

Written Statement of Brett W. Redfearn, J.P. Morgan Securities LLC

Comments to the SEC's Equity Market Structure Advisory Committee

Recommendations on Trading Venues Regulation

April 26, 2016

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

My name is Brett Redfearn. I am the global head of equity market structure strategy for J.P. Morgan Securities. As you know, J.P. Morgan is a significant participant in our equities markets and, across cash, derivatives, portfolio trading and electronic trading, our trading accounts for about 8% of volume in the U.S. equities market.

My current responsibilities include being a member of the CTA-UTP Advisory Committee (governing our equities security information processors, or SIPs) and the Limit Up-Limit Down (LULD) Advisory Committee -- two of our important National Market System (NMS) Plans. As such, I have a significant amount of experience with NMS Plan advisory committees.

I would like to start by thanking the Commission and members of the EMSAC for your hard work. The proposals put forth today are a very good start in addressing important and challenging issues. For this panel, the recommendations proposed by the Trading Venues Regulation subcommittee are all good ones. If we adopted every one of them, we would take a meaningful step forward. On the other hand, we believe these recommendations do not go far enough or always hit their mark. I have a few related thoughts and suggestions that I hope you consider as you work to finalize these recommendations.

Recommendation #1: SRO Immunity and Exchange Liability Levels

First, regarding Recommendation #1 on SRO immunity and exchange limited liability, I appreciate your use of the language "rule-based" liability limits. This conveys that liability limits should be narrowly constructed to apply to rule-based attributes of exchanges and not to the full array of diversified businesses conducted by exchanges.

I agree that rule-based liability levels must be increased. **Existing liability limits are too low and overdue for substantial increases.** The Facebook IPO experience is illuminating as the broker dealer community experienced hundreds of millions of dollars in losses, due primarily to a systems issue at an exchange. Given the fact that current liability limits are so low, the limits should be meaningfully increased, at least by 10 to 20 times for the three large exchange groups. Also, the revised limits should be formulaic, taking into consideration the relative size and import of the exchange.

I also agree that exchanges should set aside funds (i.e., have a requirement for regulatory capital) that could be made available in the event of a major operational error. This would reduce exchanges' business risk around the time of such operational errors. Other market participants such as broker-dealers (including ATs and ECNs) are already subject to these types of capital requirements. Regulatory capital and liability limits could be subject to a process of review, so that adjustments could be made without the need for another major industry-wide review.

Secondly, I note that the subcommittee did not reach a conclusion on regulatory immunity. I would argue that there should be a distinction between exchange *regulatory* functions that warrant regulatory immunity and *exchange businesses* that do not. Exchanges are operating diversified, revenue-generating, publicly-traded businesses and have entered into areas that directly compete with brokers, vendors and other participants in our economy. **Non-regulatory and non-core exchange businesses should not have immunity, because this provides exchanges with unfair and unnecessary competitive advantages over other market participants.** I highly encourage the subcommittee to continue working to develop an appropriate recommendation in this area.

Recommendation #2: NMS Plan Governance & the Need for Broker Voting Rights

The recommendations proposed by the subcommittee regarding NMS Plan governance reflect the fact that: (1) there are problems with the selection process for advisory committee members; (2) advisory committee impact is inadequate in current Plan decision making; (3) there is excessive and inappropriate use of executive sessions that diminishes the efficacy advisory committee members; and, (4) the current voting construct needs to be modified and improved.

Before addressing the specific recommendations, I would like to start with the one thing that is not included in these recommendations: **the provision of direct voting representation by broker dealers and, ideally, asset managers as well.** It is disappointing that this recommendation is not included here. We are at risk of missing an important opportunity to fix the core problem of NMS Plan governance. The other recommendations are helpful for the Plans, but they fall short of the direct representation necessary. Why is this so? Consider the following:

- Exchange boards have voting representation from BDs, and exchange boards function well.
- The FINRA board has voting representation from BDs, and it functions well.
- The DTCC board has voting representation from BDs, and it functions well.
- NMS Plans *do not* have voting representation from BDs, and, they do not function well. Their results are often less representative, less effective and more contentious than necessary.

To illustrate, I will share some thoughts on the operation of the SIP Plans, which provide glaring examples of Plan governance challenges.

The SIP Plans today (CTA & UTP) are solely governed by SROs, that -- excluding FINRA -- have clear and obvious conflicts of interest in the provision of market data. I discussed two **specific conflicts** the last time I was before this Committee:

1. The major voting exchanges of SIP Plans are selling market data products that directly compete with the SIPs.
2. The voting exchanges of the SIP Plans have a disincentive to invest in the SIPs and to make them competitive products. The more money that is invested in the SIPs, the less data revenue is left over to be divided up among the SROs. And the better the SIPs function, the less likely that the prop feeds would be necessary for all trading systems.

Exchanges are not economically incentivized to make the SIPs competitive. So how is it that only those with such clear conflicts have voting representation on the SIP NMS Plans?

