expressed He explained the Subcommittee's access fee pilot framework is designed to "root out" the issues and nomenclature. He stated there are a number of issues in which the Subcommittee could not find a consensus but could lay out the topics for public discussion. **Cronin** noted the importance to be inclusive and to bring in a number of participants in this discussion. He noted they did invite NASDAQ and NYSE but they declined to participate in the Subcommittee discussions.

**Joseph Mecane (Barclays PLC)** described the access fee pilot framework, stating that they started with the premise of the need to revisit the 30 cent access fee cap. He stated one premise they started with was trying to find the balance between a meaningful pilot and one that stayed as simple as possible. **Mecane** stated a reasonable pilot had to cover a range of possibilities. He stated they



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"landed on" a 4 bucket pilot: a control bucket; a 20 cent bucket; a 10 cent bucket; and a 2 cent bucket. He noted the 2 cent bucket was a compromise bucket because they could not agree on the need to have a "no fee" bucket. **Mecane** stated there was a discussion around the pros and cons of completely eliminating access fees and the 2 cent bucket was a compromise.

**Mecane** noted another suggestion was that the "coverage universe" is stocks with a market capitalization above $3 billion so it could run with the Tick Size pilot and not be impacted. He explained no consensus was met around whether the pilot should include inverted pricing venues. He noted Regulation NMS does not currently include inverted venues. **Mecane** stated the Subcommittee includes questions about the application to ATSs. He noted the Subcommittee did not include ATSs because access fees do not currently relate to ATSs and this additional variable could create new biases.

**Mecane** stated the Subcommittee does not endorse "trade-at" as part of the pilot but that is not a vote on "trade-at" itself. He explained a "trade-at" provision would force order flow back on exchanges but would predetermine an outcome which would impact the ability to measure the success of the pilot. He added that a "trade-at" would also add additional issues into the pilot. He stated the Tick Size pilot already includes "trade-at" so the impact on the market is already being looked at. **Mecane** stated they attempted to ensure a simple implementation which does not "drag out" for too long. He stated "trade-at" adds complexity that they were trying to limit. **Mecane** stated it is worth ensuring there are no spillover effects in other markets. He stated because the current Regulation NMS access fee cap does not apply to non-displayed liquidity they would advocate that it be specifically brought into the pilot so there is not a different rate for non-displayed liquidity.

**<u>Consideration and Discussion of Framework for Potential Access Fee Pilot</u>**
*Panelists:*
**Jeffrey Davis**, Vice President and Deputy General Counsel, NASDAQ
**Thomas Farley**, President, NYSE Group
**Charles Jones**, Professor of Finance & Economics, Columbia Business School
**Faris Matalka**, V.P., Trading and Order Management, E*Trade
**Adam Nunes**, Head of Business Development, Hudson River Trading

**Jeffrey Davis** (**NASDAQ)** stated the topic of equity market structure is important to market participants and NASDAQ. He stated NASDAQ, NYSE, and Schwab wrote a letter to Chair White on the lack of diversity on the EMSAC, namely lacking retail investor participation and representatives from the two largest exchanges. **Davis** stated the recommendations of the Committee specifically do nothing to improve the markets for early stage companies or companies tapping equity markets for the first time or secondarily or those holding less liquid securities. He suggested changing the "one size fits all" approach to equity market structure. **Davis** stated in the absence of the two largest equity market participants the recommendations would increase exchange liability and restrict exchange rule filings. He stated the lack of diversity on the committee is reflected in the recommendations. He noted NASDAQ will respond fully to the recommendations in writing.

**Thomas Farley (NYSE Group)** noted the work of the SEC and this Advisory Committee. He stated the listed companies on the NYSE are responsible for almost all innovations seen in the past 125 years. He suggested the markets are failing listed companies. He noted the number of new listed



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companies has decreased by half over the past 15 years. **Farley** stated this Subcommittee does not represent listing companies nor the viewpoints of the listing exchanges. He stated these matters are so important and the representation on this Advisory Committee is so "skewed" that the Subcommittee meetings need to be held in the "light of day."

