

Via Email

July 28, 2021

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Patrick T. McHenry
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Re: July 28, 2021 Full Committee Hybrid Markup of Various Measures¹

Dear Madam Chairwoman and Ranking Member McHenry:

I am writing on behalf of the Council of Institutional Investors (CII). CII is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about \$4 trillion in assets, and a range of asset managers with more than \$35 trillion in assets under management.²

¹ See U.S. House Financial Services, Markups, Full Committee Hybrid Markup of Various Measures (last visited July 25, 2021), <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408113>.

² For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

The purpose of this letter is to express our support for H.R. 4617, the “Order Flow Improvement Act.”³ Our support for H.R. 4617 is derived from with our membership approved policies that state:

We . . . have [a] . . . duty to communicate the interests and desires of the institutional investor community to regulators, to the public and to the industry regarding trading practices

. . . [C]urrent brokerage industry practices . . . [that] make it difficult to break out the exact costs of services . . . may be antithetical to the fiduciary obligation of obtaining best execution, and hold too much potential for conflicts of interest and abuses.

. . . .

Clarity and transparency of disclosure of all . . . brokerage arrangements is essential⁴

We agree with Securities and Exchange Commission (SEC) Chair Gary Gensler that payments from stock exchanges to market makers and to brokers known as rebates “raise questions about whether investors are getting best execution.”⁵ We also agree with the SEC’s Office of the Investor Advocate that the SEC should study and address “the potential conflicts of interest created by exchange fees and rebates in connection with broker-dealer order routing behavior.”⁶

We share the concerns of “[a]cademics, market participants, regulators, and legislators . . . about how transaction-based fees have affected order routing decisions by broker-dealers and the execution quality obtained by customers.”⁷ We

³ Amendment in the Nature of a Substitute to H.R. 4617 Offered by Mr. Sherman of California (July 23, 2021), <https://financialservices.house.gov/uploadedfiles/bills-117-4617-s000344-amdt-6.pdf>.

⁴ CII, Policies on Other Issues, Guiding Principles for Trading Practices, Commission Levels, Soft Dollars and Commission Recapture (Mar. 31, 1998), https://www.cii.org/policies_other_issues#principles_trading_commission_softdollar.

⁵ Chair Gary Gensler, Prepared Remarks at the Global Exchange and FinTech Conference (June 9, 2021), <https://www.sec.gov/news/speech/gensler-global-exchange-fintech-2021-06-09>; *see generally* Lucy Nussbaum, Market Structure Brief: Three Issues in the Spotlight Following the Meme Stock Spectacle of 2021, CII Res. & Educ. Fund 5-9 (May 2021), https://7677c7b7-7992-453f-8d12-74ccbdbee23c.filesusr.com/ugd/72d47f_1a38f62a6451402d849c087aaaae24c3.pdf (discussion of current issues relating to payment for order flow including concerns about best execution).

⁶ SEC, Office of the Investor Advocate, Report on Objectives, Fiscal Year 2022 at 9 (June 28, 2021), <https://www.sec.gov/files/sec-office-investor-advocate-report-on-objectives-fy2022.pdf> (emphasis omitted).

⁷ Transaction Fee Pilot for NMS Stocks, Exchange Act Release No. 82,873, 83 Fed. Reg. 13,008, 13,041 (proposed rule Mar. 26, 2018), <https://www.gpo.gov/fdsys/pkg/FR-2018-03-26/pdf/2018-05545.pdf>; *see* Brief of Amici Curie ICI & CII In Support of Respondent & Denial of the Petitions for Review at 4-15, NYSE v. SEC (Oct. 11, 2019) (No. 19-1042), https://www.cii.org/files/issues_and_advocacy/correspondence/2019/ICICII%20Final%20Brief.pdf

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are particularly troubled by evidence cited by the SEC that “shows lower execution quality, in terms of reduced probability of execution or increased time to execution, for non-marketable limit orders on exchanges that pay high rebates [and] [t]hus, broker-dealers may route orders to exchanges that have the best quoted prices but are suboptimal for customers in other ways because orders are either less likely or take longer to execute.”⁸ We note that such evidence indicates that broker-dealers may not be adhering to existing regulatory requirements that “member firms assure that order flow is directed to markets providing the most beneficial terms for their customer orders.”⁹

For all the above reasons, we support H.R. 4617.

We appreciate the opportunity to comment on the Full Committee Hybrid Markup of Various Measures. Please feel free to contact me with any questions regarding this letter.

Sincerely,



Jeffrey P. Mahoney
General Counsel

(describing how maker-taker pricing creates conflicts of interest that can undermine the duty of best execution brokers owe investors); Transaction Fee Pilot for NMS Stocks, Exchange Act Release No. 84,875, 84 Fed. Reg. 5,202, 5,204 (final rule Feb. 20, 2019), <https://www.federalregister.gov/documents/2019/02/20/2018-27982/transaction-fee-pilot-for-nms-stocks> (“Many commenters focused on one potential distortion – whether current pricing models ‘present broker-dealers with a potential conflict of interest,’ because their “duty to pursue best execution could be compromised when their trading venue decision is driven by the economic incentive to minimize access fees paid and maximize rebates received.”).

⁸ 83 Fed. Reg. at 13,041-42 (citing Robert Battalio, Shane A. Corwin, and Robert Jennings, “Can Brokers Have It All? On the Relation between Make-Take Fees and Limit Order Execution Quality,” *J. Fin.* 2119–2237 (May 2016), available at <https://onlinelibrary.wiley.com/doi/full/10.1111/jofi.12422>); Letter from Jeffrey P. Mahoney, General Counsel, CII to Brent J. Fields, Secretary, Securities and Exchange Commission 2 (May 10, 2018), [https://www.cii.org/files/issues_and_advocacy/correspondence/2018/May%2010%202018%20File%20Number%20S7-05-18%20Transaction%20Pilot%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2018/May%2010%202018%20File%20Number%20S7-05-18%20Transaction%20Pilot%20(final).pdf).

⁹ FINRA, Regulatory Notice 21-23, Best Execution and Payment for Order Flow 4 (June 23 2021), <https://www.finra.org/sites/default/files/2021-06/Regulatory-Notice-21-23.pdf>; see Letter from Jeffrey P. Mahoney, General Counsel, CII to Brent J. Fields, Secretary, Securities and Exchange Commission at 2-3.