115TH CONGRESS
2d Session
HOUSE OF REPRESENTATIVES
REPORT
115–883

EXCHANGE REGULATORY IMPROVEMENT ACT

AUGUST 3, 2018.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. HENSARLING, from the Committee on Financial Services, submitted the following

R E P O R T

[To accompany H.R. 3555]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 3555) to amend the Securities Exchange Act of 1934 to provide that the definition of a facility of an exchange does not apply to a line of business the purpose of which is not to effect or report a transaction on an exchange, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Exchange Regulatory Improvement Act".

SEC. 2. FINDINGS.

The Congress finds the following:

(1) Over time, national securities exchanges have expanded their businesses beyond listings and trading to include the sale of additional products and services to their members and listed companies.

(2) The Securities and Exchange Commission should be transparent in its interpretation of the term "facility" in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

SEC. 3. FACILITY DEFINED.

(a) IN GENERAL.—Not later than 360 days after the date of enactment of this Act, the Securities and Exchange Commission (the "Commission") shall adopt regulations to further interpret the term "facility" under section 3(a) of the Securities Exchange Act of 1934. Such regulations shall set forth the facts and circumstances the Commission considers when determining whether any premises or property, or the right to use any premises, property, or service is or is not a facility of an exchange.

(b) APPLICATION TO PROPOSED RULES.—The Commission shall apply the facts and circumstances set forth in the regulations issued pursuant to subsection (a) in determining whether any proposed rule is or is not required to be submitted as a pro-

posed rule filing pursuant to section 19 of the Securities Exchange Act of 1934 and the rules and regulations issued thereunder.

Amend the title so as to read:

A bill to require the Securities and Exchange Commission to issue regulations to further interpret the term "facility" under the Securities Exchange Act of 1934.

PURPOSE AND SUMMARY

On July 28, 2017, Representative Barry Loudermilk introduced H.R. 3555, the "Exchange Regulatory Improvement Act". As modified by an amendment in the nature of a substitute, H.R. 3555 acknowledges that over time national securities exchanges have expanded their businesses beyond the listing and trading of securities to include the sale of additional products and services to their members, market participants, and listed companies. This bill requires the U.S. Securities and Exchange Commission (SEC or Commission) to more clearly communicate to the public how it regulates national securities exchanges and set forth the facts and circumstances it considers for what is or is not a "facility" of an exchange and to apply those facts and circumstances in determining whether any proposed rule is or is not required to be submitted as a proposed rule filing.

BACKGROUND AND NEED FOR LEGISLATION

The SEC oversees twenty-one national securities exchanges (equity and options). A national securities exchange is a securities exchange that has registered with the SEC under Section 6 of the Securities Exchange Act of 1934 (Exchange Act). The SEC's Division of Trading and Markets (Division) assists the Commission to execute its responsibility to maintain fair, orderly, and efficient markets, which is one-third of the SEC's Congressionally mandated mission. The Division provides day-to-day oversight of these national securities exchanges, reviews, and in some cases approves under authority delegated from the Commission, proposed new rules and proposed changes to existing rules filed by these national securities exchanges. All rules and rule amendments filed and approved by the SEC are pursuant to Section 19 of the Securities and Exchange Act of 1934 and Rule 19b–4 thereafter.

The goal of H.R. 3555 is to enhance regulatory clarity and transparency as national securities exchanges business models evolve by requiring the SEC to set forth the facts and circumstances it considers in determining what is a "facility" of an exchange and to apply those in determining whether a proposed rule is or is not required to be submitted as a proposed rule filing. Section 3(a)(2) of the Exchange Act defines a "facility" of an exchange to include four parts: the premises of the exchange, property of the exchange, the right of an exchange to use any premises or property or service, or any right of the exchange to use any such property or service.

Securities exchanges in the United States historically have been member-owned and -operated entities. In 1998 the SEC confirmed that exchanges could structure as for-profit entities, and many securities exchanges have converted to demutualized and shareholder-owned entities. Consequently, exchanges have placed an increased emphasis on the profitability of business lines that go beyond the traditional exchange businesses to list and trade securi-

ties and ensure compliance with exchange rules and the actual regulatory activity of operating the exchange itself. Some of these non-traditional businesses developed by national securities exchanges include regulatory compliance software, e-mortgage registries, and data analytics.

