OVERSIGHT OF THE SEC'S DIVISION OF TRADING AND MARKETS

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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CONTENTS

OVERSIGHT OF THE SEC'S DIVISION OF TRADING AND MARKETS

Thursday, June 22, 2023

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:35 a.m., in room 2128, Rayburn House Office Building, Hon. Ann Wagner [chairwoman of the subcommittee] presiding.

Members present: Representatives Wagner, Lucas, Sessions, Huizenga, Hill, Steil, Meuser, Garbarino, Lawler, Nunn; Sherman, Meeks, Scott, Vargas, Gottheimer, Casten, Nickel, Lynch, and Cleaver.

Ex officio present: Representative Waters.

Chairwoman WAGNER. Good morning. The Subcommittee on Capital Markets will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "Oversight of the SEC's Division of Trading and Markets."

I now recognize myself for 5 minutes to give an opening statement.

I want to thank you all for joining us this morning. Today's hearing represents the first in a long-overdue series of hearings where we will hear directly from Division Directors at the Securities and Exchange Commission. Given the historic and unprecedented volume of proposed rulemakings being advanced at the SEC under Chair Gensler, it is imperative that this committee hold public hearings featuring the SEC staff responsible for overseeing these rulemakings.

Today's witnesses are important because the SEC's Division of Trading and Markets impacts a wide variety of stakeholders participating in our public markets, including millions of Main Street investors saving for retirement, a downpayment on a house, or their children's future. I would also like to note that it has been more than 4 years since this committee has had the SEC's Division of Trading and Markets testify, and I can assure you that will not be the case under our leadership.

Just last December, the SEC advanced four proposed rulemakings that will dramatically overhaul our current market structure and how it functions. Typically, when agencies seek to make meaningful reforms, they do so by advancing one targeted proposal at a time and by presenting clear and convincing evidence

of a problem or failure warranting such a drastic policy change. In the case of market structure reform proposals under Chair Gensler, the SEC has done neither. Instead of starting with one surgical proposal and observing its impacts after implementation to assess the need for additional proposals, Chair Gensler and Director Zhu have taken a wrecking ball to every corner of our current equity market structure in one fell swoop. And they have done so without any definitive explanation and without identifying any systemic market problems or failures.

You might be saying to yourself, surely, the SEC can point to some economic effects of the proposals that justify such major reforms, but yet again, the SEC comes up short. Throughout its economic analysis of the proposals, the SEC explicitly concedes numerous times that the economic effects of the proposals are, "unknowable."

And if that wasn't enough, the SEC's economic analyses are also improperly based on data that the SEC itself admits is outdated and inaccurate. For example, to justify 3 of the 4 proposals, the SEC utilizes Rule 605 reports, which provide trade execution quality information monthly. At the same time, the SEC staff has acknowledged that these reports have limitations and need reform.

These deficiencies are not limited to the market structure proposals put forward by the Division of Trading and Markets. The Division has authored additional proposals that inexplicably overlap and for which their impacts have been inadequately analyzed. It is vital the SEC only issue regulations that are absolutely necessary to avoid burdening Main Street investors.

That is why I will be introducing the SEC Regulatory Accountability Act. This legislation, which has passed in previous Congresses with strong bipartisan support, will make sure the SEC does not arbitrarily implement unwarranted and complex rules. My bill would statutorily require the SEC to identify the problem a proposed regulation is seeking to address and conduct a thorough cost-benefit analysis before issuing any regulation.

I would urge my colleagues to join me in protecting the capital markets that millions of Americans rely on for financial security and prosperity. I look forward to partnering with my colleagues on this subcommittee, on both sides of the aisle, to ensure that U.S. equity markets remain the envy of the world, and to continue to work on behalf of market participants of all sizes, as well as our constituents trying to save for the American Dream.

The Chair now recognizes the ranking member of the subcommittee, the gentleman from California, Mr. Sherman, for 4 minutes for an opening statement.

Mr. SHERMAN. Thank you, Madam Chairwoman, for having this hearing, and I look forward to hearing from, hopefully, every Division Head at the SEC before this subcommittee in the weeks and months to come. I want to commend the SEC for working hard and doing their job, and I assure you that there is more than one problem for you to work on at the present time.

One issue is payment for order flow. Many investors would be surprised to find out that often, their broker is getting paid by people on the other side of the transaction. We are told that this payment for order flow allows brokers to provide free commissions, free

trading. Often, the most-expensive price you can pay for any service is, "free," and in this case, the commission you save may be more than compensated for by the price spread.

Current SEC regulations seem to say that any price improvement constitutes the very-best price. That is not fair, and it is not true. In fact, the SEC has estimated that the current system causes investors to lose $1.5 billion a year because they are not getting the very-most price improvement. The SEC is wrestling with this issue, and that makes sense.

The witnesses here oversee securities exchanges. The securities exchanges with the biggest problem are the crypto exchanges, which the SEC has correctly determined are indeed securities exchanges. In this room last July, I had hearings with the head of enforcement, in which I urged them to go after the crypto exchanges. The SEC was a little slow, and FTX cost billions of dollars to investors around the world. Finally, we are going after the crypto exchanges.

