

ISEEE Meeting, Sarasota Florida
April 1, 2016

WASHINGTON OUTLOOK: What are the regulatory and legislative developments that will most influence equity trading in 2016?

I. SEC

A. *Overview:* We expect the Securities and Exchange Commission to continue its focus on implementing the tick size pilot program, reviewing U.S. equity market structure and developments (including, through the Equity Market Structure Advisory Committee (“EMSAC”)), and advancing several rulemakings.

B. Tick Size Pilot:

1. Background: On November 6, 2015 the Securities and Exchange Commission (SEC) [issued](#) an order **delaying the implementation of the Tick Size Pilot Program until October 3, 2016**. The order explains that several actions need to occur before the Tick Size Pilot can be implemented, including: “(1) the development and testing of applicable trading and compliance systems;” “(2) the filing and approval of SRO rules related to the Tick Size Pilot’s quoting and trading requirements;” and “(3) the development and implementation of the written policies and procedures by Participants and their members that are reasonably designed to comply with the applicable quoting and trading increments.” The Participants are also required to collect and report certain data beginning six months prior to the start of the Pilot, which would now be April 3, 2016. The order notes that the five month delay is needed because “to date, the requisite SRO rule proposals have not been filed or approved by the SEC and there has not been an opportunity to develop and test applicable trading and compliance systems.”
 - a. The implementation of the Tick Size Program was initially to occur on May 6, 2016. The pilot will be for a two year period and consist of a control group and three test groups each with 400 securities.
 - b. The Exchanges have begun to file their proposals with the SEC on how they will implement the data collection requirement of the Tick Size Pilot.
 - c. In January the NYSE proposed rules for the “trade-at” portion of the Tick Size Pilot that are more restrictive toward dark pools than proposals by BATS and FINRA, which has prompted questions about whether the dispute could further delay the program’s October 2016 start date.

C. August 24 Market Volatility Report:

1. The [research note](#) did not reach legal conclusions or determine the causes of the market volatility, but it states that the SEC staff continues “to examine a broad

spectrum of issues related to trading on August 24”. This suggests the potential for further SEC action on these issues, including the following listed in the report:

- a. factors related to volatility in Exchange Traded Products (ETPs) and other securities, “including the nature of selling pressure, sources of liquidity provision, and, for ETPs, create and redeem activity;”
- b. the effect of Regulation SHO short sale restrictions (SSRs);
- c. the primary listing exchanges’ opening process, “including the nature of trading prior to and immediately after the opening auction on the primary listing exchange;”
- d. the reopening process following Limit Up/Limit Down (LULD) halts, “including the nature of participants in the reopening auctions on primary listing exchanges and the rules and practices employed by exchanges in connection with reopenings;”
- e. how the LULD Plan has operated, “particularly as it applies in the period following the opening of regular trading hours and to reopenings following LULD halts;” and
- f. how the market-wide circuit breakers operated, “particularly as they apply in the period following the opening of regular trading hours.”

D. Equity Market Structure Advisory Committee (EMSAC)

1. The SEC EMSAC has conducted three meetings since its Membership was announced a little over one year ago (January 13, 2015).
 - a. May 13, 2015 meeting: Discussion at the first meeting focused on Rule 611 of Regulation NMS, known as the “Order Protection Rule” or “Trade-through Rule.”
 - b. October 27, 2015 meeting: Discussion of Rule 610 (Access Rule); Regulatory Structure of Trading Venues; and Discussion of August 24 Market Volatility.
 - c. February 2, 2016 meeting: Discussion of market volatility and the events of August 24, and “Certain Issues Affecting Customers in the Current Equity Market Structure,” including “Risks of Market Orders and Stop Orders,” Payment for order Flow, and Execution Quality Reports.
 - d. The next EMSAC meeting is scheduled for April 26, 2016. The meeting is expected to include discussion and votes on recommendations to create a maker-taker pilot program.

