

## Public Statement

---

# Statement on Reforming Stock Exchange Governance



Commissioner Robert J. Jackson Jr.

Jan. 8, 2020

Thank you as always to our dedicated Staff, especially Christian Sabella, David Shillman, Deborah Flynn, John Roeser, and Jennifer Colihan, for their extensive work on today's proposed order. I'm also deeply grateful to Division Director Brett Redfearn, whose leadership in this area—and so many others—continues to reflect the very best in public service.

As today's release explains, America's stock markets are riven by a fundamental conflict of interest: exchanges both operate public data feeds and profit from selling superior private ones.<sup>[1]</sup> Because exchanges have no economic reason to produce robust public data on stock prices, investors have long demanded a vote on how the public feeds are run.<sup>[2]</sup> Rather than give investors a real say over the data that drives our markets, today's release merely invites for-profit exchanges to draft their own rules on these questions. Because that approach has failed investors before, and there's no reason to expect it to succeed now, I respectfully dissent.

\* \* \* \*

In 1934, American investors struck a fundamental bargain with our stock exchanges. The Commission was created to oversee the markets, and nonprofit exchanges were given the special legal status they needed to play a role in protecting ordinary investors.<sup>[3]</sup> But over a decade ago the deal changed: Exchanges became for-profit entities with powerful incentives to maximize profits, not protect investors.

That's how we ended up with the two-tiered system for market data we have today. Congress mandated the creation of a public feed when exchanges were still nonprofits, but today's *for-profit* exchanges also sell their own private feeds. So it's unsurprising that exchanges underinvest in the public feed—it's a product they directly compete with. The only question is what the Commission should do about it. Rather than recognize the reality of the exchanges' incentives, the Commission today chooses hope over experience, asking exchanges [Return to Top](#) contrary to their own economic interests.<sup>[4]</sup> For two reasons, we should not expect that approach to produce the robust public data that American investors deserve.

**First**, by proposing an order under a national market system (NMS) plan, we're asking the exchanges to tell *us* how best to address the conflicts of interests that currently allow them to profit by controlling the public feed while selling superior private data.<sup>[5]</sup> No one should be surprised when the exchanges respond that, rather than give investors votes on the operation of the public feed, they'd rather continue controlling it themselves.<sup>[6]</sup> Instead of a clear solution to an obvious problem, today's proposal will produce little more than a long process that will benefit lobbyists and lawyers—but not the ordinary investors living with the tax of rising data costs in our markets.<sup>[7]</sup>

**Second**, our history governing markets through NMS plans is hardly encouraging. One need look no further than the consolidated audit trail to see what happens when the Commission replaces real regulation with mere hope that stock exchanges will act against their own interests. The CAT was launched in the wake of a terrifying market event nearly a *decade ago*. Both Chairman Clayton and Director Redfearn have done tremendous work to move it forward. But our predecessors left the construction of the CAT to the NMS process. And the CAT will protect investors, not produce profits. So it's no surprise that the CAT is still not complete.<sup>[8]</sup> I hope our successors won't someday say the same about today's attempt to reform exchange governance.

\* \* \* \*

Those who, like me, are frustrated by today's failure to require real reform may be tempted to direct their ire towards our stock exchanges. But it's a mistake to blame private enterprises for maximizing the profit opportunities the law gives them.<sup>[9]</sup> Instead, we should change the law to address the incentives produced by giving exchanges both control over our public feeds and the opportunity to profit by selling private ones.<sup>[10]</sup> Without changing those incentives, we cannot and should not expect the market to fix the market.<sup>[11]</sup>

That's why I hope commenters will come forward and urge the Commission to do more than merely hope that stock exchanges will act contrary to their private interests. Until we do, our stock markets will continue to fall short of the level playing field that ordinary American investors deserve.

---

[1] See Securities & Exchange Commission, Action Memorandum: Proposed Order Regarding the Creation of a New Consolidated Market Data Plan for Equity Market Data (Jan. 8, 2020), at 72 (“[C]onflicts of interest are inherent to the [data feeds] current governance structure because some exchange[s] have a dual role as both a [self-regulatory organization] and part of a publicly held company that offers proprietary data products.”). Throughout this statement I refer to the two exchange-run centralized securities information processors (“SIPs”) as the “public feed.”

[2] See Commissioner Robert J. Jackson, Jr., *Unfair Exchange: The State of America's Stock Markets* (remarks at George Mason University, Sept. 19, 2018) (citing Commissioner Daniel M. Gallagher, *Market 2012: Time for a Fresh Look at Equity Market Structure and Self-Regulation* (remarks at SIFMA's 15th Annual Market Structure Conference, October 4, 2012) and Commissioner Kara M. Stein, *Remarks Before Trader Forum 2014 Equity Trading Summit* (Feb. 6, 2014)); see also SIFMA, *Statement on Commissioner Robert Jackson's Call for Exchange Reform* (Sept. 19, 2018) (noting the market's consensus on the need for decisive action in this area).

