# Remarks at FINRA and Columbia University Market Structure Conference

## Commissioner Michael S. Piwowar

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Thank you Charles [Jones] and Jonathan [Sokobin], for those very kind introductions.[1] Also, thank you both for putting together such a great conference. I am pleased to join you tonight for this terrific event. As many of you know, the intersection of market microstructure research and practical policy implications has long been a passion of mine. When I first started attending conferences as a young academic, I usually had to sit in a hotel conference room wondering whether people would actually show up when I began presenting my paper. So, I am honored to join you tonight and appreciate the opportunity to give this keynote address in front of such a large audience of distinguished researchers and experts.

Of course the best part about giving a keynote address over dinner is that unlike in my early academic days, I have a captive audience…at least if you want to eat. That said, I will try to keep my remarks under 20 minutes as I do not want to risk finding out the hard way that even the promise of dessert is not enough to keep people in their seats for a long-winded regulator.

I would be remiss if I did not at the outset thank the two sponsors of this conference, Columbia University and the Financial Industry Regulatory Authority ("FINRA"). Both groups have been steadfast champions of market microstructure research and provide immense value to discussions on this topic.

These days you rarely hear the name FINRA in this town without some mention of "FINRA 360," the comprehensive self-evaluation initiated by FINRA President and CEO Robert Cook. From what I have seen and heard thus far, FINRA 360 is more than just a genius marketing strategy developed to kick off Robert's tenure. Over the past several weeks, I have heard from a number of people that this review is generating constructive feedback and engagement from the industry in ways that will help FINRA chart a new path forward.

We at the Commission are also proceeding down a new path. In fact, the current direction of the Commission is such a complete change from the past few years that we could appropriately call it "SEC 180."

## Where We Are

For 78 months – from July 2010 through December 2016 – the Commission's policy agenda was dominated by what I affectionately call the "Dodd-Frank Death March." The overhang of that legislative leviathan cannot be overstated, as the mandates placed on the Commission by the Dodd-Frank Act used up an incredible amount of the agency's resources and ultimately prevented the agency from working on important discretionary policy initiatives. At the same time the Dodd-Frank Act took over the Commission's policy agenda, the agency also sunk a large portion of its scarce enforcement resources into a so-called "broken windows" approach. While this misguided effort proved successful at boosting our enforcement statistics, it did not meaningfully improve investor protection.

Fortunately, those days have passed and we are charting a new course at the Commission. Instead of mechanically plodding through implementation of the Dodd-Frank Act, we are taking a fresh look

at how the agency can better facilitate capital formation, the oft-forgotten third part of the SEC's mission. (As many of you know, the SEC's three-part mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.) We are also better utilizing our enforcement resources by focusing new efforts on emerging threats through the creation of a specialized Cyber Unit, and on the protection of retail investors through a Retail Strategy Task Force.[2]

As we consider the new direction of the Commission, issues surrounding market structure will be an integral part of those discussions. Those of you in this room know quite well that market structure is not merely a subject we take up in response to a market event, a Congressional inquiry, or a creatively titled and purportedly non-fiction book on high-frequency trading. Rather, it sits at the core of the Commission's mission. This central position is not simply due to the fact that when we recite the Commission's three-part mission, the middle prong is always the maintenance of fair, orderly, and efficient markets. Market structure certainly does have a direct impact on the operation of our markets, but as many of the papers in this conference highlight, it also plays a key role in the other parts of our mission, particularly in the facilitation of capital formation.

In this way, market structure really represents the gears that turn the clock of the capital markets. From the moment we get up in the morning, until the moment we turn out the lights at night, we rely on clocks to order our days. Yet most people will never open a clock to inspect the gears that make it work, much less comprehend the operation of the complex and interrelated system sitting behind it. In the same way, most investors and business owners who rely on the capital markets will never dig into the details of market structure. They may never understand the way that tick sizes, the order protection rule, or maker-taker pricing function. But they rely on them every day to raise capital, invest in securities, and save for retirement. Thus, the details of market structure matter, not just because academics, industry participants, and regulators like to debate them, but because they ensure the smooth operation of our complex financial markets. Ultimately, the efficiency of these markets is what allows our capital markets to drive the economy in ways that benefit all Americans.