2. Four EMSAC Subcommittees have each held at least three meetings. The four subcommittees are:
 - a. Regulation NMS Subcommittee (Kevin Cronin, Chair)
 - b. Trading Venues Regulation Subcommittee (Richard Ketchum, Chair)
 - c. Customer Issues Subcommittee (Manisha Kimmel, Chair)
 - d. Market Quality Subcommittee (Eric Noll, Chair)
3. Subcommittees are examining issues such as:
 - a. access fees and a potential pilot program;
 - b. market data (which several subcommittees are examining);
 - c. ETF trading and August 24 event more generally (including LULD and erroneous process);
 - d. NMS Plan governance;
 - e. the regulatory model for trading venues; and
 - f. additional disclosures under Rules 605 and 606 for order flow.
4. It is notable that several Subcommittees are examining market data fees, which have become an emerging issue in the broad review of equity market structure.
5. The Regulation NMS Subcommittee is expected to consider recommendations on the creation of a maker-taker pilot program, which the EMSAC is expected to consider at its April 26 meeting.

E. Investor Advisory Committee (IAC)

1. The IAC has also examined some market structure issues in the past, including:
 - a. Receiving an SEC staff briefing on market structure and a proposed market structure advisory committee (July 2014)
 - b. Draft recommendation for the Market Structure Subcommittee of the IAC concerning T+2 Settlement (February 2015)
 - c. Receiving updates on (February 2015):
 - i. FINRA's CARDS proposal; and

- ii. MSRB and FINRA proposals for improved disclosures in fixed income securities
- d. Discussion of August 24 Market Volatility, and Discussion of ETF Pricing (October 2015)
- 2. The IAC met on January 21, 2016 to discuss several issues including fixed income market structure and pre-trade price transparency; a draft letter to the Financial Accounting Standards Board (FASB) regarding materiality; crowdfunding rules; and Nasdaq listing standards-shareholder approval rules.
- 3. Steven Wallman (Chairman of the IAC's Market Structure Subcommittee, and Founder and CEO of Foliofn, Inc.) has explained that the Subcommittee has had some interaction with the EMSAC, and that it will weigh in with the EMSAC as necessary.
- 4. The next IAC meeting is tentatively scheduled for April 14, 2016.

F. IEX Exchange Application:

- 1. In addition to oversight of the SEC's efforts on market structure initiatives (including EMSAC), there has been considerable attention paid to the IEX Exchange application. IEX and some of its detractors have lobbied Senate Banking Committee and House Financial Services Committee offices on their respective views of the IEX exchange application.
- 2. The IEX Exchange filing was [published](#) in the Federal Register on September 22, 2015. Many [comments](#) have been received on this filing.
- 3. On March 19, the SEC again delayed the decision in the IEX case but released a "[Proposed interpretation and request for comment](#)", which may indicate they might be supportive of the IEX application as modified. The request for comment will have a 21 day comment period from publication in the Federal Register which would put the deadline at June 18. In the request for comment the SEC states:

"Specifically, the Commission preliminarily believes that, in the current market, delays of less than a millisecond in quotation response times may be at a de minimis level that would not impair a market participant's ability to access a quote, consistent with the goals of Rule 611 and because such delays are within the geographic and technological latencies experienced by market participants today."

- 4. On March 17, a [report](#) published by equity broker Weeden & Co. acknowledged the benefits of IEX's innovative model for institutional investors. However, the

report suggests that “the rules suggesting that IEX’s quotes should be denied trade-through protection should be upheld.”

G. *Rulemakings*

1. On March 25, 2015, the Commission proposed a rule that would eliminate an exemption from national securities association membership requirements for broker-dealers that trade in off-exchange venues.
2. Proposed amendments to Regulation ATS, requiring increased disclosures and regulatory requirements on ATSs (comments were due February 26, 2016)
 - a. Proposed anti-disruptive trading rule intended to address the use of “destabilizing” trading strategies in vulnerable market conditions.
3. On February 19, SEC Chair White spoke at the 45th Annual “SEC Speaks.” During her remarks Chair White discussed several priorities related to equity market structure including:
 - a. the SEC will focus on [finalizing proposed](#) rules that would create a more narrow exemption from FINRA membership for brokers or dealers with no customers and that effect transactions on a national securities exchange;
 - b. finalize [proposed amendments](#) to Regulation ATS;
 - c. propose enhancements to order routing disclosures;
 - d. propose risk controls on algorithmic trading.
 - e. continue to advance initiatives to strengthen equity market infrastructure; and
 - f. the SEC “will soon notice for comment” the NMS Plan governing the Consolidated Audit Trail (CAT).
 - g. In other statements, Chair White has also mentioned proposing anti-disruptive trading rule intended to address the use of “destabilizing” trading strategies in vulnerable market conditions.

