

U.S. Securities and Exchange Commission
Equity Market Structure Advisory Committee

**Recommendations Regarding Enhanced Industry Participation
in Certain SRO Regulatory Matters**

June 10, 2016

AFTER CONSIDERING THAT:

- The Trading Venues Regulation Subcommittee (Subcommittee) of the Equity Market Structure Advisory Committee (EMSAC) was formed to review and analyze whether the current regulatory model for trading venues is optimally serving the market as a whole and providing a level and fair playing field for all market participants.
- The Subcommittee has held several meetings to discuss the range of issues under its purview and also held a meeting with industry representatives to gather further information and insights. Based on these discussions and analysis, the Subcommittee believes that overall, the current regulatory structure for trading venues works well and generally is operating fairly and effectively. As such, the Subcommittee does not believe a significant overhaul of the current structure is needed.
- The Subcommittee recognizes that potential conflicts and tensions do exist within and among the current trading venue models. As a result, the Subcommittee presented a set of four recommendations for discussion and preliminary consideration at the EMSAC's recent public meeting, on April 26, 2016. The Subcommittee's recommendations were posted to the SEC's public website on April 19, 2016.
- The EMSAC discussed the Subcommittee's recommendations at its public meeting held on April 26, 2016, with the assistance of guest panelists including representatives from Wellington Management, NASDAQ, and JP Morgan Securities. Based on the public discussion at the EMSAC meeting and the opportunity for public comment, and for the reasons stated in **Appendix C** (Supporting Rationale), the EMSAC determined that two of the four Subcommittee recommendations were appropriate to prioritize at this time.

THEREFORE, the EMSAC recommends that the SEC take action to make the role of NMS Plan Advisory Committees more significant, formalized, and uniform, as specifically set forth in **Appendix A** (NMS Plan Recommendation), and to promote more efficient technical implementation of rule changes, as specifically set forth in **Appendix B** (Rule Change Implementation Recommendation).

APPENDIX A – NMS PLAN RECOMMENDATION

Full Text of Recommendation: Changes should be implemented to the NMS Plan governance structure and the role of NMS Plan Advisory Committees (AC) should be expanded, formalized and made uniform.

- Clarify the Process for Selecting AC Representatives:
 - NMS Plan Participants should publish on their websites solicitation of AC members in advance of selection and Participants may also recommend candidates.
 - Once the AC has been established and is operational, the AC can nominate its own replacement candidates.
 - Selections should be approved by simple majority of Operating Committee (OC).
- Expand and Formalize the Role of AC:
 - The AC should have the right to a formal vote before any matter on which the OC votes. If the OC subsequently approves any action that was opposed by a majority of the AC, the OC should explain and document its reasons for proceeding contrary to AC input. In the event that the matter is the subject of a rule filing, the OC also should summarize and explain the results of the OC and AC votes in the filing submitted to the SEC.
 - The AC should be permitted to initiate its own recommendations to the OC and the OC should respond formally to the AC's recommendations.
- Significantly Narrow the Use of Executive Sessions by NMS Plans:
 - AC members generally should have right to attend all meetings and receive all information concerning Plan matters distributed to Participants (except executive sessions and other specific related materials as noted below).
 - The Plans should limit the acceptable use of executive sessions to only matters that present a clear conflict for AC members, such as matters relating to members' regulatory compliance, or matters subject to potential or ongoing litigation between AC members and Plan Participants. To determine that AC members are conflicted for this purpose, the OC should specifically articulate the conflict and agree by a 2/3 supermajority vote to authorize the executive session.
 - The OC may also by majority vote authorize ongoing working groups, made up of a subcommittee of the OC, to resolve a particular issue or finalize a recommendation. The size of subcommittee working groups would not exceed half of the total number of votes represented on the OC (note recommendation below on allocation of OC voting rights). These working groups would not require AC participation provided that the working group must submit regular updates and its ultimate work product to the full OC and AC, and the OC must allow for an AC vote (as described above) prior to taking any action on a working group recommendation.
- Limit NMS Plan Provisions Requiring Unanimous Vote:

- OC Voting Requirements should be 2/3 supermajority vote for substantive changes, plan amendments and fees.
- Should be simple majority vote for administrative or technical matters such as requesting system changes and interpretive matters.
- Revisit Allocation of Voting Rights Among SROs:
 - Current “one vote per exchange registration” model should be replaced with allocation of voting rights at the exchange group level, i.e., one for each “exchange family.”
 - However, if an exchange family also has consolidated market share of 10% or more in the particular market relevant to the NMS Plan, it would have two votes.

Procedural Mechanisms for the SEC or SEC Staff to Consider to Implement the Recommendation

With respect for the authority and customary procedure of the SEC and the Division of Trading and Markets, the EMSAC recommends that the SEC consider engaging in formal administrative rulemaking to revise Rule 608 of Regulation NMS to specify that NMS Plans must contain governance provisions consistent with the objectives specified in this Recommendation.

