

## Chairman Jay Clayton and Director Brett Redfearn Preview Potential Further Equity Market Structure Reforms—Exchange Market Data Business Model Targeted

By [Annette L. Nazareth](#), [Zachary J. Zweihorn](#), [Mark A. Sater](#) & [Eric B. Lewin](#)  
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Earlier this month, SEC Chairman Jay Clayton and Division of Trading and Markets Director Brett Redfearn [engaged in a public dialogue](#) on equity market structure issues. In addition to reviewing three equity market structure initiatives adopted by the SEC in 2018 ([the transaction fee pilot](#), [enhanced order handling disclosure requirements](#) and [new transparency requirements for alternative trading systems that trade NMS stocks](#)), Clayton and Redfearn highlighted three areas for potential further rulemaking:

- issues related to scope and cost of market data;
- the quality of markets for thinly-traded securities; and
- combating retail investor fraud.

Like the 2018 transaction fee pilot—currently being challenged in the US Court of Appeals for the DC Circuit by several national securities exchanges—the proposals concerning market data, if adopted, could impact exchange revenues sources, bringing the competitive battle between brokers and exchanges back to the forefront in SEC rulemaking.

### Market Data

Clayton and Redfearn expressed concern over what they described as a “two-tiered system” of market data and market access—noting that exchanges’ proprietary data

feeds are typically faster, more comprehensive and more expensive than the limited “core data” (i.e., top-of-book and last sale information) made available through the public SIP data feed. Each noted industry concerns that core data may not be sufficient for trading in today’s market environment. Consistent with his retail investor focus, Clayton noted complaints from retail brokers who argued that the fee structure for core data is too costly, in particular because of the burdensome requirements to prove the non-professional status of their customers. Redfearn echoed the SEC’s October 2018 decision in favor of SIFMA that challenged the fees charged by exchanges for proprietary market data (itself currently being challenged by the exchanges in the DC Circuit), when he questioned whether exchanges fees for proprietary market data “remain[] fair and not unreasonably discriminatory.”

As a result, Clayton and Redfearn indicated that the Division of Trading and Markets is developing recommendations to address concerns with core data. In particular, the SEC is considering recommendations to address:

- whether the scope of core data should evolve commensurate with the market;
- whether to have more competition in the dissemination of core data and, if so, how to achieve this;
- whether core data is distributed quickly enough to be sufficiently timely;
- whether odd lot information (not currently considered core data) should be included for more higher-priced securities;
- if round lot size is adjusted, considering whether the order protection requirements of Regulation NMS should apply to the new round lot size, or whether to rely instead on best execution obligations;
- examining whether core data should include liquidity beyond the top of each market’s order book, especially if round lot size is reduced for more expensive stocks;
- updating the governance of the NMS Plans, including addressing conflicts of interest, confidentiality policies and transparency and voting representation on the operating committees overseeing the SIP Plans;
- considering new disclosure requirements regarding the costs and revenues from operating the SIPs; and

- assessing whether there is no longer fair and efficient access to markets, such that exchanges can exert market power and monopoly pricing on investors.

## Thinly-Traded Securities

Chairman Clayton and Director Redfearn also noted the SEC's intent to focus greater attention on equity markets for thinly-traded securities. As one approach, the Division of Trading and Markets is exploring a suggestion made in the [Department of the Treasury's October 2017 Capital Markets Report](#)—whether to suspend “unlisted trading privileges” in thinly-traded securities. Under Unlisted Trading Privileges, though a stock is officially *listed* on one exchange, it can generally trade on all other exchanges. This promotes competition among exchanges, but by fragmenting the market for the stock, it might exacerbate illiquidity for thinly-traded securities. Director Redfearn noted that, under some circumstances, the SEC has authority to revoke or suspend unlisted trading privileges, which might be appropriate to avoid the negative effects of otherwise uniform trading rules for all traded securities.

## Combating Retail Fraud

Clayton and Redfearn also discussed protecting investors from retail fraud, and highlighted Rule 15c2-11 and penny stocks as potential areas for reform.

Rule 15c2-11 requires that certain information about an issuer of an OTC security be available before broker-dealers begin publishing quotations. However, the “piggyback exception” allows broker-dealers to continue publishing quotations where quotations have been continuously published by other broker-dealers, notwithstanding that information about the issuer may have become stale—for example, as a result of the issuer undergoing a reverse merger, resulting in effectively a new company with new management and business. The Division of Trading and Markets is preparing a recommendation to potentially limit the availability of the piggyback exception.

Clayton and Redfearn also suggested that the SEC might revisit its penny stock rules, which require broker-dealers to comply with a number of specific customer protections for customers trading penny stocks. Although light on specifics, Clayton and Redfearn suggested that the SEC might consider expanding the scope of what constitutes a “penny stock” subject to these rules.

Finally, Director Redfearn highlighted the removal of restrictive legends by transfer agents as an area ripe for rulemaking. Transfer agents are often requested to remove restrictive legends if a security becomes freely tradable. However, there are no specific SEC rules governing when and whether transfer agents can or should remove restrictive legends, and if done improperly, removal of legends could facilitate an illegal public distribution of securities. Noting that this was the subject of a [2015 SEC Advanced Notice of Proposed Rulemaking and Concept Release](#), as well as the [2018 SEC Roundtable on Combating Retail Investor Fraud](#), Director Redfearn stated he “anticipate[s] that the Division of Trading and Markets Staff will present a recommendation to the Commission to update the transfer agent rules.”

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While there are certain to be strong viewpoints around the specifics of each of the SEC’s potential proposals, changes to the market data rules, in particular, are likely to be highly controversial. Requiring more data to be made available at lower cost would greatly benefit the broker-dealers that pay these costs—but come at significant expense or lost revenue for exchanges. The fairness of the current market data fee structure has been litigated for a decade, and the question of whether exchange fees for proprietary market data are fair and reasonable has just returned to the DC Circuit for the third time. Steps by the SEC to require affirmatively through rulemaking that exchanges distribute more data at lower cost would open up yet another battle line in this debate.