

## SEC Equity Market Structure Advisory Committee: A Conversation with Jamil and Joe.

Are U.S. equity markets operating efficiently? Can improvements be made to benefit investors? Recently, the SEC created the Equity Market Structure Advisory Committee to advise on potential reforms aimed at improving market integrity and advancing the interests of investors. To learn more about the Committee and the issues it is examining, we spoke with two Committee members, Jamil and Joe.

### ***Why did the SEC form the Equity Market Structure Advisory Committee?***

**Jamil:** The Committee was formed because Chair White and the SEC wanted a broader set of insights to help guide regulatory strategy. The SEC, Politicians, and Academics get lobbied heavily, especially by my Firm. For example, Ken made a \$150 million contribution to Harvard. That paid dividends when Harvard made claims and produced research that supports my argument that the markets have never been better. Now my Firm keeps making billions and we get to point to the academic research. That's the way the world works. Nevertheless, when this Committee was announced, we knew we had to be on it to protect our interests. Ken pulled out all the stops to make that happen.

### ***How is the Equity Market Structure Advisory Committee structured?***

**Joe:** There are 17 members representing a diverse range of views – including exchanges, large institutions, program trading, regulatory bodies, academics, the AARP, broker-dealers, wholesalers, and a former U.S. senator, among others. When you think about it, it's a perfect stalemate. Our good Lord will allow hell to freeze over before this Committee makes any changes that have a shot of improving the market for investors at the expense of either of our Firm's.

**Jamil:** I'd say the composition is mostly right. The SEC purposely didn't put retail brokers on the Committee because they knew they'd come under attack for selling out their clients on every single trade. For that reason, Joe and I placed a few calls to some firms we like to call our "retail advisory council". They've got our back, and we've got theirs.

**Joe:** We want to create the appearance that retail brokers are completely plugged into the process. So after each SEC Committee meeting, we break bread and drink expensive wine with the retail advisory council. Jamil hands out the payment for order flow checks while I discuss how we're going to keep everything status quo. Nobody wants to rock any boats. Nobody.

### ***Why does the SEC feel now is the right time for this Committee?***

**Jamil:** Over the last 10 years, markets have gone through a sweeping transformation, resulting from advancements in technology and the implementation of Regulation NMS (National Market System). We've made a shit ton of money in the process. But now some people are saying the game is rigged, so we figured we'd better get ahead of it before anybody tries to change the rules on us.

**Joe:** I thought we agreed we weren't going to say the "R" word.

**Jamil:** Freudian slip, sorry. So Ken told me I better get my ass on this Committee, otherwise the SEC would have a lot of individuals advocating their own interests in isolation. And Ken is the only person who gets to do that. So we figured, okay, let's get everybody in a room together and find out who's got the biggest wallet.

**Joe:** The Committee was formed with the help of our lobbyists who also helped set the agenda. The SEC wants us to put on a show about how the retail investor has never had it better. We're going to give them that show. We'll use phrases like "holistic review" and "price improvement". But when all's said and done, we ain't changing a thing that could affect our profits.

***What is it the current state of the U.S. equities markets? What areas are most in need of reform?***

**Jamil:** My firm has this mantra: "The markets work extraordinarily well. The U.S. equities markets are the envy of the world. And over the past 10 years, the markets have become better, faster and cheaper for both retail and institutional customers." I love that phrase. It's like Nanex kryptonite.

For retail investors, they have no idea how much money we make at their expense. So who cares!? We keep paying off the politicians, the academics, and the retail brokers, so who really gives a shit.

The SEC and most of the Committee members just want to ensure we put on a good show. We know Kaufmann and the Canadian guy will complain that the market is broken and Gary will try to look smart referencing studies that contradict everything that anyone else says. But frankly, the "market is broken" story is so 2014, investors don't give a shit. Everyone is focused on Caitlyn and Greece. So let's just move on.

**Joe:** I have to admit, I go to church every week and ask God for the strength to keep me from saying that the markets are fundamentally broken. And he reminds me to think positive and ask, "What could we do now that would lead to an even better market?"

***That's a good segue into potential market structure reforms. From your vantage point, what are the most important areas for improvement?***

**Joe:** At the end of the Committee's first meeting, I suggested one reform that all my Exchange Owners and Board members agreed was inevitable: Devising a new set of transparency standards around order routing and ATS (Alternative Trading System) venue operation to give customers more information about how their orders are handled. Any regulatory change that adds superficial transparency to how order routing systems and market centers operate would be beneficial, provided it falls short of how Wall Street actually butters its bread. Even as an exchange which is known for its transparency, cocktail napkins aside, we could provide more data about market execution quality. The standards in this area are so outdated and nobody looks at it anyway.

Second, access fees. My owners are hammering me to lower their execution cost. So I'm caught between a rock and a hard place. Lord give me the strength.

**Jamil:** Joe is right. By the way, I want to make the point that anything Canada has been a disaster for me, both personally and professionally. The Canadians are all clueless.

But let's talk about what we can control. There are a few potential areas for improvement in the U.S. Damn do I hate Canada. First, the pricing of market data by exchanges is insane. Exchanges have to file their pricing with regulators, but to some extent exchanges can charge whatever they want for data. Anybody who needs that faster Exchange direct feed data to know when to trade against outdated quotes has to pay up. They need the data to be able to operate a profitable Wholesaling business. This gives exchanges extraordinary power over my own profits, so it should be regulated.

