

Written Statement of Brett W. Redfearn, J.P. Morgan Securities LLC
Comments to the SEC's Equity Market Structure Advisory Committee
On The Regulatory Structure of Trading Venues

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Chair White, Commissioners, Director Luparello, and members of the SEC's Equity Market Structure Advisory Committee, thank you for the opportunity to speak with you today on the topic of the regulatory structure of trading venues.

My name is Brett Redfearn and I am responsible for market structure strategy for JPMorgan Securities, one of JPMorgan Chase & Co.'s SEC-registered broker dealers. In this role, my responsibilities include being a member of the CTA/UTP SIP Advisory Committee, the Limit Up-Limit Down (LULD) Advisory Committee, the Board of Directors of BATS Global Markets, and Chair of SIFMA's Equity Markets and Trading Committee.

As most of you know, JPMorgan's Corporate & Investment Bank is a global leader across banking, markets and investor services, serving corporations, governments and institutions in 60 countries. Our firm provides strategic advice, raises capital, manages risk and provides liquidity in markets around the world with a global roster of 7,200 clients. Our Markets business operates a full suite of trading businesses including cash, derivatives, portfolio trading and electronic trading, which combined account for 8-9% of the total daily volume of the US equities markets, approximately 600 MM shares a day.

I greatly appreciate the opportunity to speak with you today on the current regulatory model for trading venues and for market data dissemination. This may not be the most exciting topic in the market structure debate; however, it is one of the most important. The current regulatory model and related governance structure is a fundamental underpinning of our marketplace, and the policy decisions made regarding SRO governance are interlinked with most other critical market structure issues.

Given the limited time, my remarks will focus on the governance model of our National Market System (NMS) Plans, with a specific focus on Plans for the collection and dissemination of market data, generally known as the Securities Information Processors, or SIP Plans. At the outset, it is important to make clear that my comments regarding NMS Plans are not solely limited to the SIP Plans. Governance changes to the NMS Plans are needed for all NMS Plans.

NEED FOR CHANGES TO NMS PLAN GOVERNANCE

As you know, NMS Plans are a creation of the 1975 Amendments to the Securities Exchange Act. At that time, in 1975, the world was a very different place. U.S. equity exchanges were not-for-profit, member-owned -- or mutualized -- organizations. The exchanges were not publicly traded, and they did not engage in the broad array of diversified businesses that exchanges run today. The original mutualized nature of exchanges ensured a member firm and investor linkage to Plan governance that largely deteriorated in the demutualized world.

NMS Plans are basically a form of decision making, a form of governance, and a construct to operate major parts of our National Market System. In addition to the NMS Plans used to govern and operate the SIPs, other NMS Plans are also in effect for the Consolidated Audit Trail, the Tick Pilot, and the Limit Up-Limit Down Plan (LULD). It would appear that the uses for NMS Plans are increasing. These Plans are used for our fundamental market data infrastructure, soon, our underlying regulatory infrastructure, and some of the most significant market structure rule changes to be implemented this decade: LU-LD, the Tick Pilot, and possibly other Pilots.

The key governance issue with these Plans is this: Unlike boards of exchanges, or entities like the Depository Trust & Clearing Corporation (DTCC), NMS Plan “participants” or Board members are exclusively representatives of Self Regulatory Organizations (SROs); i.e., exchanges and FINRA. As noted, exchanges today are for-profit, publicly traded companies that run businesses that not only compete with broker dealers, but that also compete with the very market data product offered by the SIPs. Today’s NMS Plan governance fails to address and mitigate this fundamental conflict of interest.

NMS Plan governance should be reevaluated and updated to fit today’s business realities. The inherent conflicts of interest in NMS Plans must be addressed and balanced to better align interests and to reflect a more holistic view of the market. An important part of the solution is to address the related governance model and to ensure broader industry representation. At a minimum, NMS Plans should include voting representation from broker-dealers and asset managers. In addition, the requirement for unanimous approval of major changes can be paralyzing and should be modified.

NEED TO ADDRESS CONFLICTS OF INTERESTS

Speaking specifically about the SIP Plans, there are two fundamental conflicts of interest that have not and can not be addressed under the current structure.

Conflict 1. Among the current Plan participants, there is a disincentive to invest in the SIPs and to make them competitive products. The more money that is invested in SIPs -- in both capital and operating costs -- the less net revenue is left for revenue sharing among exchanges. This creates an inherent disincentive to invest. A better SIP likely is a more expensive SIP. However, a more expensive SIP would take expected revenue directly out of the pockets of each of the exchange participants sitting at the table.

This issue was highlighted after an evaluation of the 3 hour trading halt of all NASDAQ securities on August 22, 2013, which resulted from a flaw in the software code of the NASDAQ UTP SIP. Observers have highlighted that this failure was, at least in part, a consequence of a lack of investment in this important part of our market’s infrastructure. This issue was not just NASDAQ’s problem; this was a problem that resulted from the overall governance over the operations of the UTP SIP Plan.

Lately, the Plan Participants are making greater investments in the SIPs, driven by Chair White’s demands for action plans back in September 2013 following the NASDAQ SIP Outage.