We have a unique opportunity at the Commission right now to inspect the gears of our capital markets and to determine how we can improve our market structure. This opportunity starts at the top, with our new Chairman Jay Clayton. One of the many benefits I have encountered in working with Chairman Clayton over the past few months is the depth of his knowledge of the financial markets. Not only has he advised financial firms on how to operate in our markets, but he also understands how these markets function and their importance to the economy.

Chairman Clayton's concern for well-functioning capital markets is evident in his selection of key senior leaders at the Commission. In August, the Commission announced the hiring of Jeff Harris as Director of the Division of Economic and Risk Analysis. As all of you know, Jeff is an internationally renowned market microstructure researcher who will be an enormous asset to the Commission.

More recently, the Commission announced last week the hiring of Brett Redfearn to lead the Division of Trading and Markets. Brett comes to us after serving as the head of market structure for a global bank, and has been a sought-after voice on market structure issues for many years.

Clearly, Chairman Clayton, Jeff, and Brett join the Commission ready to advance the ongoing market structure dialogue. Bringing together their deep knowledge of this area with that of Commissioner Stein, who has been engaged in market structure conversations and hearings for years through her work in the Senate, and a certain other Commissioner who knows a thing or two about equity and fixed income market microstructure, creates a perfect combination of both interest and expertise at the Commission right now for tackling some of the thorny issues in this space.

In addition, we are seeing market structure issues take priority in the broader discussions around our financial markets, as evidenced by the Department of the Treasury's recent report on capital markets.[3] That report contained an impressive level of focus and detail on market structure issues, and provides strong support for our ongoing efforts at the Commission.

## Where We Have Been

Before discussing some of the future efforts I foresee in the market structure space, I would like to spend a few moments highlighting some of the positive achievements we have made in the past

several years.

The dialogue on market structure issues in the equities space has been dominated in recent years by the Commission's Equity Market Structure Advisory Committee ("EMSAC"). This group of industry and academic experts has gathered on a regular basis in meetings of both the full committee and subcommittees to debate some of the most consequential issues in our markets. These discussions have included topics such as the regulation of trading venues, the order protection rule, and market volatility. But the true value of the EMSAC is that they have not stopped at merely discussing issues. The EMSAC has also submitted practical recommendations to the Commission for consideration on issues such as market quality,[4] execution quality and order handling disclosures,[5] and an access fee pilot.[6] I have been pleased both by the level of engagement of EMSAC members and by their thoughtful recommendations.

In addition to the work of the EMSAC, we have seen other positive advances in the equity market structure space. In May 2015, the Commission approved a pilot to study the impact of wider tick sizes for small cap stocks.[7] That pilot began in October 2016 and continues to collect data to help the Commission, academics, and market participants analyze the impact of these changes. As more data becomes available I trust that academics, including many of you in this room, will provide us with the results of thoughtful research. In this vein, I expect a call for papers to go out in the coming days that will provide an opportunity for academics to share their findings on the tick size pilot at a future roundtable hosted by the Commission.

One other recent market structure change worth noting is the shortening of the settlement cycle from T+3 to T+2.[8] This change was a long time coming, and I am thankful to Commissioner Stein for her support in getting it across the finish line during the period when we were the only two Commissioners at the agency. The new settlement cycle was successfully implemented on September 5, 2017, and I commend the industry for their work to prepare for this change and drive it to completion.