II. Congress

A. *SEC Nominees*

1. On March 15, the Senate Banking Committee held a hearing on the nominations of Lisa Fairfax and Hester Peirce to be Commissioners to fill the two vacancies at the SEC. Senator Charles Schumer (D-NY) stated that he is leaning toward

opposing the SEC nominations unless they provide better answers with respect to disclosures of corporate political spending. Senator Robert Menendez (D-NJ) also expressed reservations about the nominations due to their responses on this issue.

2. The nominees will be packaged together, so that they are either both confirmed or not confirmed.
3. The Committee has scheduled a vote of nominations on April 7; however, the two SEC nominees are not expected to be among those being considered that day. We still expect the Committee to advance the nominees, likely in April, with the full Senate considering the nominees soon thereafter.

B. Other Hearings and Legislation:

1. The Republican-controlled Senate Banking Committee and the House Financial Services Committee have numerous legislative and hearing priorities (such as regulatory relief, oversight of the Federal Reserve, Dodd-Frank Act reforms, insurance issues, fixed income market, and capital formation related issues), but equity market structure issues remain a significant interest. It is unlikely that they will legislate on market structure issues; instead, involvement is expected to be in the form of oversight hearings and potentially letters to the SEC.
2. The Senate Banking Committee's Subcommittee on Securities held a March 3 hearing on equity market structure, with Trading and Markets Director Stephen Luparello and FINRA Chairman Richard Ketchum testifying. SEC Division of Trading and Markets Director indicated that the SEC plans to move forward on publishing the CAT for comment, proposing a rule on institutional order routing transparency, proposing an anti-disruptive trading rule, and considering a maker-taker pilot program.
 - i. The IEX exchange application did not come up during any of the hearing.
 - ii. Subcommittee Chairman Mike Crapo (R-ID) stressed the need to examine the fixed income markets, and he expressed a frustration with the pace of the SEC's review and implementation of some market structure reforms.
 - iii. Subcommittee Ranking Member Mark Warner (D-VA) urged the SEC to quickly move forward with a maker-taker pilot program and finalizing the Consolidated Audit Trail (CAT).
 - iv. Senator Elizabeth Warren (D-MA) raised concerns with self-regulation and FINRA, particularly with financial advisers and brokers who have criminal, civil or regulatory misconduct and who are still in the industry.

3. There could be other Congressional hearings and/or roundtables on equity market structure.
4. 2016 is an election year, so the Congressional legislative calendar is shorter, but as evidenced in the March 3rd Senate hearing, they will still closely watch what the SEC does.
5. There may be legislative proposals introduced although market structure legislation is unlikely to be advanced.
 - i. Representative Robert Hurt (R-VA) is drafting legislation to address NMS Plan governance. This further shows the increased frustration with escalating exchange market data fees. It is unlikely that this legislation will move but it is an example of the increased interest in this issue.
 - ii. As evidenced at the March 3 Senate hearing, some members of Congress have expressed frustration with the pace of the SEC's review of equity market structure, even in light of the formation of the SEC's Equity Market Structure Advisory Committee.
 - iii. Several bills have been considered by the House Financial Services Committee dealing with capital formation and regulatory burden reduction.

C. Venture Exchange Legislation:

1. One area of legislative interest from several members (including Senator Mike Crapo (R-ID) and Representative Scott Garrett (R-NJ)) relates to venture exchanges.
2. The House Financial Services Committee approved the “[Main Street Growth Act](#)” on a partisan vote of 32-35, that would allow the creation of venture exchanges to serve small-cap and pre-IPO companies.