MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
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Managed Funds Association
Equity Market Structure Policy Recommendations
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The U.S. equity markets have evolved dramatically the last thirty years with both regulatory changes and technological innovations that have largely benefited retail and institutional investors. Nevertheless, regulators should periodically assess market practices and regulations to ensure that U.S. equity markets continue to remain efficient, liquid, fair, transparent, and stable for all market participants. MFA represents the global alternative investment industry and its investors; and in such capacity, welcomes a number of proposed regulatory initiatives to improve market resilience and risk management, and increase disclosure and transparency. To the extent regulators need to experiment with existing market structure, they should proceed with caution and focus on the impact any changes could have on investors.

INTRODUCTION

Over the past two decades, U.S. market regulations have supported the evolution of equity markets by reducing anticompetitive barriers and promoting fair access to markets and market information. The regulatory framework has fostered innovations in technology that have revolutionized investing in our equity markets and promoted greater competition among marketplaces, all to the benefit of both retail and institutional investors. Indeed, the cost of investing for retail and institutional investors has decreased significantly over the past decades as technologies have improved efficiency and layers of market intermediation have been removed. Advancements in technology have empowered investors with more sophisticated and efficient methods to access markets and execute their investment strategies. As with all technological innovations, however, change brings challenges to market participants, and at times, their business models as well. Nevertheless, the Securities and Exchange Commission ("SEC" or the "Commission") must stay focused on its goal to "adopt regulatory approaches that ensure intermediaries harness the forces of technology and competition to better serve the needs of investors".[1]

MFA supports regulators' plans for a holistic review of equity markets and assess whether regulatory enhancements are needed to address new or changing vulnerabilities. MFA agrees with SEC Chair Mary Jo White's recent statements that it is essential to ensure that "our markets continue to operate openly, fairly, and efficiently to *benefit investors* and *promote capital formation* [emphasis added]" as the "secondary markets exist for investors and public

[1] Mary Jo White, Chair, SEC, Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors, June 20, 2014, *available at:* http://www.sec.gov/News/Speech/Detail/Speech/1370542122012#.VBiOIVJMuM9.

companies, and their interests must be paramount."[2] Accordingly, "all equity market structure issues must be evaluated through the prism of the best interests of investors and the facilitation of capital formation for public companies."[3] In reviewing market structure, it is critical for regulators to take a systematic, data-driven and unbiased approach to continue to foster competition, while limiting harm to investors and issuers.

As the Commission considers equity market structure issues, MFA believes that a number of recent regulatory initiatives have contributed to decreasing operational risk and improving market quality. Nevertheless, MFA believes that more can be done to advance these initiatives and address risk, market quality and investor confidence:

IMPROVING MARKET RESILIENCE AND RISK MANAGEMENT

MFA has supported certain standardized market measures and believes they have been extremely effective in limiting market disruptions and reducing investor confusion in times of extreme market volatility. Such measures include the use of market-wide circuit breakers, price collars (*i.e.*, the Limit Up-Limit Down mechanism), and uniform exchange rules on clearly erroneous executions. In addition, MFA has supported the Market Access rule[4] and believes it has been effective in reducing risks faced by broker-dealers, their customers including institutional and retail investors, and the markets more generally. However, we believe additional steps can be taken to bolster risk management practices.

Pre-Trade Controls

- The Commission or the Financial Industry and Regulatory Authority ("FINRA") should provide more specific guidance on pre-trade risk controls to increase transparency to investors, encourage greater uniformity of controls among broker-dealers, and reduce concerns with respect to discrepancies in latency.

Standardized Kill Switches

- The Commission should direct the Exchanges to work together to develop a standardized mandatory kill switch protocol, methodology, and rules. Standardizing a kill switch protocol will simplify implementation and use by exchange members, as well as create a level playing field with respect to discrepancies in latency.

INCREASING DISCLOSURE AND TRANSPARENCY

Regulators and market intermediaries have taken a number of steps to increase disclosure and transparency. MFA supports these efforts but believes more work can be done to improve transparency, which is essential to investor confidence and a robust marketplace.

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[2] Mary Jo White, Chair, SEC, Enhancing Our Equity Market Structure, June 5, 2014, *available at:* http://www.sec.gov/News/Speech/Detail/Speech/1370542004312#.VAypdlJMtaQ.

[3] *Id.*

[4] Rule 15c3-5.

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Trading Venue Transparency

- MFA supports the steps FINRA and certain alternative trading systems ("ATSs") have taken in enhancing market transparency by making publicly available information on total shares traded each week per stock in each ATS, and information on how each ATS operates, respectively.
- FINRA should expand its ATS transparency initiative to include weekly volume and trade information on a stock-by-stock basis for equity securities traded over-the-counter by each FINRA member.
- The Commission should require an ATS to make publicly available on its website its Form ATS, and information on how it operates and how orders interact on the ATS. The SEC should also make available on its website a list of ATSs and links to each ATS's Form ATS. This would facilitate disclosure to investors and enhance their ability to compare venues.