Second, my Firm has consistently called for enhancements to the market that enhance the integrity of the underlying operation of the markets. Kill switches are one important example that we have been advocating for some time. The extent to which we can make these mandatory, simple and consistent will make the markets safer. The obvious example of why kill switches are vital is the Nightmare. That type of error could happen again and there is no mechanism to stop it. If that happens here, Ken will chain me to a post on the corner of South Pulaski and West Lex and never come back to get me.

Finally, we'd like to see some reforms with the SRO (Self-Regulatory Organizations) statuses of exchanges. Exchanges have evolved into for-profit institutions, but they are classified as Self-Regulatory Organizations (SRO). I think the SEC should see if that's still appropriate. And let me be clear: NYSE and NASDAQ are the problem.

***Joe, what's your perspective on market data charges, kill switches and exchange regulation?***

**Joe:** We've historically charged significantly less for market data than NYSE and NASDAQ. But we've been justifying our merger with Edge on the basis of increasing the value of our data. So we'll start raising fees too. This is a for-profit business and God tells me I deserve a second shot at that IPO. We're not running the Sunday afternoon soup kitchen.

On kill switches, we completely agree. Our owners are the biggest trading Firms in the Country. If one of their 20-something programmers decides he wants to become instantly famous, he might decide to shut down an exchange risk check while broadcasting himself live on Meerkat. We need to be able to stop these kids. They're out of control with this instant gratification.

With regards to SRO status, that's a sticky topic. From a regulatory perspective, exchanges are theoretically supposed to provide a public good. Have we turned a blind eye? Sure. But we're going to continue to lean on the legal precedents that had been set prior to the Exchange IPOs as long as we can. It's even working right now in that Providence case. Let's just keep this party going.

***What other ideas were put forward at the Committee's first meeting?***

**Jamil:** The most common idea put forward by all the brokers was reducing access fees. Under Reg. NMS, the SEC put a cap on access fees – how much you can charge someone for accessing your quote. If we can lower the broker access fee costs while claiming we've done something good for investors, I'd call that a big win.

Joe's replacement announced a great counter proposal. Instead of using the one-size-fits-all approach, we should switch to a more bespoke model that benefits both the exchanges and the brokers. The most active securities, where there's tons of liquidity, could see lower access fees. For others, fees might go higher. This approach would encourage HFT to post quotes and also improve liquidity.

**Joe:** I thought we agreed we wouldn't say "HFT".

**Jamil:** True, but I used it in the context of improving liquidity.

**Joe:** Listen, everyone agreed access fees should be examined. But it's important to remember that exchanges are a business. We have costs, and we have to charge for our services. For the past 15 years, market-makers have had an incentive to post a quote out loud, for taking risk – it's inherent in the way equity

markets have worked for a long time. To say we should just get rid of that model doesn't make sense to me. If we don't offer economic incentives, our volume and revenues will decline. And there goes my IPO.

The other polarizing suggestion is that there should be a "trade-at" rule – basically directing all liquidity to exchanges and saying dark pools can only execute if they price improve by half the spread or else they can't participate in the national markets. I was frankly disappointed to see the "trade-at" pilot the SEC put in place. It's just a pet idea discussed at spin class between Farley and Jackman.

**Jamil:** The simple explanation for a "trade-at" rule is that it would drive most trading back onto exchanges. Over the last 10 years we've seen a lot of trading move off exchanges. We kept Joe in his position to continue to advocate for his Broker Owners. "Trade-at" would benefit the exchanges and hurt his owners' dark pools. NYSE and NASDAQ are pushing it. But Joe is advocating for what is right for his Owners. I can't overstate how important Joe's voice is.

**Joe:** Hallelujah.

***Can you tell us about the agenda of the May 13 meeting? Why did the SEC lead with the trade-through rule?***

**Joe:** The SEC picked a good place to start. Market structure is such an interconnected topic, so the SEC purposely went to the heart of things – the competition of today's market, which is supported by trade-through protection. This will take us down such a convoluted path, there will never be any changes made that could affect our profits or the profits of our owners.

**Jamil:** Originally, when I saw the agenda, I was glad to see that Ken was able to keep it that simple. This was not surprising because he's so cunning. I knew that the trade-through rule created competition among incumbent exchanges, and it drove a lot of the efficiency we like to claim about the market. It fits right with our mantra: "The markets work extraordinarily well. The U.S. equities markets are the envy of the world. And over the past 10 years, the markets have become better, faster and cheaper for both retail and institutional customers." I can't tell you how much I love that phrase.

***How do you see the Equity Market Structure Advisory Committee progressing? Two years from now, how much change do you think the Committee will drive?***

**Joe:** Change will proceed slowly, just ask Jamil.

**Jamil:** The U.S. equity markets are the envy of the world. The first responsibility of this Committee is not to jeopardize the status quo. If the Committee moves too fast to make changes that could affect our profits, we'll lobby for a legislative change that distracts the SEC. That is my directive.

***What does it mean for your organizations to be involved in this Committee?***

**Jamil:** Let me be clear, we would not have it any other way.

**Joe:** My exchange grew up as an alternative to the entrenched monopolies, catering to our founders that were faster than everyone else. We've made a lot of money for those guys just acting as a vessel for them to profit. For us to be able to mention our participation in this Committee as part of the roadshow for our second IPO, is critical to reestablishing credibility after that first debacle.