I am concerned about one SEC proposal, and that is swing pricing. There are those who say that we should just, at certain times, tell mutual fund investors that the markets are unsteady, we may have a disaster, therefore, please don't sell your stocks or your mutual fund shares, and if you do, you are going to be subject to an additional charge. That is like telling people on the Titanic that there will be an extra fee for getting on the lifeboats. That is not the way to get people to calmly get on the lifeboats. The idea that in a crowded theater, where people are yelling, "fire," you are going to stabilize the situation by imposing a fee on anybody who goes to the exits is a good way to keep people out of the theater all the time.

We need people to invest for their retirement and to build America by investing in mutual funds, and the swing pricing will do just the opposite. I am particularly concerned about the swing pricing rules because of its horrendously-discriminatory effect on those of us who live by the Pacific Ocean. People would have to get their orders in by 10:00 a.m. Eastern Time, which is 7:00 a.m. in California, and 4:00 a.m. in Hawaii. Let's not adopt a rule that says that those of us who live by the Pacific Ocean will be treated worse.

Finally, we have before us the Division Heads who deal with the credit rating agencies. Talking about those who rate bonds, these are the folks who gave AAA to Alt-A and gave us the new depression of 2008. We continue to have a situation in which the issuer selects the bond rating agency that will rate the quality of their bonds.

Al Franken and I had a provision that the SEC has conveniently ignored and sidestepped to begin a system where the SEC will choose the bond rating agency. I assure you that if you let the Dodgers pick the umpires, we will be in first place. And the idea that the issuer can select the bond rating agency, and the bond rating agency cannot be sued under, they say, the First Amendment if they give too high a rating, is a recipe for what we experienced in 2008. We will probably experience something in a decade or two similar if the SEC doesn't act on this. I yield back.

Chairwoman WAGNER. The Chair now recognizes the ranking member of the full Financial Services Committee, Ms. Waters, for 1 minute.

Ms. WATERS. Thank you. Last Congress, Republicans threatened that SEC Chair Gensler would testify very frequently, but they seem reluctant, if not afraid, to hear what he thinks about their crypto markets bill, and I can understand why. Chair Gensler not only has expertise in securities markets, but he also served as the Chair of the Commodity Futures Trading Commission (CFTC) and taught courses on crypto at MIT.

Instead, Republicans will discuss legislation to give Wall Street avenues to sue the SEC over any future rulemaking under the guise of, "cost-benefit analysis." We know that for Wall Street, there is no benefit that justifies their costs. And apparently for Republicans, there is no benefit from hearing from the person who knows the cost of their crypto bill. I yield back.

Chairwoman WAGNER. Today, we welcome the testimony of first, Dr. Jessica Wachter, the Chief Economist and Director of Economic and Risk Analysis at the SEC. Previously, she was with the Wharton School at the University of Pennsylvania.

And second, Dr. Haoxiang Zhu, the Director of the SEC's Division of Trading and Markets, and a professor of finance at the Massachusetts Institute of Technology.

We thank each of you for taking the time to be here, and each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, each of your written statements will be made a part of the record.

Dr. Wachter, you are now recognized for 5 minutes to give your oral remarks.

STATEMENT OF JESSICA WACHTER, CHIEF ECONOMIST AND DIRECTOR, DIVISION OF ECONOMIC AND RISK ANALYSIS, SECURITIES AND EXCHANGE COMMISSION (SEC)

Ms. WACHTER. Thank you, and good morning, Chairwoman Wagner, Ranking Member Sherman, and members of the subcommittee. It is my pleasure to be here today. I am the Commission's Chief Economist and the Director of the Division of Economic and Risk Analysis (DERA). Today, I am testifying in my official capacity as the Chief Economist and Director of DERA, but my testimony does not necessarily reflect the views of the Commission, the Commissioners, or other members of the staff.

I know that many of you may not be familiar with my Division's work, so I wanted to give you a little bit of information about who we are and what we do. The DERA was established in 2009 from a merger of the Office of Risk Assessment and the Office of the Chief Economist. DERA is made up of over 170 economists, statisticians, engineers, attorneys, accountants, and other staff. These experts provide support to every aspect of the Commission's mission from rule writing to enforcement. As of May 31st, DERA had over 100 Ph.D. economists working on rule writing, litigation support, and risk analysis.

High-quality economic analysis is an essential part of SEC rulemaking. It helps ensure, among other things, that decisions to propose and adopt rules are informed by the best-available informa-

tion about a rule's likely economic consequences, and it allows the Commission to consider a rule's potential benefits and costs when determining if a rule is in the public interest. As a result, DERA is actively involved in the Commission's policy and rulemaking function.

In Commission rulemakings, DERA's Office of Policy Economics conducts an economic analysis which examines the costs and benefits as well as effects on efficiency, competition, and capital formation of that rulemaking. As a general matter, the economic analysis contains a statement of the need for the proposed action, a baseline against which to measure the likely economic consequences, alternative approaches, and an evaluation of the benefits and costs of the proposed regulatory action.

Finally, we also analyze the effects on efficiency, competition, and capital formation. In conducting the economic analysis, DERA staff works closely with staff from the policy divisions, including the Division of Trading and Markets, from the earliest stages of policy development through the finalization of a particular rule.

