Testimony of New York Stock Exchange President Thomas W. Farley before the U.S. Senate Homeland Security and Governmental Affairs Committee Permanent Subcommittee on Investigations on Equities Market Structure June 17, 2014

Chairman Levin, Ranking Member McCain and members of the Subcommittee, we appreciate your interest in the regulatory structure of the U.S. capital markets. My name is Tom Farley and I am President of the New York Stock Exchange (NYSE). I have been in the business of exchanges for most of my career including as President and COO of ICE Futures US (formerly the New York Board of Trade) and as Senior Vice President of Financial Markets at Intercontinental Exchange (ICE) where I oversaw the development of initiatives within ICE's financial markets.

Intercontinental Exchange has a track record of investing in markets and clearing houses that are underperforming within our industry and turning them into best-in-class exchanges. As a first step toward streamlining and improving the operations, we separated the NYSE and Euronext businesses, recreating NYSE Group. NYSE Group includes the iconic New York Stock Exchange as well as two additional equities exchanges, two options exchanges and a bond trading platform. Across these venues we list and trade equities, options, exchange traded products and debt securities. Intercontinental Exchange has also been party to many of the major policy and regulatory discussions regarding the structure of the markets in which we operate. In those discussions, we maintain that transparency and fairness should be a core consideration.

The equities market in the United States is the leader in global capital raising and trading. It is unique to any other market in the world, and thus warrants a different regulatory structure. In particular, the U.S. equities market comprises both institutional and retail market participations and millions of Americans rely on the market to grow their retirement funds through pensions, life insurance, mutual funds and individual securities. As a result, the equities market must not only have a high level of systems reliability, it must also maintain a high level of the public's trust. This trust is what gives companies confidence that they can access the public markets for capital raising and gives investors' confidence that they will be able to transact in a fair market.

As market operators, we have come to the view that the U.S. equities market is highly fragmented – making it overly complex and opaque. The regulations and structures in place today incentivize participants to make it more complex and more opaque. Numerous surveys and recent history have shown that this structure does not contribute to investor confidence or high systems reliability.

As the dominant rule setting the boundaries of equity market structure, Regulation NMS set out to accomplish several objectives. The first was to increase competition among markets and to increase competition among orders.[1] While the rule did an excellent job of increasing competition among markets,[2] we believe competition of orders has been severely damaged, particularly in recent years, due to the record level of off-exchange trading and increased levels of order fragmentation. In fact, last week off-exchange trading reached a record high of 40.5% across all Regulation NMS securities.[3] This means that despite someone taking a risk to establish the National Best Bid or Offer (NBBO) on a displayed market, brokers decided to execute the trade away from the displayed, or regulated, market 40% of the time rather than rewarding the people who established the NBBO, with an execution. We find this troubling and damaging to price discovery.[4]

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[1] Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37498, 37501 (June 29, 2005) ("Reg. NMS Adopting Release")

[2] NYSE held 80 percent market share in Tape A securities in 2005. Today five exchanges have more than 5% market share in Tape A securities.

[3] Consolidated Tape Association and Universal Trading Privileges Plan data.

[4] Daniel G. Weaver Study available at: http://www.sec.gov/comments/s7-02-10/s70210-127.pdf. John McCrank, "Dark Markets May Be More Harmful than High-Frequency Trading", *Reuters*, April 6, 2014. SEC Chairman Mary Jo White, June 2014; http://www.sec.gov/News/Speech/Detail/Speech/1370542004312.

The second objective of Regulation NMS was to design a structure to the benefit of long-term investors and public companies.[5] Long-term investors have benefited in many ways from the implementation of Regulation NMS, however data now shows that some of these benefits, such as lower costs, might be reversing.[6] In addition, we consistently hear from large institutional investors that there are too many conflicts in the current market structure and that they would like to see those conflicts eliminated or, at least, reduced. Many incentives are in place to keep orders away from the public markets where they would interact with displayed liquidity. These incentives often conflict with the interests of the investor whose orders are being executed off of public markets and are always inconsistent with the interests of those participants who are displaying trading interest and setting the public prices that are so critical to the transparency and efficiency of our markets. Perhaps most importantly, we hear from listed companies and entrepreneurs that they believe the market is not designed for them but rather for the trading community and, as a result, they have lost confidence in the market. Newly listed companies via the IPO process are the lifeblood of our economy and job creation. We must care about market structure if we care about the real economy. Now that we have had time to observe the impact of Regulation NMS, we should consider revisions that would better enable it to meet stated goals by removing some of these conflicts and thereby restoring confidence.

The New York Stock Exchange will take a leadership role in bringing about beneficial change. Our goal is simple: Reduce the level of complexity and fragmentation of the US stock market. To accomplish this goal, there are several unilateral steps that we are committing to take and that we would welcome our industry colleagues to also adopt. To start, we are self-imposing a six-month moratorium on any new, or novel, order types that further segment the market. We believe that this will give the industry and the SEC time to focus on the complexity that exists. In addition, we have already announced the elimination of more than a dozen unique order types. We believe this is a first step toward reducing complexity and toward a more efficient market structure.

At an industry level, we are seeking support for the elimination of maker-taker pricing and the use of rebates. Broad adoption of this policy would reduce the conflicts inherent in such pricing schema and further reduce complexity through fewer order types and fewer venues. In conjunction with the elimination of maker-taker and rebates, we believe regulation should require that deference be given to displayed quotes. There is risk involved in displaying a quote accessible to all market participants and we believe strongly that the person taking that risk should be rewarded with an execution at that price. Unfortunately, in today's environment, those displayed quotes are used to inform trading on dark markets which are not contributing to the price discovery process. The original investors who posted these public quotes are all-too-often left with no trade at all. This ability to transact on dark markets at the same price as posted public quotes is what is driving an increasing amount of volume off fully-regulated, transparent venues and onto dark markets at an alarming rate. Several countries, including Canada and Australia fairly recently, have adopted rules that establish the primacy of public quotes. In the cases of Canada and Australia, the regulators have established that this policy has simplified and improved their markets.

Lastly, as you heard on the first panel this morning, there are questions as to whether or not some market participants are able to build an advantage over others by using high-speed data feeds and colocation services. While it should be noted that both of these services are regulated and made available to all investors equally, we believe that if something results in a loss of investor confidence, we should find a way to change it. These changes should build on the advances we've made in technology and increase investor confidence. NYSE is willing to put all options on the table as it pertains to the delivery of market data, however we highlight that this cannot be done in a vacuum and any changes must be applied equally to all exchange and dark pool venues. By leveling the playing field for regulated and unregulated venues alike, we will see a much more simple and transparent market.

Thank you for your time and I look forward to answering any questions you may have.

[5] Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37498, 37501 (June 29, 2005) ("Reg. NMS Adopting Release")
[6] Strumpf, Dan; (June 4, 2014) Institutional Investors Paying More for Services; WSJ Online. Retrieved from: http://blogs.wsj.com/moneybeat/2014/06/04/institutional-investors-paying-more-for-services/.