However, these efforts are limited in vision and inadequate to bring the SIP infrastructure up to the standards that the private marketplace is otherwise addressing.

Conflict 2. SRO Participants of the equity SIP Plans are selling market data products that directly compete with the SIPs.

Unlike SIPs, 100% of the revenues from competing, proprietary market data products go to the exchanges selling that data. These proprietary data products are far superior to the product produced by the SIPs, such that broker-dealers -- including my firm -- must purchase these proprietary data feeds from exchanges to provide competitive trading products for our clients.

The latency issues associated with the SIP are today so well known that, for broker dealers providing electronic trading products, “using the SIP” is considered uncompetitive. In client meetings, it is imperative that we reiterate that we use direct feeds.

The SIP latency issue is the topic of an academic paper by Ding, Hanna & Hendershott that concludes that algorithmic trading systems experience higher costs if they are not using the proprietary data feeds provided by exchanges. In a paper titled “[How Slow is the NBBO?](#),” the authors compare the SIP to proprietary data feeds and conclude that:

“The speed at which investors receive new information is a form of differential information across investors.” Latency in the public – or SIP data -- is a source of “unfairness across investors” and “reduces transparency” to those investors using the SIP data.

The current SIP structure is resulting in an unnecessary and hidden cost to investors. The persistence of this situation is difficult to understand in light of the Commission’s own words in its [2012 Order against a major exchange](#) related to violations of Rule 603(a). As stated in that Order:

“The disparities in data transmissions that Rule 603(a) prohibits can have important consequences that risk undermining investor confidence and interfering with the efficiency of the markets.”

At the time of that Order, the Director of the SEC's Division of Enforcement [stated](#):

"Improper early access to market data, even measured in milliseconds, can in today's markets be a real and substantial advantage that disproportionately disadvantages retail and long-term investors... That is why SEC rules mandate that exchanges give the public fair access to basic market data. Compliance with these rules is especially important given exchanges' for-profit business interests."

Fixing SIPs and improving the fundamental market infrastructure in the US equity markets cannot be accomplished without first fixing the underlying governance model. It is simply not in the business interests of all of the current Plan participants to do so.

Also worth noting, there are issues with the Consolidated Audit Trail ([CAT Plan](#)), as another significant conflict of interest exists with CAT funding. The SROs will have the opportunity to decide how much of the cost burden of the CAT to accept themselves, and how much to place

on the broader investment community. With SROs alone having a vote and making the ultimate determination, there a question about which entities would likely have to bear the bulk of this new set of costs.

RECOMMENDATIONS

NMS Plan governance should be updated and modified in light of the business realities of today's marketplace. These Plans should, at a minimum, include representation from broker-dealers and asset managers, with voting rights both to better reflect a holistic view of the market and to help arrive at policies that will best serve all market participants. Unanimous voting decisions should be eliminated, as reaching unanimity is extremely difficult and makes material and beneficial changes unnecessarily difficult to achieve.

Such governance changes are necessary to ensure a more diversified and inclusive set of views on how these critical market structure Plans and related issues should evolve in today's post-demutualized world. A more inclusive set of views will help to ensure a better outcome for all investors: one that is focused on the quality and resiliency of the SIP product offering, and not one guided primarily by the objective of extracting as much revenue as possible from the SIPs. Such changes would make the governance of the Plans consistent with the statutory "fair representation" requirements governing the SROs themselves.

While some may suggest this can't be done or is unworkable, it is worth considering: 1) Exchange Boards, which always include industry representatives along with exchange officials; or, 2) the DTCC, which is an important financial services company providing clearing and settlement services to the financial markets. The DTCC board, in addition to FINRA and ICE, includes representatives from clearing agencies, broker-dealers, clearing banks, and investment institutions.

I am not aware of anything in the Exchange Act, or the applicable rules thereunder, that clearly prohibits industry members from fully participating in the governance of the Plans, or of any other NMS Plan, with rights equivalent to the exchanges in the administration of the affairs of the Plans.

Some might suggest that industry participation in NMS Plan governance is available through advisory committee membership. However, I would suggest that advisory committee participation is not highly impactful. While advisory committee members are provided an opportunity to air their views, advisory committee members are given no substantive voice in the actual decision making of these Plans. Advisors are excluded from working groups and other discussions where key roll-up-your-sleeves work takes place. In addition, much of the meaningful business and real decision making of the Plans occurs in executive sessions, from which advisory committee members are excluded.

When the NMS Plans were initially enacted under the 75 Amendments, exchanges were member-owner, mutualized organizations. This approach ensured a direct member firm connection to the Plan governance. Since demutualization and the evolution of exchanges into publicly traded companies, this linkage has deteriorated. It is important that the Commission

take action in this area to address this governance issue and, with that, to ensure a healthier outcome for our market data infrastructure, regulatory infrastructure, and mechanisms to address extraordinary volatility. The ultimate objective is to ensure that the right governance model is in place to enable a more competitive, more fair, and more resilient market data infrastructure for all investors.

Thank you again for your attention to these important issues and for the opportunity to discuss them with you.