In addition to working on rulemaking and policy matters, DERA economists also support the Commission's examination and enforcement functions by providing rigorous economic analysis and data analytics. We help identify securities law violations, quantify harm to investors, calculate ill-gotten gains, and assist the Division of Enforcement with returning funds to harmed investors. DERA's Office of Litigation Economics also provides expert testimony in enforcement matters. DERA staff perform risk analysis, in addition, of the capital formations to inform the Commission and those outside.

High-quality data greatly facilitate our economic analysis. Indeed, data and data analytics are becoming increasingly important to the successful accomplishment of the SEC's mission. To meet the increased demand for data analytics, DERA's data scientists and engineers develop tools and perform analysis in support of the entire Commission. This includes working with SEC's other divisions and offices to ensure data-structuring approaches for required disclosures, validation rules, and data quality assessments meet the needs for which they are designed, as well as advanced machine-learning algorithms, where necessary.

In sum, DERA staff deliver high-quality, data-driven analysis that is critical to the SEC's mission of protecting investors, facilitating capital formation, and ensuring fair, orderly, and efficient markets.

It is my great pleasure to serve at the SEC. I have been very privileged to study financial markets and to teach the next leaders of our financial industry for more than 20 years. Our markets are the deepest and most-liquid in the world, and I am honored that in this position, I am able to help them continue to grow and thrive. Thank you again for inviting me, and I look forward to answering your questions.

[The prepared statement of Director Wachter can be found on page 38 of the appendix.]

Chairwoman WAGNER. Thank you. Director Zhu, you are now recognized for 5 minutes for your oral remarks.

STATEMENT OF HAOXIANG ZHU, DIRECTOR, DIVISION OF TRADING AND MARKETS, SECURITIES AND EXCHANGE COMMISSION (SEC)

Mr. ZHU. Good morning, Chairwoman Wagner, Ranking Member Sherman, and members of the subcommittee. My name is Haoxiang Zhu, and I am the Director of the Division of Trading and Markets at the Securities and Exchange Commission. It is my honor and pleasure to appear in front of you today to discuss the Division's work. I am testifying in my official capacity as the Director of the Division of Trading and Markets, but my testimony does not necessarily reflect the views of the Commission, the Commissioners, or other members of the staff.

The Division of Trading and Markets was one of the original divisions of the SEC when it was established in 1934. As the name implies, the primary task of the Division is to oversee the trading of securities. As technology and market practices evolve, the role of the Division evolves with it. Today there are, broadly speaking, three layers of market activities and intermediaries that come under the remit of the Division.

The first layer is marketplaces. This broad category includes national securities exchanges, as well as alternative trading systems and security-based swap execution facilities. Generally, if a marketplace trades any security—stocks, bonds, options, and security-based swaps, among others—it is in the remit of Trading and Markets.

The second layer is broker-dealers. Because broker-dealers are key intermediaries for investors to access the market, they are subject to rigorous regulatory requirements about net capital, customer protection, recordkeeping, sales practices, and investment recommendations, among other activities.

The third and last layer is clearing agencies, including clearinghouses and central securities depositories. They are important for the efficient clearance and settlement of securities transactions. The Division also oversees transfer agents, which maintain the issuer's security holder records, among other functions.

I should add that exchanges, FINRA, and clearing agencies are all self-regulatory organizations (SROs). Securities laws require that SROs file their proposed rules and rule changes with the Commission, and the filings are subject to Commission review and notice and comments.

Based on the most-recent data, the Division of Trading and Markets oversees 24 national securities exchanges, about 100 alternative trading systems, over 3,500 broker-dealers, 48 security-based swap dealers, 7 registered clearing agencies, and over 300 transfer agents. In Fiscal Year 2022, the Division processed about 2,000 filings from SROs, including exchanges, FINRA, and clearing agencies. Behind these numbers are the approximately 270 staff members in the Division, who spend countless hours reviewing documents, writing Commission releases and orders, and meeting with registrants and market participants.

Our day-to-day regulatory work produces another dividend, which is that Division staff identify market evolutions that are significant enough to warrant updates to our rulebooks. And of course, if Congress decides to update securities laws, we implement con-

gressional mandates. Under Chair Gensler, over 60 percent of rule proposals and adoptions recommended by the Division of Trading and Markets received unanimous votes from the Commission.

Our current rulemaking work falls into four broad areas. The first area is to finish the mandates from the Dodd-Frank Act of 2010. The second area focuses on strengthening the U.S. Treasuries market. The third area is to update our rules on equity market structure, and the fourth area focuses on the interaction between financial regulation and technology infrastructure.

In all areas of rulemaking, the staff in the Division thoroughly consider comment letters received and actively engage with market participants before making policy recommendations for the Commission to consider. We closely collaborate with colleagues in the Division of Economic and Risk Analysis, the Office of General Counsel, and other divisions and offices. We are working hard to fulfill the mission of the SEC: to protect investors; to promote fair, orderly, and efficient markets; and to facilitate capital formation.

I would like to conclude with a personal note. Sixteen years ago, I set foot in this great country to pursue a better life. I am grateful that the United States took me in as one of its 330 million proud citizens. I had a good career as a financial economist before coming to public service. It has been my honor and privilege to serve at the Commission for the past 18 months. Our work is deeply-technical, but underneath it, is a far simpler and more-profound goal: To keep the U.S. capital markets—and indeed the United States—as the envy of the world. Thank you.

[The prepared statement of Director Zhu can be found on page 40 of the appendix.]

