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STATEMENT

OF

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BEFORE THE

US HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON
CAPITAL MARKETS, SECURITIES AND INVESTMENT

ON

US EQUITY MARKET STRUCTURE: A REVIEW OF THE EVOLUTION OF TODAY'S EQUITY MARKET STRUCTURE AND HOW WE GOT HERE

JUNE 27, 2017

EXECUTIVE SUMMARY

- Congress passed the 1975 amendments to the Securities Exchange Act of 1934 (1975 Amendments) to authorize the SEC to create a national market system for equity securities and a system for nationwide clearing and settlement of securities transactions. The 1975 Amendments aimed to empower the SEC to strengthen the equity markets by linking together the various stock trading venues. The SEC has advanced the objectives of the 1975 Amendments through a variety of means, the most significant of which are Regulation NMS and a series of NMS plans. These regulatory actions in conjunction with technological developments have created a fast-paced, highly electronic market structure with a broad range of market participants pursuing a variety of trading and investment strategies.

- The US equity market is widely recognized as being the fairest, most efficient, and most competitive in the world. It allows companies to raise capital to create jobs, grow their business, and innovate by selling ownership stakes to investors. Although the market functions well, it has changed greatly since the SEC adopted Regulation NMS in 2005, and it is time to examine and improve equity market structure. We must, however, not lose sight of a key objective of Regulation NMS: serving the interests of long-term investors and listed companies.

- To best serve ordinary American investors, regulated funds call for reforms to minimize conflicts of interest and promote transparency in the equity market. Three current practices fall short of these key principles.

    - First is a prevalent fee model in the US equity market, known as "maker-taker," which pits broker-dealers' economic interests against those of their customers.

    - Second is the governance of NMS plans—plans that administer key aspects of the national market system but are controlled by entities with inherent conflicts of interest. The plans have a significant effect on a wide range of market participants, but self-regulatory exchanges (SROs)—FINRA and the exchanges—control plan decision-making. Other market participants, such as regulated funds lack any meaningful voice in the operation of these plans and have no ability to police or monitor the conflicts that arise in the implementation of these plans. As a result, the plans do not function as well as they could and critical information regarding these plans and their operations remain opaque.

    - Third, the opacity of certain aspects of the equity market poses challenges for regulated funds in monitoring whether they are obtaining best execution from broker-dealers. Providing institutional investors such as regulated funds with uniform disclosure about broker-dealer order handling practices and the operation of ATSs must be made a priority.

- Regulators and market participants should address these issues promptly. We recommend the following steps to improve equity market structure:

  - Address conflicts with the maker-taker pricing model. The SEC should conduct a pilot program to evaluate how access fees and liquidity rebates affect trading in highly liquid stocks and whether regulated funds and other investors would benefit from a market structure that significantly reduces the incentives of brokers to route orders based on the levels of fees and rebates at trading platforms.

  - Reform NMS plan governance. NMS plan governing bodies would be far better informed—and better able to police conflicts of interest—if they included non-SROs. All NMS plans should include as voting members a range of market participants, including representatives of regulated funds.

  - Increase transparency of revenues generated by public data feeds. At a minimum, the SEC should require disclosure of the amount of revenue generated by the public data feeds for the equity markets (which are operated by NMS plans), the sources of that revenue, the allocation of the revenue, and the amount and recipient of any revenue distributed to SROs.

  - Improve transparency of order handling practices of broker-dealers. The SEC should require broker-dealers to provide institutional investors with more granular disclosure about their order routing activities.

  - Require ATSs to disclose key information about their operations and operators. All market participants should have access to basic information about how ATSs operate, including whether a particular ATS provides preferential access to certain market participants. ATSs also should be required to disclose publicly any information concerning potential conflicts of interest that may arise as a result of the other business activities of the broker-dealer operators of these trading venues.

