

SEC's Equity Market Structure Advisory Committee Considers an Access Fee Pilot and Changes to the Regulation of Trading Venues

MAY 11, 2016

On April 26, 2016, the Equity Market Structure Advisory Committee (EMSAC or Committee)¹ held its fourth meeting at the Securities and Exchange Commission (Commission or SEC) in Washington DC.² The Committee is considering whether various regulatory or industry initiatives would improve the function of the US equity markets. At this meeting, the Committee focused on the work of various subcommittees related to the framework for a potential access fee pilot and the regulation of trading venues.³

Opening Remarks

In opening the meeting, Chair Mary Jo White thanked the subcommittees for their work to date⁴ and noted that she is “fully committed to pursuing market structure reforms that enhance our markets and are driven by data and careful analysis.” She also believes that “a properly designed access fee pilot would be an appropriate step in furthering our collective assessment of this significant aspect of our current market structure.”⁵ Commissioners Kara M. Stein and Michael S. Piwowar similarly expressed interest in the details of a potential access fee pilot.

Regulation NMS Subcommittee: Potential Access Fee Pilot

The EMSAC first discussed the preliminary recommendations of the Regulation NMS (Reg NMS) Subcommittee related to a potential access fee pilot (Potential Pilot Framework). Generally, the Potential Pilot Framework is intended to measure the impact of lower access fees on the provision⁶ and taking of liquidity.⁷ The subcommittee members reached a consensus that the Potential Pilot Framework should apply to securities with a market capitalization of \$3 billion or greater, include four categories of fee caps,⁸ and should not include a “trade-at” component.⁹

Panelists then offered their responses to the Potential Pilot Framework. Some criticized the Potential Pilot Framework as well as the composition of the Reg NMS Subcommittee, noting that the subcommittee and the Potential Pilot Framework do not represent the interests of retail investors, issuers or national securities exchanges. These panelists criticized the Potential Pilot Framework

as an unworkable one size fits all approach and urged the Commission to begin anew with a new subcommittee that includes representatives from national securities exchanges and publicly listed companies.

Committee members suggested the need to clearly define the objectives of the Potential Pilot Framework, including identifying potentially positive and negative outcomes from the pilot. For example, some participants discussed the possibility that the elimination or reduction of access fees could result in wider quotations. Committee members requested that the Commission provide periodic updates on any pilot program and be willing to end the pilot in advance of the target completion date if necessary.

Trading Venues Regulation Subcommittee: SRO Immunity, NMS Plan Governance, Technical Specifications, and Centralized Regulation

The Committee then discussed the Trading Venues Regulation Subcommittee's preliminary recommendations on SRO immunity rules, NMS Plan governance, rules requiring technology changes, and the centralization of common regulatory functions.

SRO Immunity

The subcommittee discussed whether the Commission should clarify exchange functions that are subject to SRO immunity, including whether exchanges should have higher levels of liability when engaging in riskier functions, e.g., initial public offerings or opening/closing auctions. The subcommittee also considered whether exchanges should be required to set aside funds, similar to a net capital requirement, in connection with any future liability. The subcommittee did not reach a consensus on these issues.

EMSAC members and panelists generally supported the subcommittee's considerations. One panelist noted that exchange immunity is an unfair competitive advantage and requested that the subcommittee go further than currently contemplated by recommending a meaningful increase of rule-based exchange liability levels to 10 to 20 times current limits.

NMS Plan Governance

The subcommittee preliminarily recommended changes to the NMS Plan governance structure, including the role of NMS Plan Advisory Committees. The subcommittee suggested: (1) clarifying the process for selecting advisory committee members, (2) expanding and formalizing the role of the advisory committees, (3) reducing the use of executive sessions, (4) limiting NMS Plan provisions that require a unanimous vote, and (5) revising the allocation of voting rights among the SROs.

Panelists and Committee members generally supported these recommendations. One panelist requested that broker-dealers have voting rights with respect to NMS Plans, noting, for example, that current SRO voting members are not incentivized to make the SIP competitive. Several Committee members questioned the value of this recommendation considering that a broker-dealer representative would receive only one vote.

Technology Specifications and the Rule Implementation Process

The subcommittee preliminarily recommended that, where a new or amended rule requires technology changes by the industry, the Commission and SROs link the implementation date of the rule change to the publication of technical specifications or FAQs. The subcommittee also preliminarily recommended that market participants have the opportunity to review and comment on draft technical specifications. Committee members and most panelists generally agreed with these suggestions.

Centralization of Regulatory Functions

The subcommittee preliminarily recommended that the SEC centralize common regulatory functions across SROs. While the subcommittee agreed that multiple SROs provide useful functions—e.g., real-time surveillance and monitoring for compliance with listing standards—it believes that certain SRO requirements can be centralized to reduce duplication (e.g., order marking and account type indicators). Committee members and most panelists generally agreed with these suggestions.

Updates from Other EMSAC Subcommittees

The Market Quality Subcommittee intends to recommend replacement of the limit up/limit down plan reopening auction with bands that adjust over time.¹⁰ Additionally, the subcommittee believes that the clearly erroneous execution rules should be consistent with limit up/limit down bands such that if a trade occurs within the bands, it should not be broken. The subcommittee also intends to recommend that all securities open at 9:30 a.m. ET, with limited exceptions for unique circumstances. Going forward, the subcommittee intends to address market making standards, closing auctions, and capital formation.