APPENDIX B –RULE CHANGE IMPLEMENTATION RECOMMENDATION

Full Text of Recommendation: If a rule change will require technology changes by the industry that will be prescribed through the publication of technical specifications, the SEC and the SROs should link the implementation date of those rule changes to the publication of technical specifications or FAQs where appropriate.

- Draft technical specifications should be published prior to SEC approval of any related rule change.¹ Where possible, industry/affected parties should be provided an opportunity to review and provide comment on draft technical specifications.
- Except in limited circumstances that necessitate expedited implementation, the implementation date of technology-driven rules/systems changes should be linked to the issuance of final technical specifications (or, where there are interpretive issues that drive system changes, the issuance of FAQs and similar interpretive guidance as appropriate), that provide firms sufficient detail to implement the changes. The SRO rule filing should explicitly note the proposed implementation time period (e.g., 6 months from the issuance of final technical specifications/FAQs).
- Where possible, the duration of the implementation period should be determined after the draft specifications/FAQs are issued to allow the industry to better evaluate and provide input on the necessary timeframe.

Procedural Mechanisms for the SEC or SEC Staff to Consider to Implement the Recommendation

With respect for the authority and customary procedure of the SEC and the Division of Trading and Markets, the EMSAC recommends that the SEC or SEC staff consider issuing guidance, for example through an interpretive statement, policy statement, or staff legal bulletin, to advise SROs that they should, as a matter of practice, satisfy existing Rule and Form 19b-4 requirements by describing their implementation timeline for proposed rule changes, including the publication of technical specifications or frequently asked questions, as applicable, consistent with the objectives specified in this Recommendation.

¹ The Subcommittee recognizes that in limited circumstances, it may not be possible to publish draft technical specifications before rule change approval. However, given that technical specifications are required for firms to determine implementation effort, the Subcommittee believes this Recommendation is a best practice and that technical specifications should be published with as much time for industry review to help determine feasible and appropriate implementation timelines.

APPENDIX C – SUPPORTING RATIONALE

Overview

The Trading Venues Regulation Subcommittee (Subcommittee) of the EMSAC was formed to review and analyze whether the current regulatory model for trading venues is optimally serving the market as a whole and providing a level and fair playing field for all market participants. Topics considered by the Subcommittee include the appropriate regulatory structure for today’s trading venues, the impact of exchanges’ limitation of liability, governance of NMS Plans and consolidated market data feeds.

The Subcommittee has held several meetings to discuss the range of issues under its purview and also held a meeting with industry representatives to gather further information and insights. Based on these discussions and analysis, the Subcommittee believes that overall, the current regulatory structure for trading venues works well and generally is operating fairly and effectively. As such, the Subcommittee does not believe a significant overhaul of the current structure is needed.

However, the Subcommittee recognizes that potential conflicts and tensions do exist within and among the current trading venue models.¹ As a result, the Subcommittee presented a set of four recommendations for discussion and preliminary consideration at the EMSAC’s recent public meeting, on April 26, 2016.² The Subcommittee’s four recommendations were:

¹ A recent comment letter to the EMSAC file states that the Subcommittee has not sufficiently identified or analyzed these potential conflicts or tensions as a foundation for its recommendations. (See Letter from Elizabeth King, General Counsel and Corporate Secretary, NYSE, dated May 13, 2016 (“NYSE Letter”).) The Subcommittee notes that the potential conflicts at play in the SRO model were identified in an SEC staff memorandum that was presented at the EMSAC meeting held on October 27, 2015, and that the memorandum in turn catalogued the SEC’s previous public efforts to study the benefits and drawbacks of self-regulation, including the 1961-1963 Special Study of Securities Markets, the 1994 review of SROs for the “Market 2000” Report, and the 2004 SRO Concept Release. In addition, these issues were among the market structure questions raised by the SEC’s 2010 Concept Release on Equity Market Structure, which was provided as a briefing material for the EMSAC’s initial meeting. The Subcommittee notes further that the topic of conflicts in NMS Plan governance has been publicly discussed by EMSAC members and EMSAC guest panelists during at least two EMSAC meetings. These issues have been discussed and analyzed at considerable length by the Subcommittee, as reflected by minutes of the Subcommittee’s meetings.

² A second recent comment letter to the EMSAC file suggests that the Subcommittee has focused its recommendations too narrowly on exchanges, rather than “trading venues” more broadly. (See Letter from Joan Conley, Senior Vice President and Corporate Secretary, Nasdaq, dated May 24, 2016 (“Nasdaq Letter”).) As the Subcommittee Chair noted when a Nasdaq representative raised this point at the April 26 EMSAC meeting, the Subcommittee’s recommendations focus largely on issues affecting SRO regulation. While the Subcommittee discussed and considered issues affecting the regulation of other trading venues, including alternative trading systems (ATS), at several Subcommittee meetings, it has not formulated any recommendations targeted at ATS regulation in light of the SEC’s pending proposal to revise Regulation ATS.