  - Continue the SEC Equity Market Structure Advisory Committee (EMSAC). The SEC should renew the charter of the EMSAC to ensure that the Commission and its staff will continue to benefit from the expertise of this Committee. The SEC should act promptly to extend the EMSAC's charter at least two more years and to consider making the EMSAC a permanent advisory committee.

I. INTRODUCTION

My name is Matt Lyons. I am Senior Vice President and Global Trading Manager of the Capital Group. Thank you, Chairman Huizenga, Ranking Member Maloney, and members of the Subcommittee for inviting me to testify.

Since 1931, Capital Group, home of the American Funds, has been singularly focused on delivering superior results for long-term investors. Today, Capital Group manages more than $1.5 trillion in equity and fixed income assets for millions of individual and institutional investors around the world.

I also serve as the Chair of the Investment Company Institute's (ICI) Equity Markets Advisory Committee. ICI members are regulated funds, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. As of June 1, 2017, ICI's members manage total assets of US$19.6 trillion in the United States, serving more than 95 million US shareholders, and US$1.6 trillion in assets in other jurisdictions.

I appreciate the opportunity to speak to the Subcommittee regarding the 1975 amendments to the Securities Exchange Act of 1934 (1975 Amendments) and Regulation NMS—the framework for a national market system (NMS) for the US equity market. As an initial matter, the US equity market is widely recognized as being the fairest, most efficient, and most competitive in the world. It allows companies to raise capital to create jobs, grow their business, and innovate by selling ownership stakes to investors.

Regulated funds, such as the funds managed by Capital Group, play a critical part in capital formation in the United States by investing in the equity markets on behalf of millions of retail investors saving for their long-term financial goals, such as the purchase of a home, a child's education, or a secure retirement.[1] We strongly support one of the principal objectives of Regulation NMS, which is to serve the interests of long-term investors and listed companies,[2] and the priority placed by Congress on this objective since the passage of the 1975 Amendments. This objective should continue to drive any potential changes to the equity markets to fuel the American economy and support the American dream.

Although the equity market functions well, it has changed greatly in the 12 years since the Securities and Exchange Commission (SEC or Commission) adopted Regulation NMS in 2005. This regulation

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[1] Households make up the largest group of investors in regulated funds, and nearly 55 million US households own a regulated fund. *See* 2017 Investment Company Factbook at 112, *available at* https://www.ici.org/pdf/2017_factbook.pdf (Factbook). The vast majority of these households own one or more funds that invest in the equity market, and as a result, regulated funds are significant shareholders of public companies. At the end of 2016, regulated funds owned 31 percent of all US corporate equity securities. *See* Factbook at 14.

[2] Securities and Exchange Commission, Regulation NMS, Exchange Act Release No. 51808 (June 9, 2005), 70 Fed. Reg. 37496, 37499 (June 29, 2005), *available at* https://www.gpo.gov/fdsys/pkg/FR-2005-06-29/pdf/05-11802.pdf (Regulation NMS Adopting Release).

is due for an inspection. We believe the SEC should lead efforts to examine and improve equity market structure, and we greatly appreciate the Commission's commitment to conducting its review of the equity markets with extensive input from a wide range of interested parties. As a way to formalize this input, in 2015, the SEC established an Equity Market Structure Advisory Committee (EMSAC), a panel of market structure experts, to advise on potential equity market reforms. We believe that the EMSAC should continue to play an important role in any equity market structure reform.

As Congress considers the current state of the equity market, I would like to provide a number of recommendations on what the regulatory community and market participants can do to modernize equity market structure for the benefit of both long-term investors and the public companies that rely on the equity market to meet their financing needs. As important investors in the equity market, regulated funds strongly support efforts to improve the fair and orderly operation of this market and insure continued investor confidence. In this regard, ICI and its members have long advocated for an equity market structure that embodies certain key principles—minimizing potential conflicts of interest, promoting transparency and liquidity, ensuring stability and resiliency, and treating all market participants fairly and equitably.