The Customer Issues Subcommittee also highlighted its progress. The subcommittee believes that stop orders are helpful to retail customers and that broker-dealers should review their practices for educating investors on the appropriate use of stop orders. It also suggested that the SEC and FINRA issue guidance on the use of stop orders. The subcommittee also suggested the enhancement and expansion of Rule 605 and 606 reports as well as the provision of greater access to the reports.¹¹ The subcommittee continues to review payment for order flow arrangements.

Next Steps

The Reg NMS and Trading Venues Regulation subcommittees will submit their final recommendations to the EMSAC in the coming weeks and the Committee will hold a vote shortly thereafter. The Market Quality and Customer Issues subcommittees likely will present their recommendations to the Committee at the meeting held during the third quarter of 2016.

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WilmerHale. This alert is for general informational purposes only and does not represent legal advice regarding any particular set of facts.

¹ As an advisory committee to the SEC, EMSAC is organized and operates pursuant to the Federal Advisory Committee Act. See Federal Advisory Committee Act, 5 U.S.C. app. §§ 1-16 (2015). Accordingly, the Committee's proceedings are open to the public, and the Committee, while not a formal rulemaking body, ultimately will make recommendations to the Commission for possible action. Accordingly, market participants with interest in any of these topics should consider whether and how (e.g., a White Paper or comment letter) to make their views known to the Committee in a timely manner. Comments submitted to the Committee to date are available on the SEC's EMSAC Spotlight Page, as are instructions for submitting public comments.

² The EMSAC is comprised of senior executives from large institutional broker-dealers, self-regulatory organizations, an ATS, technology firms and the AARP, along with academics with specialties in economics, finance, financial engineering, computer science and artificial intelligence, and law. See [EMSAC Spotlight Page](#), SEC (last modified Apr. 26, 2016).

³ The Committee focused on the Order Protection Rule of Regulation NMS in its first meeting, access fees and the regulatory structure of trading venues in its second meeting, and market volatility and customer issues in its third meeting. See Andre Owens, Bruce Newman and Mahlet Ayalew, WilmerHale, [SEC Equity Market Structure Advisory Committee: Assessing Complexity in the U.S. Equity Markets](#) (May 21, 2015); Andre Owens, Brandon Becker, Cherie Weldon and Mahlet Ayalew, WilmerHale, [Access Fees and Regulatory Structure of Trading Venues](#) (Nov. 5, 2015); and Andre Owens, Bruce Newman, Brandon Becker, Cherie Weldon and Mahlet Ayalew, WilmerHale, [SEC's Equity Market Structure Advisory Committee Considers Market Volatility and Customer Issues](#) (Feb. 29, 2016).

⁴ Each subcommittee submitted a report to the Committee outlining the respective sub-committee's progress to date and potential recommendations going forward, which are available on the SEC's EMSAC Spotlight Page.

⁵ Mary Jo White, Chair, SEC, [Opening Remarks to the Equity Market Structure Advisory Committee](#) (April 26, 2016).

⁶ Specific areas of interest include bid/ask spreads, market depth, order routing behaviors, the ratio of hidden liquidity against displayed liquidity on an exchange, quoting behavior, and the average amount of time to receive a fill.

⁷ Specific areas of interest include the ratio of on versus off exchange trading, order routing behaviors, price impact, slippage/realized spread, and trade volume.

⁸ The first bucket would serve as the control group, the second bucket would have a \$.0020 access fee cap, the third bucket would have a \$.0010 access fee cap, and the fourth bucket would have a \$.0002 access fee cap. The subcommittee did not come to a consensus on prohibiting rebates for

the fourth fee cap category, applying the fourth category of fee caps to inverted venues, or applying access fee limits to alternative trading systems (ATSs).

⁹ See Andre Owens, Bruce Newman and Mahlet Ayalew, WilmerHale, [SEC Equity Market Structure Advisory Committee: Assessing Complexity in the U.S. Equity Markets](#) (May 21, 2015); and Andre Owens, Brandon Becker, Cherie Weldon and Mahlet Ayalew, WilmerHale, [Access Fees and Regulatory Structure of Trading Venues](#) (Nov. 5, 2015).

¹⁰ See Andre Owens, Bruce Newman, Brandon Becker, Cherie Weldon and Mahlet Ayalew, WilmerHale, [SEC's Equity Market Structure Advisory Committee Considers Market Volatility and Customer Issues](#) (Feb. 29, 2016).

¹¹ Among other things, the subcommittee believes that retail focused Rule 605 reports could include odd lots, segregate immediate or cancel orders, and include quoted spread and enhanced liquidity. Additionally, retail focused Rule 606 reports could include a section for over-the-counter equity data, identify routing destinations consistently across all reporters, and include execution quality statistics by routing destination.

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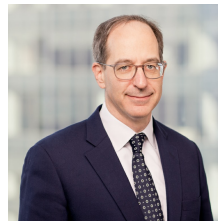
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