**Farley** stated that the Subcommittee recommendations are very disappointing. He suggested the Subcommittee recommendations will increase transactions done in the "dark" and will increase profits of intermediaries. He reiterated the need to focus on the needs of the listed company. He expressed disappointment over these recommendations as they will "pit" parts of the industry against each other. **Farley** noted Intercontinental Exchange came forward with a proposal for the markets which have been "gutted" by the Advisory Committee recommendation. He stated the NYSE will submit a written comment letter to this recommendation as they did not have enough time before this meeting. **Farley** stated many exchanges provide a rebate for those leaving resting orders on the markets. He stated the access fee pilot would eliminate or reduce the payment of rebates which means the bid-ask spread would widen and would therefore result in more "dark" trading. He stated there will also be worse pricing on and off exchanges. He noted some have argued the incentive to transact off exchange would be less because of lower market fees but he suggested that result would be negligible. He stated the real discussion should be to improve the outcome for investors and listing companies. He suggested that mandating lower access fees would be worse for both retail and institutional. **Farley** stated NYSE feels those who take the risk to state their intentions should receive a benefit for it. He encouraged a plan for transparent price disclosure such as "trade-at." He stated if the SEC proceeds with this access fee pilot, public company stocks will have wider spreads and investors will have higher costs.

**Farley** also commentated on the recommendations of the Trading Venue Subcommittee. He criticized the Subcommittee for the lack of recommendations on ATSs, even after the "litany" of enforcement actions against dark pools. He stated this proposal will increase costs and prices. He criticized the Subcommittee for "self-interest", noting that many Subcommittee member firms fund the trade association taking legal action challenging trading venues. He stated this Committee was constituted to gather expert advice but the Committee excludes listed company and retail investor views. He criticized the Subcommittee process for being "opaque." He stated the Subcommittee is unfortunately focused on increasing profits rather than focusing on the listed company and retail investors. He urged the SEC to start new with a representative committee.

**Charles Jones (Columbia Business School)** stated recently he has written on the design of regulatory pilots. He stated the focus should be on identifying a market failure the pilot is aimed to address. He stated the key in designing a pilot is to design something simple, minimize costs, and that which cannot be "gamed." He explained the pilot needs to last long enough and apply to enough stocks for economists to be able to ascertain results. **Jones** noted the Tick Size pilot includes a "trade-at" and is complex which is why this access fee pilot does not include that. He noted it also includes several buckets and a longer period. He noted the access fee pilot would apply only to those with over $3 billion of market capitalization so it can run separately from the Tick Size pilot. He suggested there needs to be a randomized sample of stocks, including high and low priced stocks, and low and high priced stocks. **Jones** noted the scope of the limits on the fees, but he suggested if the goal is to understand the agency problem the limits on fees and rebates need to apply to as many venues as possible. He advocated for the pilot to apply as broadly as possible, including ATSs. He stated the SEC should be on the lookout for changes in order flow. He stated gross bid-ask spreads are expected to widen. He stated the right way to measure bid-ask spreads is



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on a net basis but that should not be assumed as a decrease in market quality. He urged simplicity was a "guiding light" for the design of this pilot.

**Faris Matalka (E*Trade)** noted the benefits retail investors are currently receiving because of the current market structure. He stated displayed size is almost double what it was in 2005 which benefits retail investors. He stated as brokers continue to source liquidity, execution quality is at an all-time high. **Matalka** noted commissions remain low and as competition grows between brokers, retail investors are receiving more data, services, and education. He acknowledged that there is always room for market structure enhancement, but he encouraged a data driven approach to looking at market quality issues. He expressed support for the access fee pilot but the explained that the variables to be measured are important. He stated it is important to determine what the main objectives are of the pilot, and what would define success or failure. **Matalka** stated they support a proposal to assess impacts on a smaller scale to eliminate unintended consequences.