My testimony has three parts. First, I explain the evolution of the equity market since the passage of 1975 Amendments and adoption of Regulation NMS, how regulated funds transact in the equity markets, and the role of asset managers, such as the Capital Group. Second, I describe the aspects of equity market structure that pose the most significant challenges to regulated funds as they seek to provide long-term returns to their investors and how certain changes can help foster an equity market structure that is in keeping with an efficient and well-functioning market. Third, I recommend concrete steps that the SEC and market participants should take to address these challenges.

II. REGULATED FUNDS RELY ON BUY-SIDE TRADERS TO NAVIGATE THE MODERN EQUITY MARKET

Congress passed the 1975 Amendments to authorize the SEC to create a national market system for equity securities and a system for nationwide clearing and settlement of securities transactions.[3] The 1975 Amendments aimed to empower the SEC to strengthen the equity markets by linking together the various stock trading venues. The SEC has advanced the objectives of the 1975 Amendments through a variety of means, the most significant of which are Regulation NMS and a series of NMS plans. These regulatory actions in conjunction with technological developments have created a fast-paced, highly electronic market structure with a broad range of market participants pursuing a variety of trading and investment strategies.

It is unclear whether the evolution to a market structure that prioritizes speed has on balance benefited the market or long-term investors. Some of the advantages of these regulatory changes have been improved technology allowing for greater control of the equity trading process from the "buy-side,"

[3] *See* Section 11A of the Securities Exchange Act of 1934.

competition among many trading centers, and ample liquidity and price discovery for the most liquid securities.[4] The negative consequences, however, have been a single, one-size-fits-all equity market characterized by a number of challenges, including: fragmentation of liquidity among multiple trading venues; pricing structures that create opportunities for arbitrage and potential conflicts between broker-dealers and their clients and add complexities to the market; and allowing market participants with inherent conflicts of interest to dictate key aspects of market operations. Inadequate transparency exacerbates these challenges.

Today, equity securities trade on approximately four dozen trading platforms, each with its own fee schedule, rulebook, and unique order types.[5] The national securities exchanges drive price discovery by advertising the prices at which market participants will buy or sell listed securities. Regulation NMS protects these displayed quotations by requiring each trading center—such as an exchange and ATS—to adopt written policies and procedures designed to prevent the trading center from executing a transaction at a worse price than the best bid or offer displayed by a national securities exchange, subject to certain specified exceptions.[6] This prohibition on trade-throughs effectively requires market participants to have the capability to execute at every national securities exchange, regardless of an exchange's market quality or terms of use.

To navigate this fragmented equity market ecosystem in the modern era and implement their investment objectives and strategies, regulated funds rely on asset management firms—and specifically the portfolio managers and traders employed by asset management firms. In managing the portfolio of a regulated fund, a portfolio manager of an asset management firm determines which securities to buy or sell for the fund, in accordance with the objectives described in the fund's prospectus. Traders with the asset management firm (buy-side traders) seek to execute the transactions in the most efficient and cost effective manner to effectuate the fund's investment strategy.

Generally speaking, a buy-side trader's objective when implementing portfolio decisions is to optimize the balance between the market impact and potential opportunity risk.[7] To minimize market impact the trader often will break a portfolio manager's order (parent order) into smaller pieces (child orders), and send these child orders to one or more broker-dealers for execution. To minimize opportunity risk

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[4] It is also clear that transaction fees have decreased since the adoption of Regulation NMS, but it is hard to tell how much of this decrease is attributable to the regulation directly and how much derives from other factors, such as decimalization. Lower transaction fees are a benefit to investors, but I encourage Congress and regulators not to assume a direct, causal relationship between Regulation NMS's adoption and lower transaction fees.

[5] These trading platforms include national securities exchanges and alternative trading systems (ATS). In addition, broker-dealers will "internalize" client orders from time to time, essentially trading with the client directly, without sending the order to an exchange.

[6] *See* 17 C.F.R. § 242.611(a).