[3] Since exchanges have become profit-seeking entities, some of our most thoughtful predecessors have wondered whether that special status continues to make sense. See Gallagher, *supra* note 2; Stein, *supra* note 2 (“[T]he exchange-based SRO model warrants significant reconsideration.”).

[4] *United States v. Stanchich*, 550 F.2d 1294, 1300 (2d Cir. 1977) (opinion of Friendly, J.) (noting that the law does not “require[ us] to exhibit a naivete from which ordinary citizens are free”).

[5] Indeed, one former Member of the Commission has described the NMS structure as responsible for “enshrin[ing] the ability of exchanges to charge customers monopolistic prices for ‘direct’ data feeds,”  [Return to Top](#) the system we're using today to address a crucial conflict of interest in our markets is “the SEC's poster child for unintended consequences.” Daniel M. Gallagher, *How to Reform Equity Market Structure*, Heritage Foundation White Paper (Feb. 23, 2017). While Commissioner Gallagher is certainly correct that NMS plans have often come with consequences the Commission could not foresee, it's not hard to predict that asking exchanges to reform their own governance through the NMS process is a bad idea. No: “This wolf comes as a wolf.” *Morrison v. Olson*, 487 U.S. 654, 688 (1988) (opinion of Scalia, J.).

Importantly, today's proposal does nothing to address the fact that exchanges enjoy a local monopoly on their private feeds. Investors who want to know the best price on a particular exchange can only buy that information

from one source, so it's no surprise that investors complain about consistently rising prices for market data. Any serious market reform would necessarily address this lack of competition. Gallagher, *supra* (calling for a “truly holistic review” of the Commission’s oversight of equity market structure).

[6] In fact, the exchanges have already suggested in a filing before the Commission that “a disclosure-based regime is a pragmatic step to address potential conflicts of interest.” NMS Plan Regarding Conflicts of Interest (published January 8, 2020). Because market participants already know, and nobody seriously disputes, that exchanges profit from private feeds that compete with the public feed they run, it is hard to see what disclosure could accomplish. That filing does, however, offer a preview of the lengthy and unproductive process likely to follow today’s action. We should not be so naïve as to think that this process will end in a way that’s good for investors.

[7] Notably, today’s action is merely a *proposed* order, so actually today’s majority is merely inviting comment on the possibility that we might someday tell stock exchanges to propose their own rules on how to make less money. What is certain, however, is that pursuing a mere proposal will impose months of additional delay. We are apparently doing so to invite comment on a subject that we have studied for over a decade through a concept release, advisory committee, and an industry-wide roundtable. Securities & Exchange Commission, Concept Release on Equity Market Structure, File No. S7-02-10 (Jan. 14, 2010); Securities & Exchange Commission Equity Market Structure Advisory Committee, Recommendations Regarding Enhanced Industry Participation in Certain SRO Regulatory Matters (July 8, 2016); Securities & Exchange Commission, Roundtable on Market Data and Market Access (Oct. 25-26, 2018).

[8] Indeed, this past Fall the Commission was forced to propose new rules on transparency and financial accountability in order to give market participants real incentives to move the CAT ahead. Securities & Exchange Commission, Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail, Release No. 34-86901 (Sept. 9, 2019). When the Commission first proposed proceeding with the CAT under the NMS structure, at least one commentator presciently observed that, “given all of the governance issues with NMS plans,” it was unclear whether that path made sense. Letter of Dr. James J. Angel, Associate Professor of Finance, Georgetown University, File No. S7-11-10 (Aug. 9, 2010). See also Letter of Better Markets to Vanessa A. Countryman, File No. S7-13-19 (Oct. 28, 2019) (“[O]utsourcing the construction and operation of th[e CAT] to the private sector—and putting some of the very market participants it is supposed to police and punish in charge of its governance structure—were grave mistakes that embedded conflicts of interest into the very core of the CAT.”).

[9] Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, N.Y. Times Mag. (Sept. 13, 1970) (providing the seminal case for corporate profit maximization within the bounds of the law).

[10] To provide an impression of the value the exchanges assign to a single vote on the committee overseeing the production of the public feed, note that the New York Stock Exchange recently paid some \$70 million to acquire the Chicago Stock Exchange, a venue with little volume—but a valuable medallion entitling its owner to another vote on the SIP operating committee. See Austen Hufford & Alexander Osipovich, *NYSE Parent to Buy Chicago Stock Exchange*, Wall St. J. (April, 5, 2018).

[11] Important recent research shows that, even when the market for trading is perfectly competitive, exchanges can extract supra-competitive rents from selling speed technology in the form of proprietary data feeds. See Eric Budish, Robin S. Lee & John J. Shim, *Will the Market Fix the Market? A Theory of Stock Exchange C*  Return to Top and Innovation, National Bureau of Economic Research Paper No. w25855 (2019).