**Adam Nunes (Hudson River Trading)** stated as a proprietary trading firm they do not have conflicts of interest with their investors. He stated it will be important to watch whether retail investors see increased price improvement in an access fee pilot. He noted interest in impacts on display size and execution costs. He stated rebates have the potential to create artificially narrow spreads. **Nunes** stated the "value proposition" of many dark pools is to avoid the 30 cent access fee. He expressed support for pilots in areas where results are harder to see. He stated the access fee pilot is a positive step forward as it would measure the effect of fees on order routing. He stated a pilot only on the access fee will provide a good view into the impact of the "trade-at."

<u>**Discussion**</u>

**Cronin** responded to some criticisms, stating the Subcommittee attempted to be as inclusive as possible, including the participation of a person with corporate experience participating. He stated they attempted to have listed companies represented, and the EMSAC includes some representation of listed companies, namely through Invesco and others. **Cronin** asked NYSE and NASDAQ whey they are not participating in Subcommittee discussions if they care so much about the interests of issuers and customers. **Davis** stated they wanted to be full members and were holding out for a better process, adding they did not want to be part of a "dark" process.

**Jamil Nazarali (Citadel Securities)** stated Citadel has some concerns over the pilot. He stated market makers do not view a dollar from rebates any differently than a dollar from trading profits. He stated spreads will widen with the reduction in rebates. **Nazarali** stated some of this may result in wider spreads for retail but some may be competed away. He stated retail broker-dealers that place limit orders to subsidize products and services will get less revenue. **Nazarali** stated it would be hard to have a bucket with no access fee because the exchanges would not be able to charge anything. Instead, he suggested there could be a bucket that does not allow any rebates. He noted concern with applying a no access fee to other venues such as ATSs, since it is more like a commission. it would be difficult to regulate. **Nazarali** suggested in practice it would be difficult to regulate because if it was only for electronic then they could charge more for "high touch trading." He stated it is important to consider market failures and conflicts of interest. He stated in any world there will be differences in fees and those will not go away. He suggested there are easier ways to address that such as through requiring "cost plus." He stated in terms of "trade-at" there is already a "trade-at" pilot in the Tick Size pilot. **Nazarali** expressed concern that "trade-at" limits competition and will result in a huge transfer of wealth from retail investors to other investors. **Nazarali** stated that he expects the pilot would result in some liquidity being eliminated. He stated focusing on less



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liquid securities could be important. He suggested focusing only on those above $3 billion in market capitalization is missing an important factor. He stated that the pilot should include the smaller company stocks and run once the tick size pilot is finished.

**Richard Ketchum (FINRA)** noted that since Rule 610 does not apply to nondisplayed liquidity there could be a regulatory obstacle in applying the access fee cap to ATSs. He asked whether there are substantive reasons to not include a zero access fee bucket and trade-at in the pilot. **Mecane** stated that the pilot tries to measure the experiment with how the market works today. He said changing a rule on top of the access fee would make this more complicated and comparing the end results would be harder.

**Mecane** stated where everyone talks about access fees impacting particular constituents of the market, they are all valid. He stated the point is there are all these counterbalancing factors that they just do not understand. He stated it is not clear what the net impact changing access fees will have. He suggested gathering the data is the primary objective.

**Gary Stone (Bloomberg)** stated they wanted to focus on what NMS is today. He stated capping fees would require a rule change and would take longer.

**Luparello** stated if the full Committee agrees with the pilot, it will become a recommendation to the SEC which will then go through the traditional Commission process, which takes time. He stated speed to vote on the recommendation is important, but he stated it is speed to the "start line" rather than to the "finish line."

**Brad Katsuyama (IEX Group Inc.)** stated the idea is to keep things as simple as possible. He stated the more complexity the more chances there are to challenge the results. He stated the term liquidity is "rather open." He stated since there is not sub-penny quoting it is difficult to determine impacts. He stated because of the Tick Pilot they chose the access fee pilot to include stocks above $3 billion in market capitalization. He noted if impacts are seen then the pilot could be changed and re-run. He suggested this is a sensible pilot.