[7] If a market participant buys or sells too aggressively, the participant's order can have a meaningful effect on the price of the relevant security, at least in the short term. Conversely, if the strategy is too passive the market participant may fail to get the position into the portfolio to realize the potential gains from the investment.

the trader will look to source large block liquidity and typically is willing to pay a higher impact cost. A fund's broker-dealers typically parcel the child orders into the market in small increments to obtain favorable executions for the fund. The average size of child orders submitted to the market has generally decreased since the implementation of Regulation NMS, possibly because the regulation complicates efforts for institutional investors and liquidity providers to transact in large size.

Broker-dealers owe regulated funds—and other clients—a duty of best execution, which means that a particular broker dealer must exercise reasonable care to obtain the most advantageous terms for its client, taking into account price and other factors.[8] In a fragmented and complicated market structure with many different market centers trading the same security, a broker-dealer's order routing decision is critically important to fulfilling the best execution obligation and buy-side traders devote significant resources to monitoring broker-dealer order handling practices.

III. REGULATED FUNDS SUPPORT A MARKET STRUCTURE THAT MINIMIZES CONFLICTS OF INTEREST AND PROMOTES TRANSPARENCY

To best serve ordinary American investors, regulated funds call for reforms to minimize conflicts of interest and promote transparency in the equity market. Three current practices fall short of these key principles.

- First is a prevalent fee model in the US equity market, known as "maker-taker," which pits broker-dealers' economic interests against those of their customers.

- Second is the governance of NMS plans—plans that administer key aspects of the national market system but are controlled by entities with inherent conflicts of interest. The plans have a significant effect on a wide range of market participants, but self-regulatory exchanges (SROs)—FINRA and the exchanges—control plan decision-making. Other market participants, such as regulated funds lack any meaningful voice in the operation of these plans and have no ability to police or monitor the conflicts that arise in the implementation of these plans. As a result, the plans do not function as well as they could and critical information regarding these plans and their operations remain opaque.

- Third, the opacity of certain aspects of the equity market poses challenges for regulated funds in monitoring whether they are obtaining best execution from broker-dealers. Providing institutional investors such as regulated funds with uniform disclosure about broker-dealer order handling practices and the operation of ATSs—exchange-like trading platforms run by broker-dealers—must be made a priority.

This section describes each of these challenges.

[8] *See* Financial Industry Regulatory Authority (FINRA), Regulatory Notice 15-46, Best Execution: Guidance on Best Execution Obligations in Equity, Options and Fixed Income Markets (November 2015), *available at* https://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-46.pdf.

A. The Maker-Taker Fee Model Presents Significant Conflicts of Interest That Affect Fund Execution Quality and Market Fairness

Our foremost concerns is the "maker-taker" pricing model. This practice, employed primarily by exchanges, involves charging fees to participants that remove liquidity (*i.e.*, "takers") from the market while paying rebates to those participants that add liquidity (*i.e.*, "makers"). Regulation NMS caps access fees at a level that the Commission believed was a *de minimis* amount in 2005—$0.30 per 100 shares, for securities quoted at $1.00 or more.[9] The SEC believed the $0.003 per share cap on access fees would, among other things, enhance the integrity of Regulation NMS by ensuring that trading venues could not charge substantial fees for accessing protected quotations. Regulation NMS does not address rebates but, in practice, the access fee cap acts as a limit on the size of these payments because execution venues typically use the fees collected on one side of a transaction to fund the rebates paid on the other side. A trading venue's net transaction revenue equals the difference between the access fee charged and the liquidity rebate paid by the venue. A venue that offers a liquidity rebate that exceeds its access fee would lose money on every transaction that it matches.

