

**REMARKS TO THE  
SEC INVESTOR ADVISORY COMMITTEE**

**KEN BERTSCH  
EXECUTIVE DIRECTOR, COUNCIL OF INSTITUTIONAL INVESTORS**

**“DISCUSSION REGARDING STOCK EXCHANGES: INVESTOR PROTECTION  
UNDER THE MODERN EXCHANGE REGULATORY STRUCTURE”**

**MARCH 28, 2019**

Thank you for the opportunity to speak with you this morning on investor protection under the modern exchange regulatory structure. I represent the Council of Institutional Investors, which has core membership of more than 135 asset owners with about \$4 trillion in assets. We also have more than 60 asset manager associate members with more than \$35 trillion in assets under management.

Our members rely on effective market regulation. Institutional investors and their beneficiaries are among those who bear costs of incentive arrangements that undermine best execution, excessive fees for critical market data, and lack of independence in setting listing standards for public companies.

There have been various times in recent decades when market participants have discussed whether the regulatory framework for securities exchanges in general is adequate in an era of commercial, for-profit exchanges that compete globally.<sup>1</sup> We think it is time to revisit this topic. Some critical regulatory functions are delegated to FINRA, but the exchanges hold significant self-regulatory responsibilities, and seek sovereign protection as such. We believe the exchanges have commercial interests that pose conflicts of interest affecting policy outcomes.,

At one time, the New York Stock Exchange championed investor interests, for example in creating an effective regime for timely disclosure of material information from issuers, and in establishing the principal of one-share, one-vote.

Today’s exchanges fundamentally differ from that model, focusing their ingenuity on ways to monetize their role as gatekeepers and holders of information that is critical to high-functioning capital markets, or expanding global market share in listings – and cross-selling other services to listed companies – with help from conducive listing standards. They even act as trade

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<sup>1</sup> See, e.g., The World Bank, *Self-Regulation in Securities Markets*, 2011 at 2: “Forces such as commercialization of exchanges, development of stronger statutory regulatory authorities, consolidation of financial services industry regulatory bodies, and globalization of capital markets are affecting the scope and effectiveness of self-regulation, and in particular the traditional role of securities exchanges as SROs”.

associations for management of listed firms (and firms for which they seek listings), advocating for particular public policy goals in pursuit of listings.

CII has seen problems most clearly with reference to company listing standards, since CII has a strong corporate governance focus, and our members have a keen interest in listing standards for public companies. While exchanges can distinguish themselves by the strength of listing standards and the resultant quality of listed issuers, we see increasing evidence that for-profit exchanges globally compete in a race to the bottom, made clear with relation to dual-class stock by the Hong Kong Exchange, which in permitting dual class listings in 2018 cited pressures from competition with NYSE and NASDAQ.<sup>2</sup>

A key element in the effectiveness of stock exchanges from an investor protection standpoint is the role played by the SEC. While part of this relates to the authority of the SEC itself, the SEC does not have sufficient authority over listing standards, in our view, at least as interpreted by lower-level courts. But the SEC does have substantial authority over most areas of SRO rule-making and other activity, and we believe the Commission can clarify its standards and approach the SROs with greater skepticism than at times has been evident in the past. We are encouraged, for example, that the SEC has requested that the exchanges provide actual evidence related to proposed loosened standards for special purpose acquisition companies.

We believe the SEC has sufficient authority on market structure matters, notwithstanding court challenges from exchanges to the transaction fee pilot. I want to turn now to some of the market structure issues on which CII has concerns.

#### Moving forward with the pilot project

CII enthusiastically supports the Transaction Fee Pilot for NMS Stocks.<sup>3</sup> We agree with the SEC that this project “may shed light on the extent, if any, to which broker-dealers route orders in ways that benefit the broker dealer but may not be optimal for customers.”<sup>4</sup> We note that investors have been highly supportive of the pilot. We regret that exchanges are pursuing litigation to block the pilot, which, if successful, would impede understanding of whether and to what extent the current rebate system encourages brokers to send customer orders to exchanges that pay favorable rebates rather than to exchanges that offer the best results for clients.<sup>5</sup>

Institutional investors have observed internally that execution quality may be negatively impacted when brokers’ routing decisions are made to maximize rebate payments.<sup>6</sup> Broker analysis indicates that pension funds and mutual funds bear significant costs when fee

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<sup>2</sup> Hong Kong Exchange Research Report, [Listing Regime Reforms for Dual-Class Share Structure and Biotech Industry](#), at p. 3: “... fierce competition among exchanges ... substantially facilitated the adoption and use of [dual-class] structures,” at p. 13: “The US’ embrace of [dual-class structures] encouraged other countries to follow,” and “In Hong Kong, there had been an extensive discussion .. in response to Alibaba’s listing” with NYSE, November 2018.

<sup>3</sup> CII [comment letter](#) to SEC endorsing the pilot project project, May 10, 2018.

<sup>4</sup> 83 Fed. Reg. at 13,039.

