



**Oral Statement of Jeff Brown
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Before the House Financial Services
Subcommittee on Capital Markets, Securities and
Investments**

**“U.S. Equity Market Structure Part I: A Review of the
Evolution of Today’s Equity Market Structure and How We
Got Here”**

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**Chairman Huizenga, Ranking Member Maloney and
distinguished Members of the Subcommittee, my name is
Jeff Brown, and I am senior vice president and head of the
Office of Legislative and Regulatory Affairs for the Charles
Schwab Corporation. It is my honor to appear before the
subcommittee today on behalf of the Securities Industry and
Financial Markets Association, better known as SIFMA.**

SIFMA represents a broad range of financial services firms – including Schwab – that are active in our capital markets.

Congress first mandated the establishment of a National Market System in 1975. At that time, most equity trading took place manually, on the trading floor of an exchange. Today’s market is fully electronic and automated with a vibrant ecosystem of competing market venues, including more than a dozen exchanges and more than 40 Alternative Trading Systems.

Although advances in technology had a major role to play in the evolution of our markets, there have been three major regulatory developments since 1975 that have created the capital markets of today.

First, in 1998, the SEC adopted Regulation ATS, which established regulatory standards for Alternative Trading Systems. The net result of Regulation ATS has been the growth of trading venues that offer varying business models and compete for order flow to the benefit of investors of all types.

Second, in 2001, decimal pricing began, after nearly 200 years of a system in which equities traded in fractions. Trading in pennies revolutionized our markets, spurring the rapid growth of electronic trading and increasing liquidity.

Finally, in 2005, the SEC adopted Regulation NMS, which was predicated on the need to foster more efficient markets by promoting fair competition, while at the same time assuring that the markets were linked together to

encourage the interaction of – and competition between – the orders of buyers and sellers.

The centerpiece of Regulation NMS is Rule 611, the Order Protection Rule. Simply stated, the rule was designed to ensure that displayed investor orders cannot be ignored, or, quote, “traded-through.”

Together, these changes, both regulatory and technological, have created markets that are unrecognizable from the markets of 10 and 20 years ago. The markets today are highly automated and efficient, providing near-instantaneous, low-cost executions. Retail investors, Schwab’s clients, in particular have benefitted from an incredibly competitive and dynamic marketplace.

There is one other historical shift that has played an important role in the development of today's market. In the early and mid-2000s, the national securities exchanges began to become for-profit companies instead of broker/dealer-owned utilities. Today, the largest exchanges are owned by publicly-traded corporations. As such, they now have a fiduciary duty to deliver profits to their corporate shareholders. This has radically changed the incentives that exist in our capital markets and created conflicts of interest that remain unaddressed.

While we understand and appreciate that the Committee intends to evaluate policy options at a later date, we would like to highlight two critically-important areas where we believe policymakers need to address issues that have created significant inefficiencies.

First, we believe that the entire concept of Self-Regulatory Organizations, or SROs, and National Market System Plans, which are controlled by them, need to be rethought. SIFMA believes that strong self-regulation must continue to be an integral part of the oversight of the market and its participants. Exchanges, however, continue to act as SROs, even though they have become competitors with their former owners. In other words, for-profit companies act as regulators of the very market participants with which they directly compete. SROs also manipulate NMS Plans to advance their commercial interests at the expense of the industry and the investors they serve. These conflicts of interest are obvious, and we believe Congress or the SEC needs to move quickly to rethink the role and responsibilities of a self-regulatory organization in light of this new reality.

Second, we believe the market data system – the way investors receive the bids, offers, last sales and other critical information that is the lifeblood of an effective market – remains locked in a 1970s structure and is in serious need of an overhaul. Today, the exchanges offer their own market data streams faster and with far better and deeper information, but at sharply escalating fees. The consolidated data stream, which the industry must purchase by rule, is slower and contains only ephemeral top-of-book quotes. This structure has returned us to an era when privileged pros get access to better, more timely market information than ordinary investors. This outcome is absolutely contrary to all that has occurred over the last two decades of regulatory and technological development. We urge the

SEC or Congress to address this glaring issue as soon as possible.

Thank you again for the opportunity to testify today, and I look forward to answering your questions.