Maker-taker pricing and Regulation NMS's cap on access fees have become controversial features of equity market structure for three primary reasons. First, maker-taker pricing supplies broker-dealers with an incentive to route customer orders in a way that maximizes rebates earned and minimizes fees paid because broker-dealers generally do not pass fees or rebates through to their clients. Trading commissions have decreased dramatically with the increase in electronic trading, and spreads have tightened since decimalization of the US markets, making the current cap on fees more than a *de minimis* component of trading costs today and magnifying the conflict of interest that broker-dealers face in routing client orders. Second, access fees and liquidity rebates diminish price transparency because quoted prices—and prices included on trade reports—do not account for fees or rebates and therefore do not fully reflect net trading prices. Finally, exchange fees and liquidity rebates have contributed to increased market complexity and fragmentation through the proliferation of new trading venues and order types designed to exploit maker-taker pricing.[10]

Maker-taker pricing harms regulated funds and the millions of investors that entrust these funds with their savings in several ways. First, the fees and rebates associated with maker-taker pricing reduce market transparency and impair the ability of regulated funds to evaluate the quality of executions they receive. Second, access fees and liquidity rebates provide incentives that sometimes conflict with a broker-dealer's obligation to provide best execution to a regulated fund's order. Third, the avoidance of fees or the harvesting of rebates results in increased fragmentation the enables otherwise non-

[9] 17 C.F.R. § 242.610(c). This rule also limits fees to 0.3% or less of the price per share for securities quoted at less than $1.00.

[10] Maker-taker pricing, for example, has resulted in the creation of "inverted venues" that pay a rebate to market participants that take liquidity and charge a fee to market participants that post liquidity.

economically viable venues to exist[11] and complex order types that stifle traditional order competition[12] based on time price priority rules. The complexity that results from maker-taker pricing introduces unnecessary friction and risk and reduces necessary transparency to allow asset managers to monitor effectively the performance of their broker-dealers and venues to the detriment of regulated funds and other long-term investors.

B. Equity Market Governance Is Not Structured to Police against Conflicts of Interest and Hinders Transparency

NMS plans are an enduring legacy of the 1975 Amendments and Regulation NMS. Rather than engage in rulemaking in certain key areas, the SEC has chosen to rely on NMS plans to govern key aspects of equity market structure, including public market data feeds (known as securities information processors or SIPs), circuit breakers designed to limit extraordinary volatility in individual stocks, and the consolidated audit trail, which will create a single database containing information for all orders and executions for exchange-listed US equities and options.

All NMS plans share a common, deeply flawed governance framework. An operating committee composed only of SROs makes all decisions concerning the administration and operation of the plan. These decisions are often made behind closed doors and little information is provided concerning the deliberations of the operating committees. Certain NMS plans have an advisory committee that includes broader representation, but advisory committees have no formal voice in plan decisions.

The homogenous nature of NMS plan operating committees means that a broad range of market participants have no meaningful voice in the development of key aspects of equity market structure. SIPs, for example, are the exclusive SEC-approved providers of key market data, including information on national best bids and offers, last sales, and regulatory trading halts. A wide range of market participants must use SIPs to trade, and SIPs charge fees that amount to hundreds of millions of dollars a year. For years SIP operating committees failed to invest adequately in creating resilient, reliable SIPs. Although this situation has improved somewhat following a high-profile SIP outage a few years ago, the governance of the SIP NMS plan does not engender confidence that the SROs are investing adequately in SIP technology. The fact that nearly all exchanges derive significant revenues from selling proprietary market data presents SIP operating committee members with a significant conflicts of interest to ensure that SIP performance lags that of proprietary products.

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[11] Adding to this problem are UTP / CTA tape revenue plans, which were changed in Regulation NMS to allow revenue to be generated for quoting in addition to trade reporting. *See* Regulation NMS Adopting Release at 37557-37568; Exhibit 1 of the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis, *available at* http://www.utpplan.com/DOC/Nasdaq-UTP_Plan_after_37th_Amendment_-_Excluding_21st_Amendment.pdf; Section IX of the Consolidated Quotation Plan (Restatement), *available at* https://www.nyse.com/publicdocs/ctaplan/notifications/trader-update/CQ_Plan_Composite_as_of_April_11_2017.pdf.

[12] Order competition is a primary objective of Regulation NMS. *See* Regulation NMS Adopting Release at 37498.