The Committee is concerned that as exchanges have worked to innovate and grow these business lines, the SEC has asserted its jurisdiction and made regulatory inquiries (such as requests to examine the "books and records") regarding business lines that are unrelated to effecting or reporting a transaction on a national securities exchange—in other words, product and services that are not so connected to the activity of regulating an exchange that they deserve the same scrutiny as the core regulated functions of the exchange. As a result, exchanges either must adhere to these requests or pay for an opinion of counsel to justify that the specific business line is in fact not a "facility" of the exchange under the statutory definition. Either way, the lack of regulatory clarity regarding what the SEC intends to regulate and how it determines as much results in wasted time and resources, particularly if the business line does not qualify as a facility of an exchange.

In a December 7, 2017, letter to Rep. Barry Loudermilk, the sponsor of H.R. 3555, SEC Chairman Jay Clayton observed:

> Our markets have evolved significantly in recent years, and we must ensure that the regulatory framework keeps pace with market developments. . . . I believe care should be taken to ensure that the Commission retains oversight of important exchange functions, such as those relating to (1) exchange market data products, (2) listing standards, (3) member and market regulation, (4) co-location and connectivity services, and (5) order routing services, and that any modifications do not inadvertently exclude from Commission oversight exchange functions that do not currently exist but that may evolve in the future.

Importantly, though, the sponsors of H.R. 3555 have consistently emphasized that the intent of the legislation is not to hinder the SEC's ability to regulate such exchange functions.

Some broker-dealers and other market participants have expressed skepticism to changing the statutory definition of a "facility" under the Exchange Act, which has remained unchanged since the original 1934 law and appears numerous times in statute and regulation. They have argued in part that such a statutory change will result in prolonged litigation with respect to the scope of the SEC's authority to regulate exchanges. Specifically, they are concerned that a statutory change could weaken the ability of market participants to challenge rules, policies, and fees of the exchanges for the products and services used by market participants that actually do in fact relate to exchange trading.

But H.R. 3555, as amended, simply directs the SEC to conduct a rulemaking to explain its process to determine what constitutes a "facility" of an exchange. The legislation, as amended, does not instruct the Commission to narrow its interpretation of "facility" or its corresponding jurisdiction over exchange operations, but rather the legislation requires the SEC to clarify how it determines whether any premises, property, or service is a facility.

This rulemaking is intended to provide clarity regarding the facts and circumstances the SEC considers when determining whether an exchange product is a "facility," while still giving the SEC flexibility in determining what constitutes a "facility" to respond to exchange developments. This clarity will allow for exchanges to develop diverse products and services with a better understanding of what the SEC will consider to be subject to regulation as an exchange facility, while retaining authority and flexibility for the SEC to continue regulating relevant exchange functions, including exchange market data. Nothing in this bill exempts from regulation functions of exchanges that are for the purpose of effecting or reporting a transaction on an exchange or that currently are subject to regulation by the SEC, such as exchange market data, exchange listing standards, and co-location services.

HEARINGS

The Committee on Financial Services and the subcommittee on Capital Markets, Securities, and Investment held hearings examining matters relating to H.R. 3555 on June 27, 2017, and October 4, 2017.

COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on July 11, 2018, and ordered H.R. 3555 to be reported favorably to the House, as amended, by voice vote.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. On a motion by Chairman Hensarling to adopt the amendment in the nature of substitute the amendment was adopted by voice vote, A subsequent motion by Chairman Hensarling to report the bill favorably to the House, as amended, was agreed to by a voice vote, a quorum being present.

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the Committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 3555 will enhance transparency regarding how exchanges are regulated.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by

the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, July 17, 2018.

Hon. JEB HENSARLING,
Chairman, Committee on Financial Services,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 3555, H.R. 6177, H.R. 6319, H.R. 6320, H.R. 6321, H.R. 6322, H.R. 6323, and H.R. 6324.

If you wish further details on these estimates, we will be pleased to provide them. The CBO staff contact is Stephen Rabent.

Sincerely,

MARK P. HADLEY
(For Keith Hall, Director).

Enclosure.

