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**For the Record of the United States House of Representatives
Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship,
and Capital Markets**

**“Oversight of America’s Stock Exchanges:
Examining Their Role in Our Economy”**

March 30, 2022

Chair Sherman, Ranking Member Huizenga, and Members of the Subcommittee, thank you for the opportunity to provide this statement on behalf of Fidelity Investments regarding equity market structure reform, which is needed to ensure our capital markets are aligned with the needs of today’s retail investors and market participants.

Today’s hearing and the important topics being discussed could not be timelier, as we find ourselves at a critical juncture in the evolution of equity market structure. The proliferation of online brokerages and self-directed trading platforms, advances in technology, and low or no cost trading have introduced intense competition that has dramatically transformed our marketplace and fostered an unparalleled experience for retail investors. Today, investors have more financial tools available than at any time in history to take advantage of our capital markets to save money for a child’s college tuition, plan for retirement, and invest in their family’s future.

For nearly ninety years since enactment of the Securities Act of 1933 and Securities Exchange Act of 1934, regulation of our capital markets has been premised on the self-regulatory model, wherein Congress vested certain self-regulatory organizations (“SROs”), including securities exchanges, with authority to regulate other market participants, with the Securities & Exchange Commission (“SEC” or “Commission”) exercising oversight of SRO activities. Under this construct, SROs have broad authority to directly regulate the activities of broker-dealers, ATSS, exchange members, and listed firms, among others.

While our capital markets have grown and flourished under this model, over the past several decades equity market structure in the United States has experienced a series of extraordinary changes. Demutualization of the exchanges, the rise of algorithmic trading, and the introduction of intense competition in the marketplace have blurred the roles that various market participants play and given rise to potential conflicts of interest. In the face of these dramatic shifts in the marketplace, many market participants are beginning to question whether the self-regulatory model still is the best way to promote fairness and efficiency in the marketplace. Indeed, even the

Commission has raised questions about the continued viability of the SRO model, inviting public comment on a wide variety of equity market structure issues over the past several years.

As we collectively think of the path forward, it is incumbent on Congress to examine whether the self-regulatory structure remains appropriate for national securities exchanges and how it addresses current conflicts of interest resulting from the exchanges' dual role as market participant and regulator. This leads to an overarching question: Does the current structure best serve investors?

We are not the first to raise this question. Among others, in 2004 the SEC published a Concept Release requesting public comment on a variety of issues relating to the efficacy of self-regulation and self-regulatory organizations, including, the inherent tensions in this model and its strengths and weaknesses.¹ Similarly, in 2018, the Treasury Department recommended that the SEC conduct a comprehensive review of the roles, responsibilities, and capabilities of the SROs under its jurisdiction and make recommendations for operational, structural, and governance improvements of the SRO framework, including transparency into fee structures, appropriate application and limitations on immunity and private liability, and changes to SRO regulatory review process.² The SEC has not yet published this review.

SRO reform is a critically important topic for Congress to address because it impacts key structures in the U.S. equity markets in which millions of Americans invest.

Evolution of the SRO Model

Today, our capital markets include over twenty securities exchanges, such as the NYSE, Nasdaq, and Cboe BZX, which are designated as self-regulatory organizations (“SROs”) under the Securities Exchange Act of 1934 (“Exchange Act”). Historically, exchanges holding this SRO designation were member-owned utilities that maintained centralized markets while broker-dealers provided order routing and execution services.

However, the equity markets of 2022 look considerably different than the equity markets of 1934, or even 1970, which is when Congress last made significant changes to the Exchange Act. Today, exchanges are demutualized, publicly traded, for-profit commercial enterprises with a fiduciary duty to their shareholders to maximize profits. Exchanges offer similar types of order matching services to broker-dealers and directly compete with broker-dealers for order flow. Modern exchanges thus regulate the very entities that they actively compete with in the marketplace.

Fidelity supports effective regulation of the securities markets and competition. However, modern for-profit exchange businesses now bear little resemblance to the historic member-owned cooperatives that were initially granted SRO status by Congress. The SRO status of exchanges is predicated on a business model that no longer exists. Moreover, the current SRO model creates

¹ U.S. Securities & Exchange Commission, *Concept Release Concerning Self-Regulation* (Nov. 9, 2004), available at <https://www.sec.gov/rules/concept/34-50700.htm>.

² Treasury Department, *A Financial System That Creates Economic Opportunities: Capital Markets* (Oct. 2017), available at <https://home.treasury.gov/system/files/136/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf>.

conflicts of interest between the exchanges' commercial businesses and their regulatory obligations and should be updated to reflect current market practices.