Moreover, there is no public disclosure of even rudimentary information concerning the allocation of SIP revenue among SROs or the amounts expended for SIP maintenance or improvement. The lack of transparency into this information prevents an adequate check on conflicts of interest that are inherent for entities that control the administration of these plans.

Although no legal authority requires SROs to monopolize NMS plan governance, the SEC and SROs have ignored repeated calls from other market participants to democratize the operation of these plans and allow for other market participants to monitor potential conflicts of interest. The lack of diversity of NMS plan operating committees also prevents the committees from being as well informed about the perspectives of other market participants as they should be and may impair the committees' ability to understand fully how their decisions affect non-SROs.

C. Lack of Information Exacerbates Potential Conflicts of Interest in the Market

One result of the fragmentation and associated complexity of US equity market structure is that institutional investors have a compelling interest in understanding the order handling decisions of their broker-dealers and the operations and potential conflicts of interest associated with using ATSs. Unfortunately, the securities laws provide investors with inadequate information about either broker-dealer order handling practices or the operations of ATSs, which complicates regulated funds' efforts to monitor broker-dealers and trading venues.

1. Regulated funds lack transparency into the order-handling decisions of broker-dealers making it difficult for regulated funds to monitor broker-dealer performance

Although Regulation NMS requires broker-dealers to report certain order handling information, these reports focus on retail orders and, in any event, do not provide sufficient information to enable institutional investors to assess satisfactorily the performance of broker-dealers and execution venues.[13] Funds and other institutional investors can request ad hoc reports on the routing and execution quality of their equity market orders, but broker-dealers have the discretion whether to provide these reports and can provide them in varying formats, making it difficult and resource-intensive to compare execution quality across broker-dealers.

Having access to uniform, comprehensive disclosures about the order handling practices of broker-dealers would enhance the ability of regulated funds and other institutional investors (regardless of size or market power) to: (1) understand a broker-dealer's decision to expose, route, and execute an order; (2) evaluate the execution quality provided by a particular broker-dealer or trading venue; (3) determine whether the pricing structure of a trading center influences a broker-dealer's order handling decisions; and (4) assess information leakage with the routing of their orders. Ultimately, these disclosures would provide regulated funds and buy-side traders with a much-needed tool to improve the

[13] *See* 17 C.F.R. §§ 242.605 and 242.606.

execution quality of fund orders, which would reduce costs and improve long-term returns to fund shareholders.

To address buy-side interest in enhancing the level of transparency regarding order routing and execution, ICI and its members in 2014 spearheaded efforts to develop a standardized disclosure template that each broker would provide to its institutional clients. The disclosure template was intended to provide a broad range of statistical data regarding a broker's handling of a specific customer's orders, along with the execution quality achieved by the broker at each execution venue. ICI along with other trade associations submitted this template to the SEC as the product of collaboration among a broad segment of industry participants and to assist the staff in its rulemaking efforts in this area. In 2016, the SEC proposed a rulemaking based on this template, and we hope the Commission will adopt this new rule soon, with certain modifications.[14]

2. Regulated funds need more comprehensive information about ATSs, including basic disclosures about their business and the conflicts of interest associated with their operations

Market participants, including regulated funds, also lack adequate transparency into the operations of ATSs. SEC rules permit ATSs to operate in a far less transparent manner than national securities exchanges, even though ATSs, in aggregate, execute more than 15 percent of the total dollar volume of all transactions in exchange-listed equities. ATSs must register with the Commission, but all information reported on their registration form and subsequent filings that they make with the SEC are deemed confidential.

