



Council of Institutional Investors  
The Voice of Corporate Governance

July 2015

# CII MARKET STRUCTURE ROUNDTABLE

---



COUNCIL OF INSTITUTIONAL INVESTORS  
The Voice of Corporate Governance

In 2015 the Council of Institutional Investors (CII) is celebrating its 30<sup>th</sup> anniversary. Over the past three decades, CII has been the leading voice in Washington, D.C., on public policy issues affecting institutional investors and the capital markets. Consistent with that tradition, on April 1 CII held a roundtable with chief investment officer's from several of CII's general member funds to discuss the topic of market structure.

The purpose of the roundtable was to provide a vehicle for CII and its members to learn more about, and to provide input on, two of the most important public policy questions currently facing the Securities and Exchange Commission (SEC): What are the flaws in the existing structure of the U.S. equity and debt markets that are detrimental to institutional investors? And, how might those flaws best be remedied to meet investor needs?

Moderated by James Angel, an associate professor at Georgetown University, the roundtable included presentations by Stephen Luparello, director of the SEC's Division of Trading and Markets; Brett Redfean, Americas head of market structure strategy at JPMorgan Chase; and Kashif Riaz, managing director of global capital markets at BlackRock.

This paper provides a bullet-point summary of some of the key issues identified and discussed by roundtable participants as a foundation for enhancing institutional investors' understanding of current market structure issues and potential reforms.

### ***Current SEC Market Structure Initiatives Affecting Institutional Investors***

Providing more information about on-order routing

- Current rules are focused on retail investors
- New rules would require disclosure of customer-specific information that would provide institutional investors with a better understanding of broker routing practices

Providing greater oversight and regulation of high frequency traders (HFT)

- New rules would subject certain HFTs to registration and SEC rules as dealers
- New rules would improve HFTs' risk management of trading algorithms and enhance oversight of their use
- New rules would limit risk of price disruption caused by HFTs
- Goal to limit HFT activity that creates market instability
- Concern that limiting HFT activity may have negative consequences for institutional investors in form of lower liquidity

Providing improved transparency of dark pools

- New rules would require Financial Industry Regulatory Authority membership for dealers that trade in alternative trading systems (ATS)
- New rules would require that ATS expand information they disclose to SEC about their operations and make operational information available to public
- Concern that institutional investors may be placing too much trust in ATS
- Alternative concern that more regulatory limitations on ATS transactions may deprive institutional investors of choices
- ATS may provide institutional investors with segmentation advantages or trading priorities that are not currently available on exchanges

## Credit Market Structure Issues Affecting Institutional Investors

Some asset managers are concerned that a market cycle of rising interest rates may expose structural flaws in corporate bond market, potentially resulting in lower liquidity and price deterioration

Some asset manager recommendations for improving market structure for credit bond markets

- Create more “all-to-all” trading venues
- Expand electronic trading protocols
- Standardize products
- Encourage behavioral changes
  - Investors give up new issue gains and liquidity arbitrage strategies in exchange for
    - Lower transaction costs
    - Access to deeper markets
    - Ability to buy and sell in greater size

Some institutional investor concerns with recommendations for improving market structure for credit bond markets

- Whether a standardized corporate bond market may have negative implications on
  - Availability of smaller corporate bond issues
  - Costs of market research
  - Market for liquidity providers
  - Market for smaller asset managers

## Equity Market Structure Issues Affecting Institutional Investors

Some asset managers have identified equity market structure issues that they believe negatively affect institutional investors

- Lack of market transparency
  - More transparency and disclosure of ATS transactions needed
  - More transparency of broker/order routing on exchanges needed
- Lack of liquidity
  - Whether reduction or elimination of order rebates will reduce liquidity, widen spreads, and/or increase explicit trading costs
- Lack of governance
  - Operating committees of self-regulatory organizations (SRO) currently control ownership, operation and pricing of public feed of market prices and pricing of exchange proprietary data feeds
  - Whether investors should have representation on SRO committees
- Lack of fairness
  - Whether selling of better/quicker market data at a premium by exchanges is fair to investors

## Roundtable Participants

### Presenters:

Stephen Luparello, director, Division of Trading and Markets, U.S. Securities and Exchange Commission

Brett Redfearn, Americas head, Market Structure Strategy, JPMorgan Chase

Kashif Riaz, managing director, Global Capital Markets, BlackRock

### Moderator:

James Angel, associate professor, Georgetown University

### Staff:

Jeff Mahoney, general counsel, CII

### CIO attendees:

Daniel Allen, CIO, State Universities Retirement System of Illinois

Jeanne Carr, executive director & CIO, Educational Employees' Supplementary Retirement System of Fairfax County

David Kushner, former CIO, Los Angeles County Employees Retirement Association

Girard Miller, CIO, Orange County Employees' Retirement System (via teleconference)

Jennifer Paquette, CIO, Public Employees' Retirement Association of Colorado

Andrew Sawyer, CIO, Maine Public Employees Retirement System

Scott Sleyster, SVP & CIO, Prudential Financial, Inc.

### Other attendees:

Andrew Droste, CII legal intern

Kate Fulton, managing director and member of BlackRock's Government Relations and Public Policy Group