While the SRO regulatory structure can and should be modernized, the SEC has only limited authority in this regard and there is an important role that Congress must play in enhancing the regulatory framework governing the exchange/SRO model. Provided below are a number of recommendations for legislative initiatives Congress should consider pursuing to enhance equity market structure and the SRO model to align with the realities of how our capital markets operate in 2022.

Recommendation #1: Limit SRO status of exchanges so that they are SROs only for their own markets.

First, we believe that Congress should enact legislation mandating that exchanges act as SROs only for their own markets. This recommendation would codify existing exchange regulatory outsourcing practices and rationalize the exchanges' regulatory role in relation to their current business model. Such a limitation would not impact the ability of an exchange to set and enforce its own listing standards.

Today, every SRO, which includes FINRA and each of the national securities exchanges, has an obligation to examine and enforce compliance by its member firms with the federal securities laws and the SRO's own rules. Although broker-dealers may belong to multiple exchanges, and are FINRA members, they do not often find themselves facing duplicative examinations by FINRA and various exchanges. This is because the exchanges have often relied on FINRA to perform regulatory functions, including surveillance, examinations, investigations, and enforcement functions, pursuant to Regulatory Services Agreements and Rule 17d-2 plans.³ This coordinated, outsourced regulatory model has created a more efficient, centralized examination and enforcement program, allowing FINRA to identify overlapping issues, mitigate regulatory duplication and reduce contradictory regulatory outcomes.

Further, if all cross-market regulation and enforcement of federal securities laws were administered exclusively by the SEC or FINRA, in the same capacity in which they act today, certain industry concerns with the Consolidated Audit Trail ("CAT") would be alleviated. For example, under its current construct, all of the exchanges, FINRA, and the SEC have the ability to access investor trade data across all markets, both inside the CAT database and by downloading CAT data to their own systems. The ability of more than twenty regulators to download customer data and trading records presents serious data security concerns. To mitigate these concerns, exchanges should only have the ability to access trading activity for their own market, and FINRA and the SEC for all markets.

³ U.S. Securities & Exchange Commission, Division of Trading and Markets, *Staff Paper on Cross-Market Regulatory Coordination* (Dec. 15, 2020), available at <https://www.sec.gov/tm/staff-paper-cross-market-coordination>; see also Susan Schroeder and Jessica Notebaert *Decentralization and Duplication in Broker-Dealer Regulation*, Bloomberg Law (Aug. 2020) available at: <https://www.wilmerhale.com/en/insights/publications/20200901-de-centralization-and-duplication-in-broker-dealer-regulation>.

Recommendation #2: Expand NMS Plan governance representation and limit SEC use of NMS Plans.

Second, we recommend that Congress explore legislation that would expand National Market System (“NMS”) Plan governance and limit the use of NMS Plans by the SEC.

By way of background, the 1975 Amendments to the Securities Act of 1934 authorized the SEC to delegate certain of its rulemaking authority to exchanges via NMS Plans. The SEC has increasingly used NMS Plans (as opposed to direct rulemaking) to implement certain key market functions such as the CAT, Limit Up-Limit Down (“LULD”)/Market Wide Circuit Breakers and the Securities Information Processors (“SIP”) that disseminate equity market data to the marketplace.

While some NMS plans work well (for example LULD), other plans, particularly those that present a conflict of interest between the for-profit exchanges’ commercial interests and their regulatory obligations, have not worked well. In particular, the operation of the CAT and SIP Plans has given rise to dramatically escalating costs and delays. This is due, in part, to the fact that NMS Plans are currently exclusively operated by the exchanges and FINRA. Market participants, such as broker-dealers and asset managers, are not permitted to attend or vote on NMS Plan Operating Committees where key decisions on the Plan’s governance and operation are made. As a result, we have observed NMS plan policies that are designed to benefit the exchanges’ commercial business interests at the expense of broker-dealers, who the exchanges both regulate and compete with in the marketplace.

For example, the SEC delegated the design, implementation, and operation of the CAT to the exchanges and FINRA. Industry members (such as broker-dealers and asset managers) have been excluded from meaningful participation in the development of the CAT, even though broker-dealers have been asked to bear up a considerable portion of the historical and future costs of implementing and running the CAT under a recent SRO proposal. If broker-dealers will be asked to pay for most CAT expenses, they should have a seat at the table and meaningful, direct voting rights on the CAT Operating Committee. Broker-dealer participation on the Operating Committee would also introduce diversity of thought that could benefit decision-making related to the CAT.