Consequently, each ATS has a great amount of control over the information that it chooses to make available publicly. Some ATSs disclose nearly all information they file with the SEC while others disclose practically none, choosing instead to keep confidential even basic information about their operations, fee schedules, or the potential conflicts of interest that might arise as a result of the activities of their broker-dealer operators. Requiring ATSs to disclose this information publicly would ensure that regulated funds and other market participants have access to all information necessary to evaluate these trading venues, including information concerning how ATSs treat different classes of subscribers, the extent to which information is shared outside the ATS, and whether business arrangements of the broker-dealer that operates the ATS potentially conflict with the best interest of ATS subscribers.[15]

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[14] Securities and Exchange Commission, *Disclosure of Order Handling Information,* Securities Exchange Act Release No. 78309 (July 13, 2016), 81 Fed. Reg. 49432 (July 27, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-07-27/pdf/2016-16967.pdf.

[15] A number of recent SEC enforcement actions against ATSs and broker-dealers operating ATSs highlight harms that can result if broker-dealer operators of ATSs do not appropriately manage potential conflicts of interest. *See e.g., In the Matter of ITG Inc. and Alternet Securities Inc.*, Securities Exchange Act Release No. 75672 (Aug. 12, 2015), https://www.sec.gov/litigation/admin/2015/33-9887.pdf; *In the Matter of UBS Securities LLC*, Securities Exchange Act Release No. 74060 (Jan. 15, 2015), http://www.sec.gov/litigation/admin/2015/33-9697.pdf; *In the Matter of Lavaflow,*

The paucity of public information on ATSs contrasts starkly with the copious public disclosures that SEC rules compel stock exchanges to make. The uneven regulatory landscape between ATSs and exchanges may have been appropriate when the Commission adopted its rules on ATSs almost 20 years ago, but now that ATSs have become a more significant part of the trading environment, registered funds must have more information to assess fully the relative merits of these functionally similar trading venues.

Exchanges and ATSs play similar roles in the equity market; we believe they should have similar disclosure obligations. The regulated fund industry has supported efforts to improve ATS disclosures and align these disclosures more closely with those of national securities exchanges. Most recently, the industry supported an SEC proposed rule that would require ATSs to disclose publicly a broad range of information about their operations and the businesses of their broker-dealer operators.[16]

IV. RECOMMENDATIONS TO IMPROVE EQUITY MARKET STRUCTURE

The conflicts of interest inherent in maker-taker pricing and the governance of NMS plans and the opacity surrounding broker-dealer order handling practices and ATS operations work to undermine the fairness and integrity of equity markets. Regulators and market participants should address these issues promptly. We recommend the following steps to improve equity market structure:

- Address conflicts with the maker-taker pricing model. The SEC should conduct a pilot program to evaluate how access fees and liquidity rebates affect trading in highly liquid stocks and whether regulated funds and other investors would benefit from a market structure that significantly reduces the incentives of brokers to route orders based on the levels of fees and rebates at trading platforms. A discrete, well-designed pilot program would provide data that would allow the SEC to advance its equity market structure agenda and bring real benefits to investors. Any maker-taker pilot program should test how eliminating rebates affects trading and liquidity in pilot securities. A pilot program should provide the SEC with data upon which to make informed policy decisions on the best way forward. Data-driven policy determinations should diminish the potential for unintended consequences of regulatory changes. We note that the EMSAC has proposed a framework for a maker-taker pilot, and we urge the SEC to propose a maker-taker pilot program.

- Reform NMS plan governance. No legal authority requires SROs to monopolize NMS plan governance, and the NMS plan governing bodies would be far better informed—and better able to police conflicts of interest—if they included non-SROs. The proliferation of NMS plans in recent years as mechanisms to regulate the equity markets heightens these plan governance concerns. All

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Inc., Securities Exchange Act Release No. 72673 (Jul. 25, 2014), http://www.sec.gov/litigation/admin/2014/34-72673.pdf; *In the Matter of Liquidnet, Inc.*, Securities Exchange Act Release No. 72339 (Jun. 6, 2014), http://www.sec.gov/litigation/admin/2014/33-9596.pdf.

[16] Securities and Exchange Commission, *Regulation of NMS Stock Alternative Trading Systems*, Securities Exchange Act Release No. 76474 (November 18, 2015), 80 Fed. Reg. 80998 (December 28, 2015), *available at* https://www.gpo.gov/fdsys/pkg/FR-2015-12-28/pdf/2015-29890.pdf.

