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United States Senate
WASHINGTON, DC 20510–4606

March 20, 2020

The Honorable Jay Clayton
Chairman
Securities & Exchange Commission
100 F Street NE
Washington, D.C. 20549

Dear Chairman Clayton:

As you are aware, in recent weeks the markets have experienced extreme volatility, and as volatility has increased, I have read reports that displayed liquidity has diminished to astonishingly low levels. I am concerned by the long-term decline in displayed liquidity over the last decade and also the decline in the number of market makers, which, particularly in times of distress, will ultimately hurt the interests of the American investor. I think that the SEC should explore measures, including private sector innovations, that can help to address the decline in displayed liquidity and the number of market makers in the equity markets.

The long-term decline in displayed liquidity in U.S. markets was succinctly illustrated in a January 2020 Wall Street Journal (WSJ) article. In one of the article's measures, liquidity decreased by a factor of 10 since January 2010. Even worse, by the same measure, liquidity is now four times lower than it was at the lowest point of the Financial Crisis of 2007-2008. One factor leading to this sharp decline in displayed liquidity is the alarming decline in the number of market makers over the past decade. According to the CEO of a trading technology company, "a decade ago there were at least 10 times as many market makers."[1] Market makers themselves, in letters to the SEC, have pointed to the impact of high-speed traders using latency arbitrage strategies to continuously "pick off" market maker quotes, which ultimately increases costs for investors.

Given the critical role our national stock exchanges play in price formation, continued extraordinarily low levels of displayed liquidity make our markets more susceptible to flash crashes and at increased risk of market manipulation. The dominant means of trying to attract liquidity in today's stock markets is the "maker-taker" system, but this system not only introduces conflicts of interest, which I have commented on in the past, it has failed to attract more displayed liquidity. Instead, despite the "maker-taker" system's continued broad application, market participants are vastly reducing displayed orders, generating concerns for market structure overall.

Given the pressing nature of these issues, I write to ask that the Commission focus on market-based innovations that will incentivize greater liquidity provision in the markets from a diverse group of market constituents. One such proposal is the Investors Exchange (IEX) proposal for a displayed order type that uses machine-learning predictive technology to protect displayed orders

[1] https://www.wsj.com/articles/thin-liquidity-in-stock-futures-raises-risk-of-more-wild-market-moves-11583365788

on their exchange from latency arbitrage. I have read supportive letters from investors, market makers, and a long list of pension funds and other fiduciaries representing millions of individual investors who all support this innovation. I am greatly encouraged by a diverse group of supporters who all state they would be more willing to post displayed orders if IEX's order type is permitted by the SEC. Given this fact, I would encourage the SEC to strongly consider approving this innovation and giving market participants the tools they need to serve their clients.

I continue to be supportive of innovative companies who are seeking to deploy private market solutions to address problems associated with our national market structure. Further, I strongly encourage other exchanges and market participants to continue innovating in ways that help American investors.

Sincerely,

Mark R. Warner
United States Senator