Another important example of an NMS Plan function where the views of broker-dealers and asset managers have been ignored is market data. Through the SIP NMS Plans, the exchanges enjoy an oligopoly over equity market data fees. The SEC has endeavored to introduce transparency and competition for exchange market data and to enhance the ecosystem for market data and market access through two actions: the new CT Plan and the Market Data Infrastructure Rule. The new CT Plan—which governs the public dissemination of real-time consolidated equity market data for NMS stocks—would restructure the CT Plan Operating Committee to allow for direct voting participation by broker-dealers and asset managers and reduce the voting power of the exchanges. The NYSE, Nasdaq and CBOE are challenging the SEC’s authority to implement the new CT Plan in the D.C. Circuit Court. If the exchange plaintiffs are successful, it is unlikely that the SEC will act quickly to address this unlevel playing field given the agency’s already robust agenda.

We respectfully submit that Congress should amend the Exchange Act to mandate that industry representatives such as broker-dealers and asset managers have meaningful, direct voting participation in the governance of NMS Plans, as well as transparent access to the same information that exchanges currently receive. Having a broader representation of market participants will expand the expertise and value of these important NMS Operating Committees. This change would also be consistent with the statutory requirement that broker-dealers have representation on the boards of the exchanges themselves. In addition, the SEC should be discouraged from using NMS Plans to delegate rulemaking authority. The SEC should use NMS Plans sparingly (*i.e.*, primarily for technical, rather than commercial matters), and instead, regulate through direct SEC rulemaking.

Recommendation #3: Require exchange market data filings to follow a standard notice and comment process prior to SEC approval, consistent with the standard for such filings prior to the Dodd-Frank Act.

Third, we suggest that Congress advance legislation that would subject exchange market data fee filings to the standard notice and comment process that is applicable to other proposed exchange rules.

As SROs, exchanges must file rule changes, including fee changes, with the SEC. As a general matter, the SEC may approve a rule change only after determining that the proposal is consistent with the requirements of the Exchange Act. Prior to the passage of the Dodd-Frank Act, SRO rule changes related to fees were subject to a public notice and comment process before approval or disapproval by the SEC. Dodd-Frank Section 916, however, amended Section 19(b) of the Exchange Act to provide that SRO fee changes become immediately effective upon filing. Similarly, pursuant to SEC Rule 608(b) under Regulation NMS, SIP fee changes become effective immediately upon filing. The SEC addressed fee filings in connection with NMS plans (which now require a public notice and comment period) but does not have the power to change the Exchange Act.

The lack of a public notice and comment process for exchange market data fee filings has had the perverse effect of rendering the basis for an exchange's equity market data fees and accessibility requirements opaque to investors and market participants. Exchanges may implement new fees or increase existing fees for market data feeds with minimal review. The SEC has authority to suspend a fee filing after it has been filed, but it has only very rarely exercised its discretion to intervene in connection with exchange fee filings. In the public interest and for the protection of investors, there should be more transparency and stakeholder input into fee filings through the public notice and comment process, as well as more transparency into fee increases.

Recommendation #4: Only allow exchanges to claim regulatory immunity when engaged in regulatory functions.

Fourth, Congress should allow exchanges to claim regulatory immunity only when engaged in true regulatory functions.

As SROs, exchanges benefit from the judicial doctrine of regulatory immunity, which grants them protection from private liability for damages in connection with their true regulatory activities. This concept is consistent with the Exchange Act, which recognizes two statutory functions for exchanges: (1) as market participants (through the exchange function); and (2) as market regulators (through the SRO function). However, the exchanges have increasingly attempted to conflate these two functions and claim regulatory immunity for all of their activities – not just regulatory but also commercial.

Among other items, commercial activities of an exchange include (i) competition for order flow, (ii) sale of market data or connectivity, and (iii) routing and execution services, which both exchanges and broker-dealers offer but are subject to vast competitive imbalances. Allowing exchanges to claim regulatory immunity for all their activities prevents investors and market participants from holding for-profit exchanges accountable for any damages caused in connection with their commercial activities. Moreover, competition is not fair when parties that offer the same commercial services are not held to the same risk of liability. Congress should amend the Exchange Act to specifically provide that exchanges are not immune from lawsuits arising out of their commercial activities. This approach would codify the view articulated by the SEC in a 2016 amicus brief that “absolute immunity is properly afforded to the exchanges when engaged in their traditional self-regulatory functions – where the exchanges act as regulators of their members.”⁴

Recommendation #5: Prohibit exchanges from creating rule-based limitations on liability.