NMS plans should include as voting members a range of market participants, including representatives of regulated funds.

- Increase transparency of SIP revenues. At a minimum, the SEC should require disclosure of the amount of revenue generated by the SIPs, the sources of that revenue, the allocation of the revenue (including amounts invested in technology), and the amount and recipient of any revenue distributed to an SRO under the SIP plans. The disclosure of this type of information will allow market participants to monitor whether sufficient technology investments are being made and whether such decisions are influenced by SRO conflicts of interests.

- Improve transparency of order handling practices of broker-dealers. The SEC should require broker-dealers to provide institutional investors with more granular disclosure about their order routing activities. The SEC should adopt its proposal to enhance order routing disclosures for institutional investors with modifications recommended by ICI as soon as possible. Greater disclosure would empower regulated funds and other institutional investors to make much better informed decisions about how their brokers are performing and to improve execution quality to benefit the millions of retail investors in regulated funds.

- Require ATSs to disclose key information about their operations and operators. All market participants should have access to basic information about how ATSs operate, including whether a particular ATS provides preferential access to certain market participants. ATSs also should be required to disclose publicly any information concerning potential conflicts of interest that may arise as a result of the other business activities of the broker-dealer operators of these trading venues. The SEC should promptly adopt its proposal to require public disclosure of this key information to allow regulated funds to make better informed routing decisions and evaluate the performance of broker-dealers. Absent regulatory action, market participants will continue to have difficulty obtaining this critical information and certain market participants, especially smaller regulated funds, may not be able to obtain this information at all.

- Continue the EMSAC. The SEC should renew the charter of EMSAC so that it can continue its work supporting the SEC. For more than two years the EMSAC has examined US equity market structure, including maker-taker pricing, order handling transparency, NMS plan governance, and other matters. Unfortunately, the EMSAC's term expires in August 2017. To ensure that the Commission and its staff will continue to benefit from the expertise of this Committee, the SEC should act promptly to extend the EMSAC's charter at least two more years and to consider making the EMSAC a permanent advisory committee.

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I appreciate the opportunity to share these views with the Subcommittee. Capital Group and ICI look forward to continued engagement with Congress on matters of importance to regulated funds and their investors.

Appendix

Recent ICI and Capital Group Companies, Inc. Comment Letters on Market Structure Issues

Letter concerning maker-taker fees:

- Letter from David W. Blass, General Counsel, ICI to SEC EMSAC, dated January 20, 2016, *available at* https://www.ici.org/pdf/29652.pdf

Letters addressing NMS plan governance:

- Letter from Paul Schott Stevens, President & CEO, ICI, to Mary Jo White, Chair, SEC, dated October 19, 2016, *available at* https://www.ici.org/pdf/30325.pdf

- Letter from David W. Blass, General Counsel, ICI, to Brent J. Fields, Secretary, SEC, dated July 18, 2016, *available at* https://www.ici.org/pdf/30042.pdf

- Letter from Paul Schott Stevens, President & CEO, ICI, to Mary Jo White, Chair, SEC, dated November 30, 2015, *available at* https://www.ici.org/pdf/29517.pdf

Letters urging increased transparency of order handling decisions and ATS operations:

- Letter from Matt Lyons, Global Trading Manager, The Capital Group Companies, Inc. to Brent J. Fields, Secretary, SEC, dated September 30, 2016, available at https://www.sec.gov/comments/s7-14-16/s71416-25.pdf

- Letter from David W. Blass, General Counsel, ICI, to Brent J. Fields, Secretary, SEC, dated September 26, 2016, *available at* https://www.ici.org/pdf/16_ici_sec_order_routing_ltr.pdf

- Letter from David W. Blass, General Counsel, ICI, to Brent J. Fields, Secretary, SEC, dated February 25, 2016, *available at* https://www.ici.org/pdf/29733.pdf