1. Evaluate and clarify exchange functions subject to SRO immunity and increase rule-based exchange liability levels.
2. Implement changes to the NMS Plan governance structure primarily to make the role of NMS Plan Advisory Committees more significant, formalized, and uniform.
3. For rule changes that will require technological changes by the industry, link the implementation schedule for those changes to required publication of technical specifications or FAQs, where appropriate.
4. Formalize by SEC rule the centralization of common regulatory functions across SROs into a single regulator.

To facilitate robust discussion at the EMSAC meeting, the Subcommittee submitted these four recommendations to SEC staff in writing to prior to the meeting, and the recommendations were posted to the SEC's public website on April 19, 2016. Based on the EMSAC's discussion of the recommendations, the Subcommittee has decided to prioritize two of its four recommendations – specifically, Recommendations 2 and 3 in the list above – which it now submits for the EMSAC's official consideration and vote. The Subcommittee will continue to review potential action on Recommendations 1 and 4, as well as other issues the Subcommittee has identified, including the consolidation of equity market data feeds and the distribution of associated revenues, and expects to provide recommendations in those areas in the future. With respect to timing, Recommendations 1 and 4 merit continued consideration and advancement with additional opportunity to solicit and consider input from market participants.

Recommendation 2: NMS Plan Recommendation

The Subcommittee solicited feedback on its recommendations through several channels. First, as noted above, the Subcommittee's initial package of four recommendations was posted on the SEC's website on April 19, 2016. To date, two written comments were submitted on the Subcommittee's NMS Plan Recommendations.³ Second, the Subcommittee invited panelists to engage in discussion with EMSAC members at the public April 26 EMSAC meeting. The panelists included representatives from Wellington Management, NASDAQ and JP Morgan Securities.

To the extent panelists expressed views on the NMS Plan Recommendation, they were generally supportive. The representative from Wellington thought that the proposed revisions to NMS Plan governance could improve the operation of the current NMS Plans for market data consolidation. The representative from JP Morgan stated that adopting this Recommendation “as-is” would be a marked step forward for NMS Plan governance. The representative from Nasdaq did not share views on the Recommendation at the EMSAC meeting; however, Nasdaq subsequently submitted a comment letter on the Recommendation, which is discussed in greater detail below.

Beyond general support, some commenters have questioned particular elements of the NMS Plan Recommendation. Most notably, the EMSAC received conflicting views on the appropriate level of Advisory Committee involvement in NMS Plan decision making. On the one hand, the

³ See NYSE Letter at 8 – 10; Nasdaq Letter at 5 – 8. The EMSAC comment file also received the written statement of one of the panelists, the representative from JP Morgan. The views expressed in the written statement reflect the panelist's spoken comments at the EMSAC meeting.

JP Morgan representative argued for greater Advisory Committee involvement; specifically, he recommended that the Advisory Committee should have an official seat – and vote – on plan operating committees. On the other hand, NYSE argued in its comment letter that Section 11A of the Securities Exchange Act and Rule 608 of Regulation NMS enable only SROs to become official voting members or participants of NMS Plans, consistent with SROs’ regulatory obligations. The Nasdaq Letter expressed similar concern that enhanced industry participation in NMS Plans could frustrate the regulatory obligations that attach to SROs as Plan participants.⁴

The Subcommittee recognizes the efforts that have been made to grant industry representatives direct voting rights on NMS Plan operating committees. However, the Subcommittee also is aware of the potential statutory or regulatory limits on permissible NMS Plan Participants. Moreover, the Subcommittee acknowledges that, at least in the context of the Consolidated Audit Trail NMS Plan, the SEC noted the “regulatory imperative” that the operations and decisions regarding the consolidated audit trail be made by SROs who have a statutory obligation to regulate the securities markets, rather than by members of the SROs, who have no corresponding statutory obligation to oversee the securities markets. The Recommendation reflects the Subcommittee’s attempt to improve NMS Plan governance in a way that would be less likely to raise interpretive concerns, but that would nonetheless offer a meaningful, formalized, and uniform role for industry Advisory Committees.⁵

The JP Morgan representative also questioned whether the Recommendation should be changed to allow industry groups to nominate the initial Advisory Committee representatives, rather than providing that NMS Plan participants should solicit nominees through websites. The Subcommittee believes that this Recommendation, as originally proposed, allows sufficient input from industry members and industry groups. The Subcommittee envisions that the nomination process would occur through the public websites of NMS Plan participants, which would provide an open forum for AC candidates to be suggested. The Subcommittee further notes that, if the Recommendation were to be implemented, NMS Plan participants would only be involved in the selection of the initial Advisory Committee; once the Advisory Committee has been established and is operational, Advisory Committee members would nominate their own replacements.