As a side note, you might be surprised, as I was, that the shortening of the settlement cycle came up recently when I was meeting with a group of cadets at the United States Air Force Academy. During a lunch discussion, one of the cadets questioned why we chose to move to T+2, but not to shorten the settlement cycle further given modern technology. This insightful question left me with two thoughts: First, young adults these days are smarter than I was, because there is no way I would have been that up to speed on market structure issues as a 20-year-old. Second, the Air Force Academy has some really good professors teaching its students about current topics in finance. But that experience also reminded me that in the market structure space, we must continue to stay abreast of technological advances and ask ourselves, as that cadet did, whether such advances can be applied to our markets.

Finally, I would be remiss in discussing recent market structure developments, particularly at a conference co-sponsored by Columbia University, if I did not mention the efforts of the New Special Study of the Securities Markets, which is an undertaking by that school's Program in the Law and Economics of Capital Markets.[9] As I said at the initiating conference for this multi-year project, I believe the independent, unbiased, and expert point of view provided by the participants in this project will make an invaluable contribution to our understanding of how the securities markets are functioning.[10] I look forward to the fruits of their labor.

## Where We Are Going

After considering our market structure accomplishments over the past few years, and the potential we have for work in this space given the Commission's current leadership, I am optimistic that the next phase of the Commission's oversight of the securities markets will be known for its positive impact on market structure.

As we consider what direction our review of market structure will take moving forward, I would like to reiterate a few of the points I made on this topic in one of my first speeches as an SEC Commissioner.[11] In that speech I called for a comprehensive review of equity market structure and set out key guideposts for a market structure review that are still relevant today.

First, our review of market structure must begin by exploring how the markets have evolved and become what they are today. We must not limit ourselves by working solely within the boundaries of

what our current markets look like, but must ask how competitive forces and regulation have combined to create our existing market structure, and whether that result was intended or even desirable. Part of this analysis necessarily incorporates retrospective reviews of our existing rules, including a comprehensive review of the most fundamental change to our market structure in the past 20 years, Regulation NMS.

The review should also seek to uncover the incentives that drive the decisions of market participants, many of which may be the result of regulatory actions themselves. Only once we have identified the incentives at play can we make choices about which alternatives may best facilitate competition on choice, pricing, and innovation.

Finally, we at the Commission must not conduct our market structure work in a vacuum. It is vital that we receive the views and observations of the public to inform the market structure debate. The EMSAC has been a major driver of public dialogue on these issues, and we must continue to allow our review of market structure to benefit from vigorous public discourse.

With these principles in mind, I look forward to the discussions to come. In the short term, I hope to vote soon on a transaction fee pilot to test the incentives in our existing exchange pricing models. This pilot was the subject of a thoughtful recommendation by the EMSAC, and is a project I helped direct during my time as Acting Chairman. Chairman Clayton has also expressed his support for considering a proposal for a transaction fee pilot,[12] and I look forward to working with him, Commissioner Stein, and agency staff to advance such a proposal. It is my expectation that this pilot will come in the form of a rulemaking rather than an NMS plan, which was the mechanism used to implement the tick size pilot. A rulemaking would give the Commission greater control over the ultimate parameters of the pilot, as well as allow for ample input by the public regarding how the pilot should be structured.

The EMSAC itself operates under a charter that extends until January 2018, and I look forward to hearing further thoughts from the committee until that time. Given the approaching end date for the EMSAC charter, I have had many people ask whether or not it will be extended again. In my view, the answer to that question is primarily up to the committee itself. At some point the committee may run into practical limits as intractable issues arise and members are tempted to break down into camps based on competing business models. Were that to occur, I would question the value of continuing to stand up the committee. However, to the extent that the EMSAC can continue to provide the Commission with high quality recommendations, I believe there is value to continuing the committee.

In addition to the EMSAC, Chairman Clayton has announced his intention to form a new Fixed Income Market Structure Advisory Committee (“FIMSAC”).[13] I am excited about this new group and hope that there will be public steps to advance it in the near future. The fixed income market has been deserving of greater attention by the Commission for some time, and I commend Chairman Clayton for making it a priority. I fully expect the FIMSAC members to engage in difficult conversations, tackle challenging issues, and generate constructive recommendations for the Commission to consider.