Chairwoman WAGNER. Thank you, Dr. Zhu.

We will now turn to Member questions, and I will recognize myself for 5 minutes for questioning.

Dr. Wachter, you are the Director of the Division of Economic Risk and Analysis (DERA). While DERA's economic analysis in each of the individual equity market structure proposals is significantly flawed and deficient, the most-noteworthy flaw across every proposal is the SEC's failure to reasonably attempt to quantify their costs and benefits. The SEC repeatedly admits that it is, "unable to quantify, estimate, or know the economic effects," and it states nearly 100 times that it is, again, uncertain of the impacts its proposals will have.

As Chief Economist, you are willfully ignoring your duty to provide adequate economic analysis, ma'am. For example, nearly half of the data tables in the best execution proposal's economic analysis are virtually identical to tables presented in the order competition proposal. Is it standard practice for the SEC to copy and paste parts of its economic analysis for two separate proposals, ma'am?

Ms. WACHTER. Madam Chairwoman, thank you for your interest in our economic analysis on the equity market structure proposals, and——

Chairwoman WAGNER. I am asking about the copy-and-paste.

Ms. WACHTER. ——about the copy and paste. The economic analysis has several different parts, and one very important part is the baseline. The baseline is the world as it is, so we have to measure costs and benefits against some flat line, the world as it is. So for

each of those four proposals, there is going to be some commonality, and that is why you will see some of the text repeated between them.

Chairwoman WAGNER. But, ma'am, you haven't quantified their costs and benefits. Nearly 100 times, you say you don't know, you are uncertain. And as I said, my question is specifically, is it standard practice for you to copy, cut, and paste parts of your economic analysis for two separate proposals? Yes or no?

Ms. WACHTER. When the baselines are——

Chairwoman WAGNER. Okay, ma'am, I need to reclaim my time. I would like you to answer the specific question, do you agree that these proposals could interact with each other? For example, the order competition rule needs to comply with the best execution rule, correct, yes or no?

Ms. WACHTER. The order competition rule and the best execution rule do solve different problems, and both the costs and benefits in each of those separate rules are going to be evaluated——

Chairwoman WAGNER. They interact with each other.

Ms. WACHTER. ——against the baseline, and they are——

Chairwoman WAGNER. Okay. I don't know what this, "baseline," is, but we are going to move on.

Director Zhu, typically, significant market structure reforms have been carried out with comprehensive outreach to investors and businesses, broker-dealers, exchanges, and various other market participants before formal rulemaking. However, in this instance, the SEC appears to be moving at a breakneck speed, without giving the public an adequate opportunity to meaningfully comment on the proposed changes.

In 2005, when the SEC adopted Regulation National Market System (Reg NMS), it held multiple public hearings and roundtables, convened an advisory committee, issued several concept releases, and gave adequate comment periods allowing for ample public input. Why hasn't the SEC done any of these things this time around or provided any justification for the pace and the breadth of these rulemakings?

Mr. ZHU. Chair Wagner, thank you for the question. The public engagement part is extremely important for us in the rulemaking process. Before we proposed regulation, the equity market releases in December, there was extensive discussion with the market participants of all the years before. I would say ever since the adoption of Regulation NMS in 2005, the ongoing discussion has been really fruitful. And, in fact, some of the ideas that we eventually learn from the market come from the market itself, including lower access fee, including lower tick size, including reform to Rule 605. So my answer to you, ma'am, is that, indeed, we have engaged actively with the market.

Chairwoman WAGNER. Okay. Dr. Wachter, let's try again. Each of these four rules is significant and will have a material impact on trading outcomes for millions of investors. With the rules scheduled to go into effect simultaneously, how can you, as the Director of DERA, with a straight face, claim to measure to what degree each of the four rules contribute to or a better or worse outcome for investors? Wouldn't it make more sense to issue them incrementally so that each rule's efficacy could be measured distinctly?

Ms. WACHTER. You are concerned about the interaction of the rules, should the proposals be adopted? Right now, these are four proposals. They are proposed rules, and so we are measuring the economic effects against the baseline, which is actually our standard practice.

Chairwoman WAGNER. My time has expired, and I am backed up over it, so I will give you a little extra time.

The Chair now recognizes the distinguished ranking member of the subcommittee, Mr. Sherman, for 5 minutes for questions.

Mr. SHERMAN. I want to praise you and your colleagues at the SEC for your hard work, your dedication to solving many problems, and to do it at the same time, and especially, I want to commend you for going after the crypto exchanges.

But in my time, I want to try to push you in the right direction on some areas, one area, in particular, where I think you are getting it wrong. People up here, me for example, are here because we understand people. I have won 13 elections in spite of my personality and my looks because I understand my district. And this swing pricing seems like the worst idea you could have in trying to achieve our objectives. We want people to save in an orderly way for their retirement, not their trading, not putting all their money in a single stock. We need people to invest in American equities, not foreign equities, and certainly not crypto. And the swing pricing seems to be designed not for the purpose, but with the effect of deterring investments, particularly in equity mutual funds.

The Administration is absolutely dedicated to getting rid of junk fees, and yet, swing pricing looks like such a giant junk fee that it would make an airline CEO blush. I am old enough to remember when mutual funds had loads; you had to pay extra money to get out or to get in. Thank God, we don't have that anymore, but swing pricing imposes a load, right, when you might want to sell.

