

Healthy Markets Association

Statement for the Record

“Solutions in Search of a Problem: Chair Gensler’s Equity Market Structure Reforms”

House Financial Services Subcommittee on Capital Markets

June 27, 2024

Good afternoon, Chair Wagner, Ranking Member Sherman and Members of the Subcommittee;

Healthy Markets Association (HMA) is a not-for-profit member organization focused on improving the transparency, efficiency, and fairness of the capital markets. Healthy Markets promotes these goals through education and advocacy to reduce conflicts of interest, improve timely access to market information, modernize the regulation of trading venues and funding markets, and promote robust public markets. Its members include public pension funds, investment advisers, broker-dealers, exchanges, and data firms.¹ As such, HMA views reforms and changes to market structure thoughtfully and through the lens of its members.

HMA engages market participants, regulators, members of Congress, and other policymakers with extreme frequency, offering detailed commentary regarding the plumbing of our capital markets. HMA has sent more than 65 detailed comment letters addressing capital markets regulation under the Biden Administration alone.²

HMA appreciates the Subcommittee’s interest in market structure reform and welcomes the opportunity to submit this statement for inclusion in the record of today’s hearing.

I. HMA Supports Reforms to Market Structure Rules Pertaining to SRO Filings

At the heart of our market structure are about two dozen national securities exchanges,³ about seventy five Alternative Trading Systems,⁴ and hundreds of additional off-exchange trading venues on which U.S. investors buy and sell securities.⁵

¹ To learn about HMA or our members, please see our website at <http://healthymarkets.org>

² A complete list of HMA’s communications with regulators, members of Congress, and the Biden Administration, is accessible at <https://healthymarkets.org/publications/regulatory-letters-testimony>

³ See: <https://www.sec.gov/rules/sro>

⁴ See: <https://www.sec.gov/foia/docs/atstlist>

⁵ See: <https://otce.finra.org/otce/mp-list>

Because of their central roles in our capital markets, national securities exchanges are required by law to file changes to their rules and fees with the SEC. The SEC, in turn, is obligated to review exchange filings and determine that those filings are consistent with the law.

The law also requires the SEC to ensure that SRO fees reflect “an equitable allocation of reasonable dues, fees, and other charges”; are “not ... designed to permit unfair discrimination between customers, issuers, brokers, or dealers”; and do “not impose any burden on competition not necessary or appropriate in furtherance of the purposes of” the Act.

SEC rules further stipulate that exchanges have the “burden to demonstrate that a proposed rule change is consistent with the [Exchange Act] and the rules and regulations issued thereunder.”

Unfortunately, in recent years, exchanges have increasingly flouted and even abused “effective on filing” privileges to inflate fees for market data and connectivity, often without any basis or justification.⁶ In the absence of clear SEC rules or evaluation procedures put in place by the SEC, and in the absence of competition, exchanges fees have increased at rates that bear little relationship to reality.⁷

Accordingly, HMA believes that Congressional attention to the SEC’s ongoing failure to meaningfully review or analyze SRO fee filings to assure their conformity with the requirements of the Exchange Act should be central to any Congressional discussion of market structure reform. We also reiterate our call for Congress to require the Commission to revise its SRO rule change filing processes to ensure that fee filings comply with the Exchange Act and Commission rules and better protect investors and other market participants.

II. HMA Perspective on Certain SEC 2022 and 2023 Market Structure Proposals

On December 14, 2022, the SEC announced four rule proposals (“proposed rules” or “proposals”) that would make changes to the way the stock market functions.⁸ A fifth proposal, released in October 2023, aims to address other issues related to equity market trading.⁹

⁶ For just one example, in 2022 alone MEMX has filed the same exact rule changes increasing connectivity fees four times, has been able to continue to collect hundreds of thousands of dollars from market participants for connectivity fees, despite the fact that the fees have subsequently been suspended and withdrawn, and despite clear evidence that such fees are likely inconsistent with the Exchange Act’s requirements.

<https://healthymarkets.org/wp-content/uploads/2022/06/6-28-22-MEMX-Connectivity-and-Data-FINAL1.pdf>

⁷ See, for example, HMA’s recent letter to the SEC regarding filings by the Cboe family of exchanges. May 10, 2024.