**Matthew Andresen (Headlands Technologies LLC)** expressed concern with the potential for a zero access fee bucket in the pilot. He stated that when exchange revenue is capped at zero, exchanges will simply mine non-transactional fees "to their hearts content." He noted fees for the Securities Information Processor (SIP) have gone up, as have co-location fees. He expressed concern that if the access fee revenue goes away for exchanges, other exchange fees will be pushed into the "dark." He suggested NYSE's view on maker-taker is refreshing, but he asked if that is a recognized market structure tenet, why they do not take that view in other markets such as futures as well. **Farley** responded that it is suboptimal. He stated if he could "wave a magic wand" they would eliminate rebates as a matter of course entirely. He stated if there were a fee it would apply to the maker and the taker, to incent prices there would be real meaningful obligations, and there would be no ability to trade away from the optimal price. **Nunes** stated one of the benefits of the pilot is that it could see which fee is best.

**Davis** stated if what they want to do is test hidden fees they would look at a broader sample such as algo fees, connectively fees, or payment for order flow (PFOF) rather than the one fee that does not impact "your own venue."

**Reginald Browne (Cantor Fitzgerald & Co.)** expressed an interest to also look at competition. He stated there will be reduced competition if this study goes forward and that should be a consideration. He expressed concern about lower participation by providers of liquidity, including for ETFs. **Browne** stated market-makers provide nearly a billion to industry to propagate innovation. He stated the study needs to consider those consequences surrounding the ETF markets.

**Nunes** referenced the discussion about hidden fees and stated that exchanges have protected quotes. He stated the cost of connecting and the protected quote is a few thousand dollars. He stated Reg NMS provides a "toll booth" and access fees are not the only way they use it.

**Joe Ratterman** (BATS Global Markets, Inc.) stated the access fee was put in place because of protected quotes. He expressed worry about "trade-at" and suggested regulating the size of rebates is the SEC is getting into micro-market regulation. He stated regulating where market competition can get out of "whack" makes sense, but he stated regulating all fees is a "much longer path." He reiterated the need to "keep it simple." **Ratterman** stated he met with retail companies and he has carried those ideas forward. He stated spreads and commissions are great from the retail perspective. He noted retail has stated simultaneous pilots and overlaying pilots can be a drain on resources. He noted the vital importance of defining success and failure in advance. Finally, he noted retail believes that a pilot will not properly address complexity or conflicts in the marketplace. **Ratterman** stated conflicts will exist as long as there is no central limit order book (CLOB). He stated conflicts can be mitigated but not eliminated. He stated BATS believes a pilot makes sense as long as it is simple and a broad range of views are gathered. He stated the pilot should be withheld until a consensus can be reached.

**Farley** stated the retail investor is currently in a good spot, so he acknowledged the importance of doing no harm. However, he stated changes and improvements can be made. He disagreed that a "trade-at" would diminish the experience of the retail investor. He stated it is a tricky balance but no harm should be done to retail. He suggested Citadel does a good job giving customers price improvement. He stated having a "trade-at" set at a small enough increments might be a decent approach and could help retail. He said he rejects the notion that nothing can be done.

**Stone** stated the recommendation addresses the discussion of defining success of the pilot. He stated failure needs to be defined in all of the buckets. He stated it is implied in this that the SEC needs to provide periodic reports, such as 6 and 12 months, on what is going on in the pilot so the "trigger can be pulled" if it is not working.

**Cronin** stated who they are trying to be successful for also needs to be defined. He noted most retail access the market through institutional investors. He stated they are willing to take some risk to get to a better place in market structure. He stated there are some conflicts in the marketplace which are not being addressed. He suggested the pilot is designed to change the status quo in a scientific way. **Cronin** stated this pilot will show how the access fee impacts all of the things they believe need to be looked at. He noted this will not be perfect but it is worth the risk.

