

# Brash of the Titans

June 24, 2020

The latest shock to the markets isn't what is happening in the S&P or the Dow Industrials, but what is happening slightly behind the scenes. In a somewhat unusual presentation on Monday, June 22, 2020, the SEC and the Anti-Trust Division of the Department of Justice (DOJ) presented a webinar on the topic of market structure.<sup>[1]</sup> After espousing on the virtues of competition, and the need to modernize regulatory schemes to keep pace with fast moving markets and data, the Assistant Attorney General for the Anti-Trust Division of the DOJ, Makan Delrahim, announced a Memorandum of Understanding (MOU) between the SEC and the DOJ.

## In this Corner

Although this first-of-its-kind MOU between these agencies does not appear to be public, Delrahim expects it to:

- Establish periodic meetings among agency officials
- Allow for enhanced sharing of information, insights, and experience
- Creates a framework for the agencies to discuss and review law enforcement and regulatory matters affecting competition in the securities industry
- Lead to even more robust, comprehensive analyses incorporating both competition and securities laws concerns

Delrahim was followed by SEC Chairman Jay Clayton and Director of the Division of Trading and Markets Brett Redfearn. Chairman Clayton and Director Redfearn took turns discussing the regulatory approach to their main areas of concern. While their discussion was robust<sup>[2]</sup>, let's focus on the main intersection for the DOJ and the SEC's under their MOU (try to say that three times fast).

### Hanging in the Balance



## Weighing in at 800 Pounds

The SEC has three filings which form the basis of their recent Reg NMS 2.0 initiative. First - a proposal to rescind the effective upon filing for NMS Plan fee filings.<sup>[3]</sup> In the post Dodd Frank era, SRO fee filings are effective upon filing, but NMS Plan fee filings are only effective upon filing pursuant to Rule 608 of Reg NMS. The SEC staff expects this will be up for action with the commissioners shortly. Second - the “governance” SIP proposal, which the SEC recently ordered the SRO’s to implement.<sup>[4]</sup> Under this order, the current multiple SIPs will be replaced with a single unitary body. Third - the “infrastructure” proposal - which would add additional data to the SIP and provide for a decentralized competing SIP model.<sup>[5]</sup>

The SEC’s main thrust is that the markets have changed, and changed mightily, since the imposition of Reg NMS back in 2005, to say nothing of the National Market System itself back in 1975. They argue that their proposals will bring much needed scrutiny over the competitive nature of the SIP presided over by the SROs. To bolster their claims, the SEC pointed to data derived from exchange Form 1s from 2008 to 2013 showing that for seven of the largest U.S. equity exchanges revenue from market data and connectivity rose “at least” 65 percent. During the same period, net revenues from transaction services rose “at most” 13 percent. Moreover, according to the SEC, exchange operating expenses declined 4 percent and operating income increased 106 percent during this same time frame.

This renewed focus on the costs of running the exchanges, and the revenues generated by differing parts of their enterprises should come as no surprise. Back in May of 2019, the Staff promulgated Guidance on SRO Rule Filings Related to Fees.<sup>[6]</sup> That guidance laid out the Staff’s expectations of what the SRO’s would be required to substantiate in order to justify individual SRO fee filings to the SEC. In significant part, that guidance related to the ability of exchanges to provide data and analysis to prove competition, whether via market-based review or a platform economic theory.

## Ten, Nine, Eight...

So, the question has to be asked, why now? Well, the SEC has received a recent defeat through the courts. The long-standing SIFMA (fka NetCoalition) case challenging SRO fee filings was finally decided by Court of Appeals for the D.C. Circuit.<sup>[7]</sup> In that decision, the court held that a challenge to SRO fees as a “denial of fair access”<sup>[8]</sup> was not applicable to a fee of general applicability (e.g. that wasn’t targeted at a specific individual). However, the court made no decision regarding the applicability of the proper standard of review for the SEC regarding its statutory authority regarding such fee filings.

For those of a slight Machiavellian bent, the timing of the MOU announcement does seem portentous. Handed a defeat in court, on limited technical grounds, the SEC is showing its hand toward an even more strenuous review of exchange market data fee filings.<sup>[9]</sup> The introduction of the DOJ’s ability to bolster the SEC’s already rigorous competitive analysis would seem to spell a long road ahead for the exchanges.

# Not Yet Down for the Count

For a very long time, the industry has clamored for more information from exchanges regarding their costs for market data provision. Although there has been little direct success, the changing of the guard at the SEC has clearly opened the door here for some action. To be fair, the exchanges spend a tremendous amount of time, energy and talent on the development of their systems and infrastructure and deserve a fair recompense for that expenditure. At this juncture, the question becomes how the exchanges will prove it, and will the SEC (and the DOJ) believe it.

<sup>[1]</sup> [https://www.sec.gov/video/webcast-archive-player.shtml?document\\_id=062220msd](https://www.sec.gov/video/webcast-archive-player.shtml?document_id=062220msd)

<sup>[2]</sup> Covering cooperation with other government agencies, modernizing market structure of thinly traded securities, combatting retail fraud, etc.