Of particular importance to me in the fixed income market structure space are areas like pre-trade transparency and the appropriate role of regulators vis-à-vis market-based solutions in providing that transparency. I have also commented in prior speeches about the need for further investigation into the complexities of the fixed income markets, particularly in the municipal bond area.[14] I hope that the FIMSAC can provide insights into these and other key issues.

Finally, we cannot form a fixed income market structure committee without expecting them to discuss the long running topic of bond market liquidity. There are enough issues within that topic alone to keep the committee members busy for some time, including the impact of bond ETFs on liquidity in the underlying securities, the evolving role of the buy-side in the provision of liquidity, and the impact of regulatory and monetary policy decisions on fixed income markets. I am excited to have the FIMSAC opine on these issues, which continue to generate significant public debate.

## Conclusion

Let me close by commending each of you for your interest in these topics, as evidenced by your attendance at this conference, and particularly those of you submitting your research. I applaud

your work and dedication to digging into the complexities of these market structure gears. As you well know, the inner mechanisms of our markets are interrelated – sometimes maddeningly so – and not every research project or policy recommendation comes out clean and simple. But I believe that work in this space has true value, and we must continue to dedicate ourselves to seeking ever more efficient operation of these markets for the benefit of issuers, investors, market participants, and the economy as a whole.

Thank you. I am happy to take any questions.

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[1] The views I express today are my own and do not necessarily reflect those of the Commission or my fellow Commissioners.

[2] https://www.sec.gov/news/press-release/2017-176

[3] A Financial System That Creates Economic Opportunities: Capital Markets, Report to President Donald J. Trump (Oct. 2017), *available at* https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

[4] *See* Recommendations for Rulemaking on Issues of Market Quality (Nov. 29, 2016), *available at* https://www.sec.gov/spotlight/emsac/emsac-recommendations-rulemaking-market-quality.pdf (discussing recommendations related to limit up/limit down, market-wide circuit breakers, and the market opening).

[5] *See* Recommendations Regarding Modifying Rule 605 and Rule 606 (Nov. 29, 2016), *available at* https://www.sec.gov/spotlight/emsac/emsac-recommendations-rules-605-606.pdf.

[6] *See* Recommendation for an Access Fee Pilot (July 8, 2016), *available at* https://www.sec.gov/spotlight/emsac/recommendation-access-fee-pilot.pdf.

[7] https://www.gpo.gov/fdsys/pkg/FR-2015-05-13/pdf/2015-11425.pdf.

[8] https://www.sec.gov/rules/final/2017/34-80295.pdf.

[9] http://www.law.columbia.edu/capital-markets/new-special-study .

[10] *See* New Special Study of the Securities Markets: Keynote Address, Acting Chairman Michael S. Piwowar (Mar. 23, 2017), *available at* https://www.sec.gov/news/speech/piwowar-keynote-columbia-university-032317.

[11] *See* The Benefit of Hindsight and the Promise of Foresight: A Proposal for a Comprehensive Review of Equity Market Structure, Commissioner Michael S. Piwowar (Dec. 9, 2013), *available at* https://www.sec.gov/news/speech/2013-spch12013msp.

[12] *See* Remarks at the Economic Club of New York, Chairman Jay Clayton (July 12, 2017), *available at* https://www.sec.gov/news/speech/remarks-economic-club-new-york.

[13] *See id*.

[14] *See*, *e.g.*, Remarks at University of South Carolina and UNC-Charlotte 4th Annual Fixed Income Conference, Commissioner Michael S. Piwowar (Apr. 21, 2015), *available at* https://www.sec.gov/news/speech/remarks-usc-unc-fourth-annual-fixed-income-conference.html.