**Mehmet Kinak (T. Rowe Price Group)** stated the buy side has been pressing this issue for years. Responding to criticism about the Subcommittee, he stated there is no self interest in this and that his company is also a large investor in the Intercontinental Exchange (ICE). He suggested there is a conflict in routing which occurs in the market and the access fee pilot proposal is attempting to get



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rid of that. He noted this is for the benefit of retail. **Kinak** explained the pilot is intended to be simple, take stocks where the spreads are artificially narrow and reduce the access fee. He stated removing that access fee minimizes the conflict. **Kinak** stated everything should be included because if anyone can avoid this then the actual impacts will not be seen.

**Eric Noll (Convergex Group)** stated one point being missed is with the rebate structure as designed there are distortions in trading. He stated there is some level of rebate in which they are creating incentives that distort trading activity. He stated the idea is to look at how to minimize that distortion.

**Matalka** stated Regulation NMS Rule 611 eliminated a lot of the trade-throughs. He stated they do measure the exception ratio. He stated it is important to make a distinction between retail brokers and buy-side brokers. He noted price improvement is important but it is not the only factor in decisions.

**Luparello** suggested there is no "ground swell" of opposition. He asked the Subcommittee to change the outline into a full recommendation to be posted on the website and circulated within the next one or two weeks. He suggested the Committee will have a vote in the next few weeks on the recommendation, either by phone or through another meeting. **Cronin** agreed that approach would work. He asked NYSE and NASDAQ to participate in the conversation.

**Trading Venues Regulation Subcommittee Recommendations to the Committee: Recommendations Relating to Trading Venues Regulation**

**Richard Ketchum** said the Subcommittee tried to bring in representatives of the industry, the ATS community, and the exchange community. He noted that they invited NYSE and NASDAQ, but they chose not to participate. He said CBOE did participate, so they had one major exchange participating. **Ketchum** said the Subcommittee recognized that there are conflicts and implementation questions which must be addressed for trading venues. He stated that the Subcommittee deferred further evaluation of ATSs in light of the SEC's recent actions on proposed amendments to Regulation ATS. He said they will evaluate the comments received on these actions before engaging in any recommendations. He expressed interest in the issue of SIP oversight.

**Ketchum** said the Subcommittee's first recommendation focused on SRO immunity and rule-based exchange liability levels. He said the Subcommittee was not able to reach a full consensus on the immunity issue, so it had no views to express at this time. He noted that each of the recommendations was based on a consensus agreement, except for the fourth recommendation, in which he recused himself. He said the trading environment has become more complex, partly due to the rise of algorithmic trading, so the Subcommittee agreed that the liability levels should be increased and this should be done consistently across exchanges. He said they also recommended that the SEC consider whether there should be a requirement on exchanges to set aside funds to be made available in the event of liability.

**Ketchum** said the Subcommittee's second recommendation was that changes should be made to NMS Plan governance structure and that the role of NMS Plan Advisory Committees (ACs) should be expanded. He said industry participants should be able to provide input. He said they recommended that once Advisory Committees are established the members should be able to nominate their own replacement candidates. He said selections should be approved by a simple



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majority of the Operating Committee (OC). **Ketchum** said they also recommended that the SEC expand and formalize the role of Advisory Committees. He noted that they also recommended that the ACs be able to initiate their own recommendations to the OC. He said they also recommended that the use of Executive Sessions by NMS Plans should be significantly narrowed. He contended that AC members should have the right to attend all meetings and receive all information concerned plan matters. He said they also recommended revisiting the allocation of voting rights among SROs, particularly suggesting that the current model of one vote per exchange registration should be replaced with the allocation of voting rights at the exchange group level.

**Ketchum** said the Subcommittee's third recommendation emphasizes the need for greater clarity regarding technology changes. He stated that draft technical specifications should be published prior to SEC approval of any related rule change. He also suggested that where possible, industry and affected parties should be provided an opportunity to review and provide comment on draft technical specifications. He suggested that where possible, the duration of the implementation period should be determined after the draft specifications and FAQs are issued to allow the industry to better evaluate and determine the necessary timeframe.