Finally, we suggest that Congress consider legislation that would prohibit exchanges from creating rule-based limitations on liability.

Exchanges unilaterally impose limitations on liability on their members that have no relation to the financial losses a member firm could sustain as a result of exchange activity. Conversely, broker-dealers are subject to the same liability as any other commercial entity. Most of the exchanges limit liability to an aggregate of \$500,000 a month, and the SEC is required to approve any awards beyond the level set in the exchanges’ rules. Broker-dealers are powerless to negotiate the limitations on liability demanded by exchanges because these limitations are established in the exchanges’ rule books, which are approved by the SEC. This special, one-sided arrangement, which to our knowledge is not present in any other regulated American industry, confers on the exchanges an unfair and inappropriate competitive advantage over their competitors and eliminates an important form of market-based discipline, creating a moral hazard. Moreover, with over twenty national securities exchanges, and close to 34 alternative trading systems, if any one exchange were to fail, trading could migrate to another venue, and would not risk the overall stability of the financial markets.

Congress should amend the Exchange Act to prohibit exchanges from creating rule-based limitations on liability. This would allow broker-dealers to negotiate directly with the exchanges in arms-length transactions and, when appropriate, allow courts to impose liability in amounts

⁴ See Brief of the Securities and Exchange Commission, Amicus Curiae, City of Providence, Rhode Island et al. v. Bats Global Markets, Inc., et al., No. 15-3057 (2d Cir. 2016), available at <https://www.sec.gov/litigation/briefs/2016/providence-bats-global-markets-1116.pdf>.

commensurate with the actual losses sustained. Doing so would impose market discipline on exchanges to make responsible decisions to prevent systemic issues in the marketplace and to maintain financial resources to absorb the consequences of any failure without relying on market participants.

Recommendation #6: Require the SEC to modernize additional Antiquated Rules, such as Rules for E-Delivery.

As Congress considers actions to modernize the SRO model of the US equity markets, Congress should similarly ask the SEC to modernize the way broker-dealers communicate with their customers. The SEC's current guidance governing the use of electronic delivery of documents is more than twenty years old, defaults investors to paper delivery, and fails to reflect advances in technology and changing investor preferences.

Today, we are required to send millions of paper statements annually, inundating our customers with paper and harming the environment. SEC rules requiring firms to send investors paper documents by mail should be replaced with a framework based on electronic delivery. This framework would not prevent an investor from receiving communications in paper format via postal mail, if that's their preference, as an alternative to electronic delivery.

Electronic delivery of documents provides investors with access to their document in the most timely and effective manner, by sending immediate notifications when documents are available. This allows investors to take action and be more engaged with their investments. Electronic delivery is secure, with sensitive documents accessible when an investor securely logs-in to their account, rather than when an envelope is delivered by postal mail. Individuals with disabilities, also benefit from electronic delivery. Many of these customers use screen readers and other assistive technologies to read documents, which are much easier to access electronically. Finally, electronic benefits the environment by significantly reducing paper use and printing and mailing resources.

Along with this electronic delivery approach, we recommend that Congress encourage the SEC to examine its rules to eliminate any "in writing" requirements in the regulatory text. This should be a relatively straightforward exercise, as it involves revising wording in the text of rules from "in writing" to such words as "furnishing" or "providing." We recommend this change to eliminate any confusion that the SEC's rules and interpretations apply to the delivery of regulatory documents instead of being regulated under the E-Sign Act.⁵

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Our U.S. capital markets are the deepest, most dynamic, and most liquid in the world. The retail investor experience has never been as affordable or accessible. However, to sustain the

⁵ The E-Sign Act states that "if a statute, regulation, or other rule of law requires that information relating to a transaction or transactions in or affecting interstate or foreign commerce be provided or made available to a consumer in writing," then specific requirements, which are different from the SEC's, must be met to deliver it digitally. See 15 USC S.7001, at <https://www.law.cornell.edu/uscode/text/15/chapter-96>.

preeminence of our markets, it is incumbent on legislators and regulators to continuously monitor the market environment and modernize and enhance the underlying regulatory framework to ensure that it is aligned with the needs of today's investors. Congress has a vital role to play in this process, and a reexamination of the continued viability of the self-regulatory model is a critical step whose time has come.