Imagine trying to buy a ticket on an airline and they say, we will charge you extra if you use the life preserver. I wouldn't fly that airline. So, the idea that we are going to stabilize markets and cause people not to sell their mutual fund shares at a tough time—again, if I was dumb enough to buy a ticket on an airline that said that we charge extra for the life preservers, you can be sure that I would pay and use the life preservers if I thought they were needed. In fact, I would be more interested in putting on the life preserver before the plane even took off.

Dr. Wachter, have you done a detailed, peer-reviewed economic analysis on how the swing fees would deter interest in investing in American mutual funds?

Ms. WACHTER. Ranking Member Sherman, thank you for your interest in the swing pricing.

Mr. SHERMAN. Oh, please. Yes or no?

Ms. WACHTER. The swing pricing proposal, you say?

Mr. SHERMAN. Yes or no?

Ms. WACHTER. Our economic analysis on the proposal——

Mr. SHERMAN. Look, I am going to reclaim my time if you won't answer the question. Have you done the work, and has it been peer-reviewed?

Ms. WACHTER. We have done the work.

Mr. SHERMAN. You have done the work. Has it been peer-reviewed?

Ms. WACHTER. It has been put out for public comment.

Mr. SHERMAN. It has been put out for public comment. And what analysis did you do to conclude that telling people that just when they want to sell the stock is when they are going to be deterred from selling the stock, and, oh, by the way, if you live near the Pacific Ocean, you are going to be particularly oppressed, and for some reason, that didn't deter people from investing in mutual funds? On what basis did you reach that conclusion?

Ms. WACHTER. We did do the analysis, and we share your concerns about those costs that you mentioned, and those costs are in our economic and——

Mr. SHERMAN. I am not so concerned about the cost; I am concerned about the effect on investors. Junk fees. It is not the 20 bucks. It is the lack of simplicity. I want to buy an airplane ticket, pay so much, and get to my destination. I want to know what it is. I want to put my money into a mutual fund, pay a little fee for them to manage it, and get my money out at net asset value when I want it out. You complicate that, and investors, particularly, when they see something they don't understand, think they are getting ripped off. You are saying your economic analysis shows that this isn't going to deter investment?

Ms. WACHTER. Congressman, we do talk about that in our economic analysis in the swing pricing rule. The problem that this rule is designed to address is, given how the net asset value is calculated right now in some mutual funds, we have a situation where some investors may be subject to dilution.

Mr. SHERMAN. That is not some mutual funds. Every single mutual fund in this country could use swing pricing, and I think 0.0 have decided to do it. So, we are dealing with all mutual funds. There is not a single mutual fund seeking investment that has thought that investors would choose them if they went to a swing pricing system, because then, investors would think it was fair.

Chairwoman WAGNER. The gentleman's time has expired.

Mr. SHERMAN. I yield back.

Chairwoman WAGNER. And before we move on, I would ask our witnesses to please answer the questions in an expeditious, clear, and direct fashion to our Members of Congress who have to perform oversight on both sides of the aisle. Thank you.

The gentleman from Michigan, Mr. Huizenga, who is also the Chair of our Subcommittee on Oversight and Investigations, is now recognized for 5 minutes.

Mr. HUIZENGA. Thank you, Madam Chairwoman, and I was going to start by asking, please don't start your answer with, "Thank you for asking me this great question." I know it is a great question.

Director Zhu, and Director Wachter, I am going to jump right in. I want to start by discussing SEC Proposed Rule 10B-1, Position Reporting of Large Security-Based Swaps. Dr. Craig Lewis of Vanderbilt, who, interestingly, had your job, Dr. Wachter, under Chair Mary Schapiro, conducted a review of your economic analysis for proposed Rule 10B-1. And I would like to submit that report for the record, Madam Chairwoman.

Chairwoman WAGNER. Without objection, it is so ordered.

Mr. HUIZENGA. In the course of this review, Dr. Lewis discovered that the Commission repeatedly mischaracterized the academic research it relied on to support public disclosure of positions. In one instance, the Commission quoted a paper asserting it was in support of public disclosure of positions, when, in fact, the paper did not discuss public disclosure at all.

Director Zhu, have you conducted an internal investigation to determine how this mischaracterization occurred and who was responsible? Quickly, please.

Mr. ZHU. Congressman, the objective of Rule 10B-1 is the Dodd-Frank Act.

Mr. HUIZENGA. I don't want to know the objective. I want to know whether you have conducted an investigation to determine who is responsible for these mischaracterizations.

Mr. ZHU. Congressman, I joined the SEC in December 2021. That is right at the moment.

Mr. HUIZENGA. And I joined Congress in 2011. Would you please stop stalling? If not, then I would respectfully suggest that we have another hearing with you in front of us so we can get 10 minutes of you stalling instead of 5 minutes of stalling.

Chairwoman WAGNER. We are on the road to that, Mr. Huizenga. Please answer the Member of Congress' question.

Mr. HUIZENGA. Okay. Have you retroactively examined other SEC releases to ensure that they do not contain similar misrepresentations? Yes or no, Dr. Zhu?

Mr. ZHU. Congressman, we make sure that whatever we say in the release achieves the policy objective, the transparency, and the investor protection.