**Ketchum** noted that he did not participate in drafting of the fourth recommendation due to his role at FINRA. **O'Hara** described the fourth recommendation, saying it is meant to address potential conflicts of interest amongst SROs, as they are profit-seeking entities. She said the Subcommittee determined that creating a single SRO was not the appropriate solution. She said the general view of the Subcommittee is that removing all SRO functions from exchanges is not warranted. She suggested that certain regulatory activities are better done at a centralized level, such as the surveillance of cross-market activities. She suggested that there be more centralization of common regulatory functions across SROs when such centralization can avoid duplication of effort or when it can result in more effective handling of regulatory activity. She suggested that with the eventual rollout of CAT, the risk of duplicative regulatory oversight increases, underscoring the need for active monitoring to ensure against such duplication.

**Consideration and Discussion of Recommendations Relating to Trading Venues Regulation**

*Presenters:*

*Panelists:*

**David Cushing**, Director of Trading and Market Strategies, Wellington Management
**Jeffrey Davis**, Vice President and Deputy General Counsel, NASDAQ
**Brett Redfearn**, Head of Market Structure Strategy, J.P. Morgan Securities

*Presentations*

**David Cushing (Wellington Management)** noted that Wellington is a global asset manager and that its views are based on their clients' best interests, since they have a fiduciary duty. He stated that the SRO governance structure would benefit from reevaluation and redesign. He said there are conflicts with how market data is collected and distributed. He stressed the challenges of keeping clients out of the data "slow lane." He said they support more comprehensive SRO governance reform over time. **Cushing** said Wellington supports reviewing SRO liability limits and the adequacy of reserves held against them. He stated that they also support the second recommendation regarding changes to NMS Plan Advisory Committees. He suggested that the third recommendation on the timing of technical changes makes sense, noting that rushed system changes have gone poorly in the past. He also expressed support for the fourth recommendation to simplify and centralize common regulatory functions.

**Jeffrey Davis (NASDAQ)** said NASDAQ is open to a discussion on these issues and would be submitting a comment letter.

**Brett Redfearn (J.P. Morgan Securities)** said J.P. Morgan is a very large participant in the equity markets. He commended the Subcommittee for its work in drafting the recommendations, describing them as a "meaningful step forward." He suggested that there are some areas where J.P. Morgan believes the recommendations should be tweaked or do not go far enough. He said rule-based liability levels should be meaningfully increased, pointing to the issues with the Facebook IPO. He said suggested that the level should be ten to twenty times higher. **Redfearn** noted that the Subcommittee did not reach a consensus on regulatory immunity, suggesting that they should pursue this issue further, describing the current immunity regime as an "unfair competitive advantage." He emphasized his support for the Subcommittee's third and fourth recommendations. He said they also support the second recommendation, but suggested that direct voting representation should be included. He noted that BATS supported a vote for brokers and asset managers on the SIP Plan. **Redfearn** said SIPs are solely governed by SROs which have a conflict of interest. He said the voting members of the SIP Plans sell competing products to the SIP Plan and have disincentives to invest in improving the SIP. He said exchanges have clear conflicts and are the only entities with votes on the SIP plan. He stated that brokers want to make SIPs more competitive and usable. He said the existing participants have not upheld their obligations to the plan. He said there are significant problems with latency in the SIP. He said the economic incentives for exchanges relate to their proprietary data products with unconstrained fees. He described the SIPs as delayed data being sold as real-time data. He suggested that SIPs should either be fixed or phased out, contending that they will not be fixed if the governance model is not fixed. **Redfearn** expressed support for expanding the role of NMS Plan Advisory Committees and limiting the use of Executive Sessions. He said he has some concerns with the recommendations related to working groups.

*Discussion*

**Ratterman** said unlike broker-dealers, exchanges have a fair access obligation. He said the exchange liability limits must be looked at in light of this obligation. **Redfearn** asked if Ratterman believes this should apply to all areas of the exchange. **Ratterman** said the liability limits must apply on a fair access basis, noting that broker-dealers can negotiate different limits for different clients.

**Manisha Kimmel (Thomson Reuters)** asked how much of an impact granting an Advisory Committee direct voting representation would have, as they would only have a very small minority. **Redfearn** emphasized the importance of being able to offer a formal vote, rather than simply expressing views.