<https://healthymarkets.org/wp-content/uploads/2024/05/CBOE-5th-Port-Filing-Letter-May-2024-2-merged-1.pdf>

⁸ SEC, *SEC Proposals: Market Structure* (Dec. 2022).

⁹ SEC, SEC Proposes Rule to Address Volume-Based Exchange Transaction Pricing for NMS Stocks (Oct. 18, 2023).

HMA has commented extensively on the Commission’s proposals.¹⁰

HMA’s perspectives on the various recent SEC proposals are summarized in this statement, but we encourage the Subcommittee to view them in their entirety of our website.¹¹

Broadly speaking, although HMA supports the objectives and intentions of many of the proposals, HMA has a number of specific concerns with some of the proposals that must be addressed for the proposals to have a positive impact on market structure and investor protection. Should they not be improved and implemented carefully, in their present form, some of the proposals stand to have negative consequences for market structure.

a) HMA Supports Enhanced “Best Execution” Rules but has Concerns with SEC Proposal

HMA has long been concerned about weak and ambiguous best execution obligations for broker-dealers (BDs) and investment advisers (IAs). Accordingly, HMA has for many years encouraged the Commission to adopt more detailed best execution requirements for both BDs and IAs. In that respect, we welcome the Commission’s present interest in adopting its own best execution rule for brokers.

At the same time, HMA is concerned that, as proposed, the Commission’s 2022 best execution rule proposal would create new gaps in protections for institutional investors.

Accordingly, should the SEC finalize the proposal, HMA urges that it revise the proposal to ensure that it, at a minimum, meets existing quality of care requirements for all investors as per the existing FINRA rules and guidance. Alternately, the Commission may prefer to simply abandon the proposal and instead urge FINRA and the MSRB to improve their existing rules.¹²

b) HMA Supports the SEC’s Proposed Rule to Modernize Rule 605

Timely, reliable, and useful statistics about order execution information from trading venues is essential to empowering investors and their brokers with the information they need to make sound order routing decisions. HMA strongly supports the SEC’s recently finalized Rule 605 amendments.

HMA has advocated modernizing Rule 605 for many years, including by making recommendations to the Commission itself and the Commission’s now-defunct Equity Market Structure Advisory Committee. The previous metrics– which are decades-old– are wildly

¹⁰ <https://healthymarkets.org/publications/regulatory-letters-testimony>

¹¹ Ibid

¹² See HMA Comment Letter to SEC RE Best Execution; disclosure of order execution information, regulation NMS, and the order completion rule (March 31, 2023), available at healthymarkets.org/wp-content/uploads/2023/03/Market-Structure-Comment-Ltr-to-SEC-3-31-23-Final.pdf

outdated. Updating these metrics to reflect modern trading practices and time horizons will greatly enhance competition for order flow and investors' abilities to achieve best execution.

c) HMA Supports Significant Changes to the SEC's Proposed Rule on Tick Fees and Odd Lots.

HMA has expressed support for provisions in the SEC's Tick, Fees, and Odd Lots Proposal to permit quotation increments to be narrower on the majority of NMS stocks, and standardize trading increments across all trading venues, including ATs and OTC market makers.

At the same time, HMA has suggested the Commission adopt significant revisions to the proposal to reduce the complexity and implementation risks, by suggestions such as reducing the number of tick and fee buckets. We believe the revisions recommended by HMA are of significant import and critical to ensuring the rule's fair and equitable application.

d) HMA Takes No Position on the SEC's Order Competition Proposal

HMA takes no position regarding the SEC's Retail Order Competition Proposal, which would create a new Rule 615 that would establish an order-by-order competition requirement for some retail orders. However, HMA has offered some observations related to this proposal that arise from the interplay between other proposals and existing SEC rules.¹³

e) HMA Believes the SEC's Proposal on Volume-Based Exchange Transaction Pricing for NMS Stocks in an Inadequate Half-Step

HMA commented on the recent proposals on Volume-Based Exchange Transaction Pricing for NMS Stocks,¹⁴ and Proposed Rule Change Relating to Alternative Display Facility New Entrant.¹⁵ In its commentary, HMA noted that while the proposal recognizes some of the problems with aggregate volume-weighted pricing tiers, the Commission has proposed an inadequate half-solution that would not fully address the identified market ailments and investor harms, and may create or exacerbate market inequalities and distortions.

