

Intro

Thank you, Heather for the introduction. I am the Senior Securities Policy Advisor for Better Markets. We are grateful for the opportunity to offer our views to the Equity Market Structure Advisory Committee; to Commissioners Piwowar and Stein, both of whom I've had the pleasure of working with in our days at the Senate Banking Committee; and to the SEC staff about the Trading Venues Subcommittee's recommendations that Rick just presented.

If I may, I'd like to briefly introduce my organization, offer some observations on the state of the Exchange-SROs, and then address the specifics of the preliminary recommendations.

Better Markets' Mission

Better Markets is an independent, non-profit organization that fights for the economic security, opportunity and prosperity of the American people by ensuring that finance serves society, and is not a threat to it. We accomplish this goal by advocating for financial reform. We have submitted over 200 detailed comment letters to all of the major financial regulators, and many of them to the SEC. We also conduct research, engage in litigation when necessary, and advocate for reform through all forms of media.

At the same time, Better Markets is a strong believer in markets and market discipline and believes that the private sector is key to ensuring that the economy works for everyone. That, however, requires clear rules of the road that are enforced with no favors to large and politically savvy firms. Ultimately, we want the SEC to succeed in its mission of protecting investors, ensuring the integrity of the markets, and facilitating capital formation.

State of the Exchange-SROs

Exchange-SROs are tasked with writing and enforcing rules that govern all aspect of their members' securities business, including their financial condition, operational capabilities, sales practices, and the qualifications of their personnel. In addition, Exchange-SROs are supposed to surveil the markets to detect rule violations, and objectionable practices such as insider trading and market manipulation. The Commission, aiming to augment its regulatory capabilities, enlists the help of the exchanges because of their proximity to the markets and on the theory that using the wisdom of seasoned practitioners would be beneficial for both the industry and the investors the Commission is statutorily required to protect.

This interdependency between the government and quasi-governmental entities in pursuit of investor protection can work, but it presents extraordinary and inherent risks. It therefore requires the Commission's robust oversight. Or, as the 1961-63 SEC Special Study, which thoroughly examined the securities markets and the self-regulatory model, put it, the Exchange-SROs will need "the pointed stimuli" of the SEC to be effective front-line regulators of the market.

Unfortunately, today's profit-seeking exchanges have morphed into entities that are unrecognizable from the first organized exchange, established under a tree on Wall Street in 1792.

Today's large exchanges are conflicted to the core: On the one hand, they have committed to the Commission and the investing public that they will be the front-line regulators overseeing members who abuse the privileges of their membership and manipulate the markets. On the other hand, they sell data, offer preferential access to markets, and existentially depend on some of the most egregious manipulators of the markets.

How are they supposed to bite the hand that feeds them? Isn't that too much to ask?

The Commission itself has recognized this serious conflict. In a 2004 Concept Release, the Commission warned that "Unchecked conflicts in the dual role of regulating and serving [the markets] can result in poorly targeted SRO rulemaking, less extensive SRO rulemaking, and under zealous enforcement of SRO rules against members." I would add that all these conflicts are intensified when an Exchange-SRO is over-dependent on a few large members.

As competition among profit-seeking Exchange-SROs grows, the increased business pressure of attracting listings and order flow is only making this worse.

The Commission depends on this Advisory Committee to help it rid the markets of abusive practices, and help restore and maintain the investor confidence that is the essential ingredient of strong capital markets.

Unfortunately, today's recommendations, and really, this Advisory Committee's body of work, has yet to begin addressing these serious conflicts and the problems our equity markets face.

The Recommendations are a good start but they do not provide anywhere near complete solutions to our market structure challenges.

I'll now briefly address the Subcommittee's recommendations.

On SRO Immunity: A topical and important issue today is whether Exchange-SROs are immune to lawsuits by members or investors when they design and sell certain potentially harmful products. It is disappointing that the Subcommittee did not come to an agreement on Exchange-SRO immunity. It is clear to us and others that Exchange-SROs cannot have their cake and eat it too. They either should not be in the business of selling data and preferential access to some members who use this access to manipulate markets, or, be ready to face fraud and liability claims by members who feel they are wronged by such abusive practices.

On consistent liability limits and creation of reserve fund: The recommendation would set consistent liability limits and create a reserve fund. We think both recommendations are worthy of serious consideration by the Commission. The reserve fund should be funded by the

industry at levels set by the Commission, which in turn should be informed by real-world episodes of market disruptions caused by the exchanges.

On regulatory centralization: The recommendation would centralize certain regulatory programs under one non-Exchange SRO. As I discussed earlier, today's Exchange-SROs are more conflicted than ever before in their dual role of creating wealth for their own shareholders and regulating the members who help generate this wealth.

We therefore view the Subcommittee's recommendation – perhaps wishfully – through this lens: Any initiative that begins to mitigate this inherent conflict of interest is worthy of serious consideration by the Commission.

Centralizing certain market surveillance may provide some benefits. When the Consolidated Audit Trail becomes operational, it is conceivable that Exchange-SROs will use it to surveil cross-market activities. This surveillance can cause multiple Exchange-SROs to make inquiries to firms who engage in potentially violative practices.

These multiple inquiries can be costly to members, but much more importantly, it can slow the enforcement process down, which will hurt investors. Consolidating cross-market surveillance into one non-Exchange regulator will likely speed up enforcement proceedings and reduce the harm to investors.

Additionally, by putting the responsibility of cross-market surveillance on the shoulders of a non-conflicted SRO, the Commission may end-up encouraging more proactive and vigorous surveillance of the markets.

If the Commission does decide to consolidate cross-market surveillance into one non-exchange SRO, it must also enhance its own oversight of that SRO. The pointed stimuli of the Commission will be especially critical, as more of the surveillance eggs will be in one basket.

Conclusion

Americans who depend on functioning and safe capital markets are harmed because of the conflicts of interests that exist in the Exchange-SRO model. The Commission has both the staff expertise and the tool-kit to address these conflicts. The recommendations offered today are a small step in the right direction, and ought to be given their due consideration. But reliance on the self-regulatory model to fix our market structure problems can only go so far. Commission must forge ahead with additional regulatory measures that will fully address the many challenges we face in today's markets, so they become more fair, transparent, and free from abusive practices.

Thank you for your attention.