<sup>[3]</sup> <https://www.sec.gov/rules/proposed/2019/34-87193.pdf>

<sup>[4]</sup> <https://www.sec.gov/rules/sro/nms/2020/34-88827.pdf>.

<sup>[5]</sup> <https://www.sec.gov/rules/proposed/2020/34-88216.pdf>

<sup>[6]</sup> <https://www.sec.gov/tm/staff-guidance-sro-rule-filings-fee>

<sup>[7]</sup> [https://www.cadc.uscourts.gov/internet/opinions.nsf/127CE4C0762C082F8525857E00506366/\\$file/18-1292-1845826.pdf](https://www.cadc.uscourts.gov/internet/opinions.nsf/127CE4C0762C082F8525857E00506366/$file/18-1292-1845826.pdf)

<sup>[8]</sup> Under Exchange Act Section 19(d). However, the court notes that a party may petition under Section 19(c) to amend an SRO's fee through notice and comment. If the SEC denied such petition, the court would be able to review (albeit under an extremely deferential standard of review to the SEC). Alternatively, although there is no right to appeal if the SEC chooses not to suspend a fee filing within 60 days, after it does make such a decision, the final determination to approve or disapprove the fee filing is appealable.

<sup>[9]</sup> In my opinion, the SROs do themselves no favors when they use blatant anti-competitive language in said fee filings, however (e.g. one such filing stating "it is reasonable to charge [the fee] ... because such use of the data is directly in competition with the Exchange and the Exchange should be permitted to recoup some of its lost trading revenue be charging for the data that makes such competition possible."

Coalition Greenwich, a division of CRISIL, an S&P Global Company, is a leading global provider of strategic benchmarking, analytics and insights to the financial services industry.

We specialize in providing unique, high-value and actionable information to help our clients improve their business performance.

Our suite of analytics and insights encompass all key performance metrics and drivers: market share, revenue performance, client relationship share and quality, operational excellence, return on equity, behavioral drivers, and industry evolution.

## About CRISIL

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better. It is majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics, and data to the capital and commodity markets worldwide.

CRISIL is India's foremost provider of ratings, data, research, analytics, and solutions with a strong record of growth, culture of innovation, and global footprint.

It has delivered independent opinions, actionable insights and efficient solutions to over 100,000 customers through businesses that operate from India, the U.S., the U.K., Argentina, Poland, China, Hong Kong, and Singapore.

For more information, visit [www.crisil.com](http://www.crisil.com)

## Disclaimer and Copyright

This Document is prepared by Coalition Greenwich, which is a part of CRISIL Ltd, an S&P Global company. All rights reserved. This Document may contain analysis of commercial data relating to revenues, productivity and headcount of financial services organisations (together with any other commercial information set out in the Document). The Document may also include statements, estimates and projections with respect to the anticipated future performance of certain companies and as to the market for those companies' products and services.

The Document does not constitute (or purport to constitute) an accurate or complete representation of past or future activities of the businesses or companies considered in it but rather is designed to only highlight the trends. This Document is not (and does not purport to be) a comprehensive Document on the financial state of any business or company. The Document represents the views of Coalition Greenwich as on the date of the Document and Coalition Greenwich has no obligation to update or change it in the light of new or additional information or changed circumstances after submission of the Document.

This Document is not (and does not purport to be) a credit assessment or investment advice and should not form basis of any lending, investment or credit decision. This Document does not constitute nor form part of an offer or invitation to subscribe for, underwrite or purchase securities in any company. Nor should this

Document, or any part of it, form the basis to be relied upon in any way in connection with any contract relating to any securities. The Document is not an investment analysis or research and is not subject to regulatory or legal obligations on the production of, or content of, investment analysis or research.

The data in this Document may reflect the views reported to Coalition Greenwich by the research participants. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Coalition Greenwich compiles the data received, conducts statistical analysis and reviews for presentation purposes to produce the final results.

THE DOCUMENT IS COMPILED FROM SOURCES COALITION GREENWICH BELIEVES TO BE RELIABLE. COALITION GREENWICH DISCLAIMS ALL REPRESENTATIONS OR WARRANTIES, EXPRESSED OR IMPLIED, WITH RESPECT TO THIS DOCUMENT, INCLUDING AS TO THE VALIDITY, ACCURACY, REASONABLENESS OR COMPLETENESS OF THE INFORMATION, STATEMENTS, ASSESSMENTS, ESTIMATES AND PROJECTIONS, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE ARISING OUT OF THE USE OF ALL OR ANY OF THIS DOCUMENT. COALITION GREENWICH ACCEPTS NO LIABILITY WHATSOEVER FOR ANY DIRECT, INDIRECT OR CONSEQUENTIAL LOSS OR DAMAGE OF ANY KIND ARISING OUT OF THE USE OF ALL OR ANY OF THIS DOCUMENT.

Coalition Greenwich is a part of CRISIL Ltd, an S&P Global company. ©2024 CRISIL Ltd. All rights reserved.