HMA believe the Commission must revise the proposal to ensure that all pricing tiers (i.e., incentive payments or fee levels) are based upon the characteristics of the orders themselves (i.e., whether taking liquidity or not, whether a limit order, etc.), as opposed to the characteristics of the parties sending the orders; abandon its deeply flawed, unjustified distinction between agency and principal trading; provide that details of all pricing tiers, including numbers of transactions, firms who qualified, and dollars paid for each tier are publicly disclosed on a monthly basis; and ensure that the proposed reforms apply to any trading venues that enjoy protected quotations.

¹³ HMA Comment Letter on Order Competition Rule, File No. S7-31-22.

<https://healthymarkets.org/wp-content/uploads/2023/03/Market-Structure-Comment-Ltr-to-SEC-3-31-23-Final.pdf>
(March 2023)

¹⁴ File No. S7-18-23)

¹⁵ File No. SR-FINRA-2022-032).

Tiered pricing schedules that allow for registered securities exchanges to implement pricing practices that favor specific customers are facially discriminatory and anti-competitive, inequitable, and harmful to investors.¹⁶ Therefore, it is imperative that any proposed reform in this area is done correctly with this significant consideration in mind.

f) HMA Strongly Supports the SEC’s Consolidated Audit Trail

Lastly, HMA has long supported the Commission’s use of the Consolidated Audit Trail (“CAT”). The CAT is a critical tool that enables securities regulators to understand how our capital markets work. By empowering the Commission to see what’s actually happening in the markets, the CAT ensures regulators are not exclusively dependent upon the often-cherry-picked data and analysis of self-regulatory organizations and interested market participants and academics (who may have limitations and incentives that undermine their reliability).¹⁷

HMA opposes any efforts to undermine the CAT and preserve investor protection.

III. Conclusion

Thanks for the opportunity to offer a statement.

¹⁶ HMA has repeatedly expressed concerns with preferential pricing practices that discriminate against smaller volume trading firms, and distort brokers’ order routing decisions in ways that often harm investors, for years. See, e.g., Letter from Tyler Gellasch, HMA, to Brent J. Fields, SEC, Oct. 12, 2018, available at <https://www.sec.gov/comments/sr-nyse-2018-40/srnyse201840-4510950-175996.pdf>; Letter from Tyler Gellasch, HMA, to Brent J. Fields, SEC, Nov. 13, 2018, available at <https://www.sec.gov/comments/sr-nyse-2018-49/srnyse201849-4640899-176435.pdf>; Letter from Tyler Gellasch, HMA, to Hon. Gary Gensler, SEC, Nov. 16, 2022, available at <https://healthymarkets.org/wp-content/uploads/2022/12/HMA-Ltr-re-Volume-Based-Pricing-11-16-22-1.pdf>; Letter from Tyler Gellasch, HMA, to Vanessa Countryman, SEC, at 10, Mar. 31, 2023, available at <https://healthymarkets.org/wp-content/uploads/2023/03/Market-Structure-Comment-Ltr-to-SEC-3-31-23-Final.pdf>; Letter from Tyler Gellasch, HMA to Hon. Gary Gensler, SEC, Aug. 1, 2023, available at <https://healthymarkets.org/wp-content/uploads/2023/08/Ltr-to-SEC-re-Pricing-Tiers-August-1-2023-1.pdf>.

¹⁷ For a detailed discussion of HMA’s views related to the CAT, see Testimony of Tyler Gellasch, Executive Director of the Healthy Markets Association, Hearing on Implementation and Cybersecurity Protocols on the Consolidated Audit Trail, Before the House Financial Services Committee, Subcommittee on Capital Markets, Securities and Investment. November 30, 2017. https://democrats-financialservices.house.gov/uploadedfiles/11.30.2017_tyler_gellasch_testimony.pdf