**O'Hara** said the Subcommittee has not examined the SIP. She suggested that she has concerns with the SIP beyond those described by Redfearn, particularly related to timestamps. She suggested that they will examine this issue in the future.

**Stone** suggested that the Subcommittee drafted its recommendations related to ACs to allow the SEC to know when the AC is outvoted by the Operating Committee, reflecting a difference of opinion between the AC and the OC. **Redfearn** said he views the recommendation as a positive step forward, but feels it does not go far enough. He questioned why brokers should not be given a vote.



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**Davis** said NASDAQ is open to recommendations about Plan governance, noting that they have more members on their advisory committees than ever before. He said they have worked to reduce the number of items considered in Executive Sessions. He noted that most of the cases where they use Executive Sessions relate to litigation or issues related to specific parties. He said NASDAQ has concerns with the AC vote recommendation, as it could create problems in meeting their obligations. He said there are many different types of NMS Plans and they have different obligations, so there is a need for specificity in how each Plan operates. He noted that NASDAQ has announced that they are creating a new SIP for the NASDAQ ETP which will have latency as low as 50 microseconds.

**Ketchum** said one of the challenges of industry participation in the Plans is accountability. He said the SEC can hold the exchanges accountable, such as for failing to produce a CAT plan. **Redfearn** stressed the benefits of including industry voices in the Plans, suggesting that it would create checks and balances. He stressed the need to create incentives to improve the SIP.

**Luparello** stated that the recommendations are general, but very substantive. He said the second recommendation is the most immediate and "meaty." He said they would work on timetable to distribute a formal recommendation in a couple of weeks, with a public meeting to vote a couple of weeks after that.

**Market Quality Subcommittee Status Report to the Committee**

**Market Quality Subcommittee Chairman Eric Noll (Convergex)** provided a status report on the work of the Market Quality Subcommittee. He said the Subcommittee has largely been examining the August 24 market event. He noted that CBOE, ETP issuers, and BATS have participated in the Subcommittee's meetings. He said the Subcommittee will present recommendations at the next EMSAC meeting. He said the first of these recommendations relates to the Limit Up/Limit Down (LU/LD) regime. He said LU/LD works in a "macro" sense, but there are issues with the reopening after a halt. He said the majority of the Subcommittee has concluded that the auctions are not fixable under the current market structure. He said their recommendation is to eliminate the auction and have the LU/LD band slide over time. He said the minority view on the Subcommittee is that under certain circumstances there should be auctions under a volume-weighted reopening process. He said there are concerns that this process could place greater stress on the stock if they reopen too slowly. **Noll** said they will also recommend that the LU/LD regime have a focus on mean reversion, to avoid extra halts. He said the Subcommittee agreed that clearly erroneous rules should be consistent with the LU/LD bands.

**Noll** said the Subcommittee also examined market-wide circuit breakers, noting that they examined using the value of the S&P 500 futures product as opposed to the cash value of the S&P 500 Index. He stated that the Subcommittee determined that the current market-wide circuit breaker construct should remain in place. He suggested that the Subcommittee will likely recommend that all markets should open at 9:30 a.m. He suggested that this would have helped to mitigate the ETP LU/LD halts on August 24. He said the Subcommittee will also be examining market maker standards and the closing auction process. He noted that they would also be examining what can done to promote capital formation for small and mid-cap stocks, and he thanked Ted Kauffman for inviting David Weild and others to participate in that discussion. He noted that the Subcommittee has asked for issuer representation on a regular basis.



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**Ketchum** said interim day auctions have not worked optimally, but he has concerns with the Subcommittee's proposal to eliminate them. He questioned whether the Subcommittee examined whether there should be longer periods for readjustments. **Noll** said they examined whether there should be different limit conditions, but most of the Subcommittee felt this was not a good solution. **Nazarali** said the Subcommittee agreed that market halts are disruptive and have the opposite effect of what is intended. He said when stocks are halted "most people leave the marketplace." He expressed support for eliminating the re-opening auction. **Mecane** questioned why the Subcommittee did not recommend conforming to the SPX and SPY constructs. **Noll** said he supported using futures rather than the cash index, but he was in the minority on the Subcommittee.