<sup>5</sup> McCrank, John, “[Big U.S. exchanges to sue SEC over ‘overreaching’ fee experiment.](#)” Reuters, February 19, 2019.

<sup>6</sup> See [Capital Group comment letter](#) to SEC, May 30, 2018.

minimization, including through rebates, gets prioritized over getting the best prices for clients.<sup>7</sup> We believe the pilot will provide the data needed to improve trading fee structures.

### Market data and access

Access to high-quality equity market data is a necessity, not an option, for brokers and institutions that want to trade competitively and achieve best execution. As exchanges' data is currently delivered, this need extends to two tiers of information: first, through consolidated core data delivered through the NMS system by securities information processors ("SIPs"), and secondly, through lower-latency proprietary data and access services sold by separate exchanges. With a handful of exchange conglomerates controlling the dissemination and sale of essential market data, market forces of supply and demand cannot independently provide a viable path for ensuring an optimal market.

In this context we support Chairman Clayton's direction to SEC staff to explore the adequacy of the speed, content, depth, transparency and access of consolidated core data.<sup>8</sup> This inquiry may lead to the identification of information currently provided on a proprietary basis being incorporated into consolidated core data, delivering benefits to market efficiency and investors broadly.<sup>9</sup>

Related to that inquiry, we also support transparency of fees paid to exchanges on a product-by-product level.<sup>10</sup> Sunlight on revenue and expense information with respect to data fees, technology fees and connectivity fees facilitates more robust assessments of whether proposed fee hikes are reasonable. Additionally, we believe a rule ensuring that Notice and Comment periods occur prior to fee increases would likely enhance the fulfillment of this objective.<sup>11</sup>

### Thinly-traded shares

Lack of liquidity is a concern for our members who trade shares in smaller companies, and we recognize that the solution, aggregating liquidity into fewer trading venues, is at odds with the Regulation NMS requirement that non-listing exchanges must be permitted to trade non-listed securities.

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<sup>7</sup> See [Clearpool Group analysis](#), May 16, 2018.

<sup>8</sup> Chairman Jay Clayton and Director Brett Redfearn remarks, "[Equity Market Structure 2019: Looking Back and Moving Forward](#)," March 8, 2019.

<sup>9</sup> The [Securities Exchange Act of 1934](#), requires the SEC to ensure that exchange rules provide for "equitable allocation of reasonable dues, fees and other charges among its members and issuers and other persons using its facilities"; "promote just and equitable principles of trade," and prevent "unfair discrimination between customers, issuers, brokers or dealers" in Section 6. Section 11 of the Exchange Act provides that exchanges will distribute data on "fair and reasonable" terms, that are "not unreasonably discriminatory." Section 11 also emphasizes the "fairness and usefulness" of the information's form and content. The SEC has stated that consolidated core data needs to "be tied to some type of cost-based standard in order to preclude excessive profits if fees are too high or underfunding or subsidization if fees are too low." See [Concept Release: Regulation of Market Information Fees and Revenues](#).

<sup>10</sup> For example, see IEX publication, "[The Cost of Exchange Services: Disclosing the Cost of Offering Market Data and Connectivity as a National Securities Exchange](#)," January 2019.

<sup>11</sup> The Dodd-Frank Act of 2010 amended Section 19(b) of the Exchange Act to require immediate application of new SRO fees. Rule 608(b) of Regulation NMS requires immediate application of SIP fee changes.

We support the Division of Trading and Markets' exploration of whether trading markets for thinly-traded securities could be enhanced by the Commission suspending unlisted trading privileges (UTP) in an effort to enhance liquidity of smaller companies. Following from that inquiry, we anticipate that the Commission could craft carefully drawn exemptive relief from Regulation NMS in order to deepen trading markets for these securities.<sup>12</sup>

### **Transparency of Stock Exchanges in Regulatory Role**

In recent years our organization has submitted rulemaking petitions to national exchanges. These petitions, submitted directly rather than through the SEC, generally pertain to how exchange listing standards address public companies that deny public investors voting authority in proportion to their equity stake in the company.<sup>13</sup>

Setting aside the substance of that debate, the range of responsiveness we have encountered with respect to those petitions' *mere consideration* leads us to believe that there is room for improvement with respect to the quality of exchanges' review process for such petitions. We encourage the SEC to work with exchanges to ensure that exchanges publicly post the petitions receive, as well as market participants' comment letters responding to such petitions.

I am happy to respond to questions and comments, and appreciate the IAC considering how the SEC is responding to exchanges' evolving role in the market. Thank you for your time.

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<sup>12</sup> See Chairman Jay Clayton and Director Brett Redfearn remarks, "[Equity Market Structure 2019: Looking Back and Moving Forward](#)," March 8, 2019.

<sup>13</sup> See, for example, October 24, 2018 [CII letter to NASDAQ Stock Market](#) and [CII letter to NYSE](#), both dated October 24, 2018.