Mr. HUIZENGA. Have you gone back to review that? Yes or no? I will take this as a, no. Okay. What steps has the Commission taken to correct the record to accurately convey the views of these distinguished academics?

Mr. ZHU. I am not familiar with that particular letter you refer to, sir.

Mr. HUIZENGA. It is a study, and we will get you a copy of that. And I will submit in writing the questions that I apparently can't get answers to today.

Given that the Commission has heavily relied on the summary of the academic literature, have you notified the Commissioners that your summary is, in fact, unreliable? Yes or no?

Mr. ZHU. Congressman, on 10B-1, it is a live rulemaking. In fact, earlier this——

Mr. HUIZENGA. Okay. Reclaiming my time, I am concerned that you have just made the SEC legally vulnerable to challenges in court. Are you concerned about that?

Mr. ZHU. We published a reopening of 10B-1 earlier this week, so that went into the public domain.

Mr. HUIZENGA. Okay. I guess I will take that as an, I don't care. Moving on, I know people watching this hearing, and maybe even some of my friends on the other side of the aisle, believe that this is somehow partisan, when, in fact, that is simply not true. Last December, Congressman Gottheimer and I sent Chair Gensler a bipartisan letter on the SEC's market structure proposal. In response

to our letter, Chair Gensler noted, "As is the case in all rulemaking activities, these proposals were developed by experienced staff from across the Commission." That statement is particularly noteworthy given that just months prior, the SEC's own Inspector General released a report about their concerns surrounding the level of expertise used when crafting many of the proposed rules in question.

So, Director Wachter, quickly please, the SEC has been very active and has issued a number of proposals over the last 2 years. Yes or no, do you believe DERA has had the proper time to be able to provide robust economic analysis for each of the proposals, that sufficiently explores all impacts?

Ms. WACHTER. Congressman, as the Director of DERA, I concur on all the economic analysis and my belief——

Mr. HUIZENGA. And you believe you have had sufficient time?

Ms. WACHTER. Sufficient time. We conduct a robust economic analysis.

Mr. HUIZENGA. Okay. The Consolidated Appropriations Act of 2023 instructed the Commission to re-conduct their economic analysis on the proposed rule for private fund advisors. Has your Division completed that directive from Congress?

Ms. WACHTER. Congressman, we are currently evaluating the comment file on that proposal, and we——

Mr. HUIZENGA. So, you have not completed it. Okay. In my remaining 10 seconds, in February 2022, in a second letter to Chair Gensler, I asked whether or not the SEC had considered the economic impact of the climate disclosure rule on energy prices. The response I got was a repackaging of the rule itself. I will be following up, but please, pray tell me that somebody has done the analysis.

Chairwoman WAGNER. The gentleman's time has expired.

Mr. HUIZENGA. And, Madam Chairwoman, again, to the objections, this is ridiculous. This is absolutely ridiculous, and whether we have to do——

Chairwoman WAGNER. The gentleman's time has expired.

Mr. HUIZENGA. ——an investigation in closed questioning, we have to get to the bottom of these areas.

Chairwoman WAGNER. The gentleman's time has expired. I now recognize the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Thank you very much. First, Dr. Wachter, I understand you are associated with the Wharton School of Finance at the University of Pennsylvania. I am a graduate of the Wharton School at the University of Pennsylvania, I got my MBA there, and served on the executive board of directors, so I want to give you a special welcome to the House Financial Services Committee.

Now, Director Zhu, our capital markets are the world's gold standard. And in recent years, new investors who began trading and investing in markets have been younger and more racially-diverse and have come from lower-income populations, more so than prior generations of investors, and I want to compliment you on that. These are welcome trends given the critical role of our capital markets in enabling individuals to obtain good solid financial security.

And this is why I am pleased to see the SEC pursue updates to Rule 605 data through the Disclosure of Order Execution Informa-

tion Proposal, particularly by expanding the scope and content of the information that is close.

However, currently, only market centers, like national security exchanges, over-the-counter market makers, and alternative trading systems, are required to produce publicly-available monthly execution quality reports.

So what I want to ask you, Director Zhu, is, taking into account the changes in equity market conditions and the technological advancements which have eroded the effectiveness of Rule 605, does the SEC believe they have the most accurate, up-to-date data available to support adopting the other three equity market structure proposals?

Mr. ZHU. Thank you, Congressman. First, I want to say that what you mentioned earlier about broader participation in the equity market, with a younger, more-diverse population, I think that is indeed a phenomenon to be celebrated. To your question about Rule 605, this data was, I guess, adapted in 2000, and for 20 years or so, it has been providing valuable information to the market. And currently, we are trying to expand the coverage of Rule 605, as well as adding to the granularity of this data set. So, this data has been used for rulemaking in the equity market structure releases. And we believe that while this data could be made more perfect, it is sufficient and informative enough for us to rely on it.

Mr. SCOTT. Wouldn't you agree that if adopted, the proposal would significantly expand the data that is made available to the public about the execution quality of equity transactions? Yes or no?

Mr. ZHU. If adopted, it will as to the granularity.

Mr. SCOTT. Okay. So, you are saying, yes. Let me ask you this while I have a moment left. Would the Commission consider delaying the other three proposals until you can use the updated Rule 605 data?

Mr. ZHU. Congressman, that is also a comment that was shared by many commenters in the comment file, and we will consider comments submitted in this manner, including this one.