**Ratterman** asked if there is a way to test, under non-volatile conditions, how the market would react to a market-wide stop in trading. He expressed concern with how the market will react. **Noll** said the Subcommittee has a bias to keep the markets open rather than closed. **Nazarali** stated that when the markets are closed it adds to the panic. He suggested that markets should only close under very extreme circumstances. **O'Hara** said the Committee should examine situations where futures are closed at the open. **Browne** suggested that there is "not much to fear" from market-wide halts.

**Customer Issues Subcommittee Status Report to the Committee**

**Customer Issues Subcommittee Chair Manisha Kimmel (Thomson Reuters)** provided a status report on the work of the Subcommittee. She said the Subcommittee has focused on four issues: (1) understanding retail investor perspective on equity market structure, (2) use of stop order types by retail customers, (3) review execution quality statistics from a retail perspective, and (4) payment for order flow. She said the Subcommittee is expecting to complete its analysis of retail investor protection in the next few weeks and make a recommendation on how the Commission can assess retail investor perception of the equity markets on a regular basis. **Kimmel** said the Subcommittee believes that firms should review their practices regarding stop orders, with an emphasis on educating investors regarding the risks and benefits of stop orders and special considerations around the use of stop orders during volatile market conditions. She stated that the Subcommittee recommends that the SEC and FINRA consider issuing additional guidance to further emphasize the importance of these effective practices relating to stop orders.

**Kimmel** said the Subcommittee sees value in expanding Rule 605 to include all broker-dealers, with a possible exception for small broker-dealers. She suggested that the Subcommittee believes access to Rule 605 and Rule 606 reports should be readily available in a centralized location, possibly the SEC's existing Market Structure Data and Analysis website. She suggested that the general principles of standardization and meaningful disclosure should guide changes to Rules 605 and 606. She said that based on an evaluation of Rule 605 and Rule 606 from a retail perspective, including discussions with retail broker dealers and a review of issues raised in comment letters, the Subcommittee believes there is opportunity for enhancements. She suggested that retail-focused Rule 605 enhancements could include the following: (1) Inclusion of odd-lots; (2) Segregation of Immediate or Cancel (IOC) orders; (3) Inclusion of "quoted spread" and "enhanced liquidity"; and (4) Revision of FAQs regarding methodology to assign an NBBO for orders received in the same second as a quote change.

**Kimmel** noted that the Subcommittee has not come to a consensus on action with respect to payment for order flow (PFOF). She said discussions on PFOF spanned several topics including prohibiting the use of payment for order flow, managing conflicts of interest, and opportunities for enhancing existing or requiring new disclosures.



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**Kimmel** said the Subcommittee's next steps include an examination of institutional order routing and execution quality. She said they will speak to institutional focused groups and plan on meeting with the Chair of the SEC's Investor Advisory Committee's Market Structure Subcommittee and other industry groups.

**Advisory Committee Members**
Matthew Andresen, Headlands Technologies LLC
Reginald Browne, Cantor Fitzgerald & Co.
Kevin Cronin, Invesco Ltd.
Brad Katsuyama, IEX Group Inc.
Ted Kaufman, Duke University Law School and former U.S. Senator from Delaware
Richard Ketchum, FINRA
Manisha Kimmel, Thomson Reuters
Mehmet Kinak, T. Rowe Price Group
Andrew Lo, MIT and AlphaSimplex Group
Joseph Mecane, Barclays PLC
Jamil Nazarali, Citadel Securities, LLC
Eric Noll, Convergex Group
Maureen O'Hara, Cornell University and Investment Technology Group Inc.
Joe Ratterman, BATS Global Markets, Inc.
Nancy Smith, AARP Inc.
Chester Spatt, Carnegie Mellon University
Gary Stone, Bloomberg Tradebook LLC



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