Remarks at the 2014 SRO Outreach Conference

Commissioner Daniel M. Gallagher

Washington D.C.

Sept. 16, 2014

Thank you, Drew [Bowden], for that kind introduction. I'd like to thank Steve Luparello and Drew Bowden for inviting me to speak as well as for their leadership and support for today's conference. Thanks also to the Trading and Markets and OCIE staff that put together this year's conference. This is a valuable opportunity for SRO and SEC staff to discuss pressing issues in an open and candid manner, and I hope that you take full advantage of that opportunity today.

At the January 2012 SRO Outreach Conference, I stated that we were at a crossroads with respect to the status of self-regulation. I posed fundamental questions to the audience, such as whether we should continue to have exchanges with statutory self-regulatory responsibilities when the vast majority of those responsibilities have been outsourced to another SRO and whether the Commission should impose limits on the ability of SROs to contract with others.[1]

Well, we're still at that crossroads, and the questions discussed at that conference are still pressing today. Earlier this morning, in fact, I posed additional questions on SROs to the Conference on Financial Markets Quality held by the Georgetown Center for Financial Markets and Policy. For example: what is the appropriate balance of regulatory oversight between the government and by market participants themselves? Does it still make sense to distinguish between national securities exchanges and ATSs? Should we distinguish between exchanges that list securities and those that do not? What does the fact that over 35% of securities transactions today are effected not on SRO platforms, but rather through ATSs mean for the future of SROs?

What distinguishes the situation today from January 2012 is that now the Commission is committed to conducting a holistic review of equity market structure, and we should have a clearer path ahead to address and resolve these questions. When the Commission begins this review, it will be crucial to examine the status and structure of SROs today and address the questions I've posed – as well as many others.

In doing so, we must evaluate the SROs and markets as they are today and acknowledge that, in many cases, SROs today are fundamentally different from what Congress conceived of as self regulation decades ago. The circumstances under which the self-regulatory framework was put into place almost eighty years ago - private, mutualized, self-regulating exchanges and a simple association of dealers –no longer exist.

The fact that the majority of the equities exchanges outsource their SRO obligations and market surveillance to FINRA, for example, calls into question the very meaning of the SRO concept as it exists today. There are benefits that arise from the consolidation of oversight in a single entity with access to market data from transactions on multiple exchanges. With the majority of exchanges subject to FINRA's rules, market participants know what to expect in the event of disciplinary action, and a single arbitration regime facilitates the dispute resolution process.

For all these advantages, however, we still need to ask whether this is the optimal solution. Indeed, we need to ask whether exchanges that outsource their regulatory responsibilities to FINRA are still SROs at all, or whether they've instead effectively become FROs – FINRA-regulated organizations. A related question is whether the benefits of rule standardization amongst exchanges are canceled out by the lack of a competition of ideas among exchange regulatory regimes contributing to the development of best practices.

And as for FINRA itself, we need to ask whether it has inappropriately exceeded its mandate, or is simply evolving with the markets. Regardless of the answer, we need to consider what that means for both the SEC and SROs. This is especially pressing as we continue to consider the possibility of subjecting investment advisers to self regulation. Although FINRA has ceased to actively pursue the possibility of expanding its mission to encompass IAs, were Congress to pursue new legislation to establish an investment adviser SRO, the conversation would inevitably turn to FINRA as a possibility again.

In addition, as I have noted in the past, leveraging the current resources and expertise of broker-dealer SROs to serve as third-party examiners for investment advisers examinations could greatly facilitate our ability to examine "dual-hatted" investment advisers without having to rely on Congressional action to create a new investment adviser SRO out of whole cloth.

Regardless of the path we ultimately end up taking to strengthen our examination program for investment advisers, one thing is clear: an "SEC-only" approach would not work for investment advisers any more than it did for broker-dealers. In other words, the answer is not to exponentially expand the SEC staff by adding a brigade of new investment adviser examiners when there are third parties that could perform that role.

This would not only be a severe management problem, but it could negatively impact the SEC budget approval process on an indefinite basis.

It's worth noting that as with so many issues facing the Commission, the question of whether to establish an SRO for investment advisers is not a new one. In 1980, for example, Commissioner John Evans issued a paper on the "Delegation of Powers Between the Commission and the Self-Regulatory Organizations and Professional Associations" discussing the issue and referencing an April 1980 release soliciting comment, among other things, on the question of "whether the authority to prescribe and administer requirements for investment advisers should be vested in one or more self-regulatory organizations."[2] The issue has proved to be no less vexing during the intervening 34 years.

The fact that the investment adviser industry has operated without SRO supervision offers an opportunity for what could be considered a control experiment: two regimes alongside one another, one with SROs, one without. Even as we continue to ponder whether that situation needs to be changed, we should compare and contrast the two industries to better examine some of the strengths and weaknesses of self-regulation. We certainly must do this before even considering a fiduciary duty rulemaking for brokers.

Thank you for all of the work you do to protect investors and help the SEC carry out its mission. I wish you all a successful conference.

[1] Commissioner Daniel M. Gallagher, Remarks at the SRO Outreach Conference (Jan. 12, 2012), available at http://www.sec.gov/News/Speech/Detail/Speech/1365171489690#.VBhftRC8-6I.

[2] Commissioner John R. Evans, Delegation of Powers Between the Commission and the Self-Regulatory Organizations and Professional Associations (Sept. 1980), available at http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1980/1980_0901_EvansDelegation.pdf.

Last modified: Sept. 16, 2014