Securities and Exchange Commission Legislation

On July 11, the House Committee on Financial Services ordered eight bills to be reported related to the rules, regulations, and operations of the Securities and Exchange Commission (SEC). The bills are:

- H.R. 3555, the Exchange Regulatory Improvement Act, would require the Securities and Exchange Commission (SEC) to issue regulations regarding its definition of what constitutes a facility used by a national securities exchange;
- H.R. 6177, the Developing and Empowering our Aspiring Leaders Act of 2018, would direct the SEC to conduct a rulemaking to expand what types of asset acquisitions are considered qualifying investments for a venture capital fund;
- H.R. 6319, the Expanding Investment in Small Business Act, would require the SEC to conduct a study on the limitation on the amount of outstanding securities a closed-end fund may hold from a single issuer and still be classified as diversified;
- H.R. 6320, the Promoting Transparent Standards for Corporate Insiders Act, would require the SEC to conduct a study of various proposals to change agency rules regarding the use of written trading plans by certain securities traders;
- H.R. 6321, the Investment Adviser Regulatory Flexibility Improvement Act, would require the SEC to revise the definitions of a small business and small organization applicable for assessing the effect of the agency's rulemakings under the Investment Advisers Act of 1940 on those entities;
- H.R. 6322, the Enhancing Multi-Class Share Disclosures Act, would direct the SEC to issue a rule requiring securities

issuers with multi-class stock structures to make disclosures regarding the voting power of certain individuals;

- H.R. 6323, the National Senior Investor Initiative Act of 2018, would direct the SEC to establish a taskforce to identify challenges that senior investors face and to report on its findings every two years; and
- H.R. 6324, the Middle Market IPO Underwriting Cost Act, would direct the SEC to study the costs associated with small and medium-sized companies undertaking an initial public offering and to report on its findings.

Using information from the SEC regarding the costs of similar activities, CBO estimates that implementing seven of those bills—H.R. 3555, H.R. 6177, H.R. 6319, H.R. 6320, H.R. 6321, H.R. 6322, and H.R. 6324—would each have a gross cost of about $1 million for the agency to conduct the required studies and rulemakings and to issue reports. CBO estimates that implementing the eighth bill—H.R. 6323—would have a gross cost of $7 million over the 2019–2023 period for the SEC to establish and carry out the functions of the taskforce established under the bill.

However, the SEC is authorized to collect fees sufficient to offset its annual appropriation; therefore, CBO estimates that the net effect on discretionary spending of implementing each of those bills would be negligible, assuming appropriation actions consistent with that authority. H.R. 6323 also would require the Government Accountability Office (GAO) to conduct a study on the economic costs of the financial exploitation of senior citizens and CBO estimates that implementing that section would cost GAO less than $500,000; such spending would be subject to the availability of appropriated funds.

None of the bills would affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply for any of the eight bills.

None of the bills would increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2029, CBO estimates.

None of the bills contain intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments. All of them would require the SEC to take actions that could raise the agency's administrative costs and the fees it collects to offset those costs. If the SEC increased fees, it would increase the cost of an existing mandate on private entities required to pay those fees. CBO estimates that none of the bills would increase fees in an amount that would exceed the annual threshold for private-sector mandates established in UMRA ($160 million in 2018, adjusted annually for inflation).

The CBO staff contacts for this estimate are Stephen Rabent (for federal costs) and Rachel Austin (for mandates). The estimate was reviewed by H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

FEDERAL MANDATES STATEMENT

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995.

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of section 102(b)(3) of the Congressional Accountability Act.

EARMARK IDENTIFICATION

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

DUPLICATION OF FEDERAL PROGRAMS

In compliance with clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program; (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139; or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Pub. L. No. 95–220, as amended by Pub. L. No. 98–169).

DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(i) of H. Res. 5, (115th Congress), the following statement is made concerning directed rule makings: The Committee estimates that the bill requires one directed rule making within the meaning of such section, such that the SEC must adopt regulations to further interpret the term "facility" under Section 3(a) of the Exchange Act.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Short title

This section cites H.R. 3555 as the "Exchange Regulatory Improvement Act."

Section 2. Findings

This section states the finding of Congress in regards to how the businesses of national securities exchanges have expanded over time and the need for the SEC to be transparent in how it interprets the term "facility."

Section 3. Facility defined

This section requires the SEC to, not later than 360 days after the date of enactment of the act, to adopt regulations to further interpret the term "facility" under Section 3(a) of the Exchange Act. Such regulations are to set forth the facts and circumstances the Commission considers when determining whether any premises or property, or the right to use any premises, property, or service is or is not a facility of an exchange, and the Commission must apply the facts and circumstances set forth in the regulations in determining whether a proposed rule is or is not to required to be submitted as a proposed rule filing under section 19 of the Exchange Act.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows: H.R. 3555 does not repeal or amend any section of a statute. Therefore, the Office of Legislative Counsel did not prepare the report contemplated by clause 3(e)(1)(B) of rule XIII of the Rules of the House of Representatives.

○