Mr. SCOTT. I believe that comprehensive and accurate data is critical to enabling regulators and market participants to make the most-informed decisions. So that is very important, using the latest, most available decisions. Many of these decisions, financially, are life-and-death decisions, moving up or moving down the economic ladder. Thank you to both our witnesses for being here today, and I yield back the balance of my time.

Chairwoman WAGNER. The gentleman yields back. The Chair now recognizes the gentleman from Arkansas, Mr. Hill, who is also the Chair of our Digital Assets Subcommittee, for 5 minutes.

Mr. HILL. Thank you, Madam Chairwoman. The SEC has been working on the Consolidated Audit Trail (CAT) for a long time, almost a decade. And during my 9½ years in Congress, I have consistently opposed the idea of the CAT, under both Republican and Democratic leadership, because I think it is unnecessary, and I think it is a very, very costly intrusion to the marketplaces, and all of those costs will be borne mostly by retail investors, the way this is structured now.

And the reason I oppose it, too, is because substantively every analytic surveillance tool that the Commission or FINRA needs, that might be contemplated in capturing every brokerage account and every trade for every American citizen, can be done under the rules now, under the surveillance policies now, of both the exchanges and FINRA in their broker-dealer work. So, I just view it as a catastrophically bad idea, and I think it outlines the risks of another giant Federal database that people can query without a real rationale.

The SEC has spent a lot of time over the last year proposing rules intended to increase cyber defenses for every public company, broker-dealer, and fund. Mr. Zhu, what do you think the biggest cyber vulnerabilities are of the Consolidated Audit Trail? And are you concerned about cyber vulnerability in collecting that data in the CAT?

Mr. ZHU. Congressman, I think you raised a really important issue that resonates with all of us. I think the protection of customer information, customer data, is of the utmost importance. That is why, I think in 2010, the Commission issued exempt relief so that the most-sensitive personally identifiable information (PII), such as Social Security Numbers, account numbers, and a full date of birth, will not be collected by the CAT.

Mr. HILL. But don't you agree that you still have the ability in this kind of a database to expose that, and the Federal Government doesn't seem to have a very good track record in that? I will give you an example, geographically. In Little Rock, Arkansas, there is a huge trade in a couple of different stocks. It is identifiable who it is. And if that number was released to the public, it could be very damaging to somebody's privacy, even if you don't know their name or address.

So, I think this policy has concerns. And what kind of screening would be required for anyone who has access to looking at the CAT? What qualifications would they have, and how many people is that? I read that it could be 3,000 people, is that true, to have the opportunity to look at this database?

Mr. ZHU. Congressman, currently, the Commission is evaluating the comment file on the rule proposal issued under former Chair Clayton about the data security of CAT. I would also add that CAT is a system run by the self-regulatory organizations. It is not a system run by the SEC.

Mr. HILL. Yes, but let's not hide behind the fact that it is done at the direction of the SEC. So, would you say that FINRA agrees with the CAT proposal from the Commission?

Mr. ZHU. It is a proposed rule on which we received a lot of comments, and we evaluated them very carefully.

Mr. HILL. Okay. Let me change subjects. I am not going to make much progress there. Let's turn to your Treasury dealer proposal. Here, you are trying to sweep up people who are Treasury buyers and suddenly rule them as dealers, and you have defined the quantitative threshold somebody buying or selling $25 billion in U.S. Treasuries for the past 6 months automatically makes somebody a dealer.

Now, on a bipartisan basis, we have objected to that. We don't understand the rationale for it on a bicameral basis. Have you re-

searched how many firms would be impacted by that definition? How many people now do you think are suddenly Treasury dealers because they buy Treasuries in that quantity, at that level? How many people are we talking about? How many firms?

Mr. ZHU. In the proposal of the dealer rule——

Mr. HILL. No, no. I know what it says. I am asking you, based on that quantification of the amount of Treasury securities, how many entities might be swept up in that definition?

Mr. ZHU. Given the available data, as it says in the release, if I recall correctly, there are between 20 and 30 entities. There are comments from the comment file suggesting that there are others who might be affected by that threshold, and we are currently evaluating the comment file.

Mr. HILL. Okay. Thank you. Madam Chairwoman, I yield back, but I will submit these questions for the record, regretfully. Thank you.

Chairwoman WAGNER The gentleman from New York, Mr. Meeks, is now recognized for 5 minutes.

Mr. MEEKS. Thank you, Madam Chairwoman. Let me start with Dr. Zhu. The last time the SEC pursued major market structure reforms, it held public hearings to receive input from market participants before and after releasing the proposals, and, ultimately, the SEC reported Regulation NMS in response to extensive public comment.

I have heard from a number of public stakeholders, particularly from New York, that the process for developing the four equity market structure proposals released last December was entirely different. So, what I am trying to understand is, why did you take a different approach on the equity market structure proposals than you did with the Regulation NMS proposals?

Mr. ZHU. Congressman, thank you for that question. I think this is a really important topic that we do engage with the public extensively on throughout the rulemaking process, and that is what we did. Ever since the Regulation NMS adoption in 2005, the Division staff have been engaged with the public and the market participants very extensively. And, in fact, some of the ideas that we eventually proposed were supported by the market participants, at least I would say, 5 or 10 years ago. We had extensive meetings with the industry and also with a broader set of market participants. Staff have attended industry conferences. We read industry-wide papers. So, there was an extensive period of discussion with the market participants.