Timely Market Data

- MFA believes it is critical for market data and pricing information from all sources to be timely and accurate.
    - **Co-location** is one means by which market participants obtain timely and accurate market data. MFA supports the Commission's current approach for regulating co-location services and believes co-location services should be available to all market participants on a fair-access basis.
- The SEC should request Plan Participants of the Securities Information Processors ("SIPs") to improve the reliability, resilience, connectivity and latency of the SIPs. Recent outages and other issues highlight the fragility of the SIPs, which are integral components of the of equity market infrastructure.
- In addition, each market providing data to the consolidated data feeds should include a time stamp, synchronized with a synchronized time server, to indicate when a trading venue processed the display of an order or executed a trade. Timestamps on third-market trades should be taken at the time the trading center executes the trade. In this way, market participants would be able to monitor the latency of each feed and assess its sufficiency.

Order Routing Disclosure

- The SEC should require broker-dealers to provide more detailed disclosures of order routing and execution practices. Providing more detailed information on price improvement and order execution to investors, in a uniform manner, would allow investors to compare routing and execution across broker-dealers. The SEC should consider amending Rules 605 and 606, not with a one-size-fits-all approach, but to require disclosure reports that provide more granular information and are designed specifically for the use of either the retail or institutional investor in mind. These reports should serve as a minimum level of disclosure by broker-dealers, as investors should have the ability to seek greater information.

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- Exchanges should provide clearer disclosure on order routing, order type interaction, and execution volume from displayed orders, partially displayed/undisplayed orders, and fully undisplayed orders.

Exchange Order Types

- The SEC has recently heightened its review of the function of order types and should continue to ensure that order types "promote just and equitable principles of trade" and, in general, "protect investors and the public interest".[5] Exchanges should ensure that order type information is readily accessible to market participants, including clear descriptions on function, use and benefits, as well as data on use and fill rates.[6]

Implementing Careful and Controlled Pilot Programs

MFA supports the Commission's policy of making changes to market structure deliberately and only after careful study: "[a]ddressing the issues of our current market structure demands a continuous and comprehensive review that integrates targeted enhancements with an expansive consideration of broader changes."[7] A disciplined, data-driven approach ensures that rulemaking is driven, less by competitive interests among market participants, and more by measurable benefits to liquidity, efficiency, competition and capital formation. To safeguard the integrity of experimental data, however, the Commission must design pilots wisely. Implementing many changes simultaneously will make it hard to evaluate the results and will increase market complexity.

Tick Size Pilot Program

- Historically, MFA supported a more limited tick size pilot program. MFA believes, however, that the proposed Tick Size Pilot Program, as submitted by the national securities exchanges and FINRA, will harm investors by artificially widening spreads and increasing trading costs without any tangible benefit to market quality.
- The proposed Tick Size Pilot Program has expanded far beyond the original focus on small cap stocks—now including 1,200 companies with capitalization levels that are generally higher than those recently contemplated by Congress or prescribed in other contexts in the Jumpstart Our Business Startups ("JOBS") Act.[8]

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[5] Section 6(b) of the Securities Exchange Act of 1934, as amended. 15 U.S.C § 78f(b).

[6] *See, e.g.,* NYSE Arca, Executed Order Types Usage, *available at:* *https://www.nyse.com/publicdocs/nyse/markets/nyse-arca/NYSE_Arca_Order_Type_Usage.pdf*; *and* BATS Global Markets Inc., Order type Usage Summary, *available at:* http://www.batstrading.com/market_data/order_types/.

[7] *Id.*

[8] *See, e.g.,* U.S. House, 113th Congress. "H.R. 3448. Small Cap Liquidity Reform Act of 2014" *available at:* *https://beta.congress.gov/bill/113th-congress/house-bill/3448*. H.R. 3448 provides that issuers eligible for the liquidity pilot program are emerging growth companies with total annual gross revenues of less than $750,000,000. *See, e.g.,* JOBS Act, Pub. L. No. 112-106 (defining an "emerging growth company" as an issuer with total annual gross revenues of less than $1,000,000,000) *available at:* http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf.

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- For purposes of testing market quality for small cap stocks, the SEC should limit its Tick Size Pilot Program to truly small cap stocks—*i.e.*, stocks with gross revenue of $750 million or less.
- The Trade-At provision complicates the Tick Size Pilot by adding variables that could meaningfully impact the data of the Tick Size Pilot by drastically changing market participant behavior. The Commission should exclude a Trade-At provision from a Tick Size Pilot, as it will likely frustrate the Commission's intent to assess the impact of increased tick sizes on liquidity for small cap stocks.
- If the Commission is still inclined to experiment with tick sizes, the SEC should consider also a pilot to reduce the tick increment to a half-penny for stocks with the highest trading volumes. MFA believes this change in tick size could improve market quality for investors and reduce trading costs.

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