In addition, the JPMorgan representative expressed concern that the concept of “working groups” in the Recommendation could be misused to improperly limit Advisory Committee

⁴ Both NYSE and Nasdaq also questioned the need for the recommendation because, in their view, NMS Plan governance already functions well and incorporates industry input as intended. The Subcommittee believes there is a sufficient record of deliberation on this topic, at both the Subcommittee and full EMSAC level, to justify the Recommendation. See footnote 1 above for additional detail.

⁵ The Subcommittee notes that this Recommendation should also avoid the potential concerns that Nasdaq raised about undermining NMS Plan regulation. Under the Recommendation, if a Plan Advisory Committee objected to a particular change that SRO Plan participants felt was necessary to satisfy their regulatory obligations, the SRO participants would not be prevented from moving forward with the change, provided they explain their reasons for doing so. Furthermore, the Recommendation would not prevent SRO Plan participants from meeting in executive session to discuss matters that present a clear conflict for Advisory Committee members, such as matters relating to members’ regulatory compliance, or matters subject to potential or ongoing litigation between Advisory Committee members and Plan Participants.

participation. The Subcommittee believes that the Recommendation, as presented, strikes a balance between enhanced Advisory Committee participation and the need for NMS Plan participants to practically resolve certain technical matters. The Subcommittee notes that the Recommendation would provide for working sessions only when specifically authorized by a majority vote of an NMS Plan's Operating Committee – which the Advisory Committee would also have a right to vote on under the Recommendation. The Recommendation further contemplates that a working group would be required to submit regular updates and any work product to the full Operating Committee and Advisory Committee, and that the Advisory Committee would have additional voting rights before any working group matter was acted on by an NMS Plan Operating Committee. Moreover, the Subcommittee has modified the Recommendation to provide a further measure of protection against the potential misuse of working group sessions. The Recommendation now would limit the size of subcommittee working groups to no more than half of the number of votes represented on the Operating Committee, to limit situations where all or most of the Operating Committee could engage in substantive discussion outside the presence of the Advisory Committee.

Finally, NYSE and Nasdaq objected to the elements of the Recommendation that would limit unanimous voting requirements in NMS Plans and reallocate votes among NMS Plan participants by “exchange family.” The Subcommittee recommends limiting the use of unanimity requirements to prevent undue friction or delay in Plan voting matters. The Subcommittee's recommendation on the reallocation of voting rights is intended to better reflect the proportional interests of NMS Plan participants. Overall, the Subcommittee continues to believe that these elements are important parts of the overall Recommendation package, which is intended to improve NMS Plan governance on balance.

Recommendation 3: Rule Change Implementation Recommendation

Like the NMS Plan Recommendation, this Recommendation was subject to public comment after it was posted on the SEC's website, and it was also subject to discussion by panelists at the April 26 EMSAC meeting. To date, two written comments have been received on this Recommendation.⁶

Panelists at the EMSAC were generally supportive of this Recommendation.⁷ NYSE, in its written comment letter, also supported a portion of the Recommendation. Specifically, NYSE supported the Recommendation to the extent it would enhance technical implementation of NMS Plan rule changes. However, NYSE opposed the Recommendation to the extent it would apply to other SRO rule changes, on the grounds that SROs already provide sufficient guidance and notice to their members of impending technological changes. The Subcommittee believes that NYSE's rationale for supporting the Recommendation with respect to NMS Plan changes is applicable as well to other SRO rule changes. The Subcommittee continues to believe that this Recommendation could provide for more efficient technical acceptance of SRO-driven regulatory changes. To the extent that SROs voluntarily provide specifications as part of their

⁶ See NYSE Letter at 10 – 11; Nasdaq Letter at 7 – 8.

⁷ As with the NMS Plan Recommendation, the Nasdaq panelist did not express a view on this Recommendation at the EMSAC meeting. Nasdaq later submitted written comments on the Recommendation.

rule-making process currently, this Recommendation would serve to encourage all SROs to do the same going forward.

Finally, the Subcommittee notes that the Nasdaq Letter raised concerns that the Recommendation could require the disclosure of proprietary information or create an impediment to rule change approval, potentially inconsistent with Exchange Act Rule 19b-4 and Form 19b-4. It should be noted that all SRO specifications related to trading interfaces and regulatory reporting are currently publicly available. Nothing in this recommendation would require the disclosure of proprietary information. The focus of this Recommendation is on the timing of technical specification release and the importance of technical specifications in determining implementation timeframes. The Subcommittee added a footnote to the Recommendation clarifying that its intent is to see technical specifications published with as much time for industry review and input to achieve feasible and appropriate implementation timeframes, while recognizing that may not be possible in limited circumstances.