The suggestion has been made that brokers – if they were given votes – would not have the same obligations to the Plan that the SROs have. But, the broker community’s primary objective is to fix the SIPs and to make them useable. Good, fast, and reasonably-priced market data is essential to our ability to provide best execution to our clients. **Our recommendations have been about increasing transparency, adding redundancy, and improving speed and data quality.** These are the incentives that one should want among voting participants.

In my view, **the existing Participants have arguably *not* upheld their responsibilities under the Plan’s mandate.** The Participants are tasked to provide “prompt” access to market data. For most brokers’ trading systems, the equity SIPs are of limited use and primarily serve as a back-ups to the superior proprietary data products. In the most recent data provided, average quote latency at the UTP SIP is over 900 microseconds (Q1 2016) and that doesn’t include the additional inefficient travel times around the state of New Jersey that the SIPs currently require. And if anyone thinks that 900 microseconds isn’t meaningful, read the comment letters on the IEX exchange application. Some suggest that such slow quotes should not be protected. There is an uncomfortable inconsistency here.

The economic incentives for exchanges in today’s market data landscape revolve around proprietary data products. Proprietary data feeds have been the beneficiary of significant investment and innovation. They are also characterized by unconstrained and increasing fees. In contrast, the consolidated data feeds are characterized by an antiquated architecture, an inadequate consolidation process, and questionable practices regarding the purchase and utilization of bandwidth, practices that result in even greater delay. **The SIPs are basically delayed data being sold as real-time data at a cost of nearly \$400MM a year to the investors.**

We need to either fix the SIPs or phase them out. However, **if we do not fix the governance of the SIPs, we are not likely to fix the SIPs themselves.** The incentives to do so are simply not there for existing SRO participants. And if we were to get rid of the SIPs instead, **we would need a regulatory structure around costs and fees of proprietary data to deal with the**

continued escalation of market data costs. Actually, because of our dependence on proprietary data feeds today, we need that anyway.

To wrap up this point, while the recommendations proposed here today would help, they fall short of ensuring true representation. **The provision of voting representation is the only way to ensure that Plan decisions will be reflective of a broader industry view.** This is the best way to avoid the unnecessary contentiousness that is the hallmark of the current Plans (although I would exclude the LULD Plan from this characterization).

I would also like to offer **suggestions regarding the specific recommendations proposed to NMS Plan governance.** We believe that these recommendations are important and should be adopted in concert with the voting provisions previously discussed, after addressing the following issues:

1. With respect to the recommendation to **clarify the process for selecting Advisory Committee representatives:** Advisory Committee representatives must not be selected solely by SRO Participants. Even if non-SROs recommend names for the Advisory Committee, the exchanges can still vote down individuals that may be critical of the status quo. We have already seen this happen. We should ensure that there is representation that can carry forth the views of the major industry trade associations, like SIFMA, STA, ICI & FIF. The EMSAC could be an appropriate body for the selection of committee representatives assuming that it receives a long-term mandate.
2. With respect to the recommendation to **expand and formalize the role of the Advisory Committee:** this is a great proposal and would be helpful. It should be implemented along with providing brokers and, ideally, asset managers with votes.
3. With respect to the recommendation to **significantly narrow the use of executive sessions:** this is necessary and would help. Advisory committee members have brought this up many times at CTA-UTP Plan meetings and the criteria for warranting executive sessions is still vague and overly subjective.
4. With respect to the recommendation regarding working groups: this one misses its target. **Working groups must offer Advisory Committee members the opportunity for participation.** Otherwise, working groups could replace executive sessions as the primary – or only-- place where substantive discussions take place, especially after restrictions are placed on executive sessions. The Operating Committee would be at risk of becoming a rubber stamping body. As an example for how this could work in practice, Advisory Committee members have been invited to (and currently) participate in LULD Plan working groups and this has been very constructive.
5. With respect to the recommendation to limit NMS Plan provisions requiring a unanimous vote: this is critical. I would suggest replacing the word “limit” with “eliminate.” **It is imperative that we eliminate any unanimous voting requirements.** There is a no reason to give any single participant veto power over all others.

6. With respect to the recommendation to **revisit allocation of voting rights among SROs**: we are supportive. The subcommittee should also address whether defunct SROs should retain a vote. If an (e.g., options) exchange no longer runs an equities exchange and has no intention to do so in the future, after some defined period of time it should not retain voting power within an NMS Plan for the equities market.

Recommendations #3 & #4: Commenting on Draft Technical Standards and Centralization of Regulatory Functions

I will only comment briefly regarding recommendations 3 & 4 given time constraints. In general, we are fully supportive of both of these recommendations.

- Regarding Recommendation 3, we agree that **industry participants should have an opportunity to provide comments on draft technical specifications**. We also believe that when the timing for implementation of rule changes is delinked from the publication of technical specifications, we introduce unnecessary risk into our market system. In addition, development work/coding at firms cannot commence in earnest until after a given rule is approved by the SEC and an approval order is issued. As a result, if SEC approval is delayed beyond the planned timeline, implementation dates likely need to be pushed back as well.
- On Recommendation 4, **we support centralization of common regulatory functions across SROs to avoid unnecessary and inefficient duplication**. This becomes critically important as we proceed with the implementation of the Consolidated Audit Trail.

Thank you for your time. I look forward to discussing further.