And also, after the proposal, we have received thousands and thousands of letters from individuals, from our trade associations, and from institutional investors. So, we do believe that the public does have the opportunity to weigh in as extensively as they wish in the rulemaking process.

Mr. MEEKS. I will go back and forth with you because having public proposals with one way—I think we can debate that issue. But let me jump to something, and I will go to Director Wachter on this because this is something that is important to me.

Since I have been in Congress, my goal has been to ensure that people from all backgrounds have access to the opportunity to create wealth and establish financial well-being. I think that is tre-

mendously important. And last week, I reintroduced the Improving Corporate Governance Through Diversity Act, with Senator Bob Menendez. It has received bipartisan support in the past, and I hope that we get it done now. But in addition to representation, I think that we must always look at policies and proposals through the lens of whether they are treating people equitably, and especially if there are negative economic impacts through unintended consequences.

So, Dr. Wachter, last year's Omnibus Appropriations bill included language that strongly encourages the Commission to reconnect the economic analysis in the private funds advisor proposal to ensure that analysis adequately considers the disparate impact on emerging minority- and women-owned asset management firms, minority- and women-owned businesses, and historically-underserved communities. So, can you tell us what the status is of the re-conducted economic analysis?

Ms. WACHTER. Congressman, we are currently working on that economic analysis as part of the adoption of the private funds role.

Mr. MEEKS. You haven't finished it? The question then is, do you have any initial assessment on what the impact would on minority- and women-owned law firms? Is there any assessment that you can give us at this time?

Ms. WACHTER. The concern about women- and minority-owned law firms comes from the fact that the academic literature shows that those firms tend to be smaller, and it is possible that there may be a disproportionate impact on smaller entities. This is what the comment file says, so we are evaluating those comments at the moment, but it is an issue that is under consideration by my——

Mr. MEEKS. It is under consideration, but is it a priority?

Ms. WACHTER. We conduct an economic analysis for every proposal in rulemaking, including this one. We are carefully considering it——

Mr. MEEKS. There is considering it, and then, there is considering it when it is a priority. Is it a priority?

Ms. WACHTER. Congressman, we share your concern about these costs very much.

Chairwoman WAGNER. The gentleman's time has expired. The gentleman from Oklahoma, Mr. Lucas, is now recognized for 5 minutes.

Mr. LUCAS. Thank you, Madam Chairwoman. I would like to begin by focusing on our proposed rule pertaining to security-based swaps. The SEC's proposed Rule 10B-1 would require public dissemination of security-based swap positions. Market participants are concerned that this would deeply harm market liquidity. In November of last year, I sent a letter to the SEC, with several of my Republican and Democrat colleagues on this committee, regarding this proposal. We specifically asked if the Commission supported an approach that requires confidential reporting, noting the potential unintended consequences of public dissemination.

I was pleased to see that the SEC reopened the comment period yesterday, and I am optimistic this will give the SEC more time to review existing data and appropriately consider bipartisan feedback.

Dr. Zhu, has your Division considered a phased approach to implementation, first analyzing the confidential data before mass disseminating the information out to the market?

Mr. ZHU. Congressman, thank you for that question, and also for recognizing that we indeed reopened a comment period for 10B-1, accompanied by an economic analysis, and additional data analysis produced by colleagues in the Division of Economic Risk and Analysis. To your question about the phased implementation, including those reporting to the Commission before public dissemination, it is one of the comments in the comment file, and thank you for that letter, which I have read. This is something we are considering very carefully right now.

Mr. LUCAS. I am very concerned, I will acknowledge to you, about the major impact that this rule could potentially have on the credit default swap market, which is critical for banks to be able to manage risk, so harming liquidity in this market would have major implications for the safety and soundness of the banking system. So I ask, has the SEC discussed this rulemaking with the Treasury, the Federal Reserve, or, for that matter, the OCC?

Mr. ZHU. Congressman, this is a Dodd-Frank rule, because this is the congressional mandate, so we implemented it this way. I can get back to you on the specifics of the discussion if there are any.

Mr. LUCAS. But you see where I am coming from. When we pass rules that can potentially have dramatic effects on financial institutions' ability to use the market system to protect themselves and their depositors, it would seem that it is only logical that the Securities and Exchange Commission would discuss that with Treasury, the Federal Reserve, and the Office of the Comptroller of the Currency because of the potential effect it would have on their responsibilities.

Continuing with you, on March 9th of this year, the Division of Investment Management proposed a new rule to address how investment advisors safeguard client assets. The proposal would expand the scope of the Commission's custody rule to encompass all assets. And many industrial participants have expressed concerns that this rule could have a negative impact on several traditional financial markets in conflict with regulatory frameworks overseen by the Division of Trading and Markets, I think such things as prime brokerages and derivatives. More broadly, there has been widespread concern from the commenters that the proposal would result in worse outcomes for investors.

Did the Division of Investment Management consult with you before issuing the proposal, and did your Division provide any feedback or raise any potential concerns?

Ms. WACHTER. Congressman, the Division of Investment Management did consult with us, and we provided our economic analysis as we always do on rule proposals.

Mr. LUCAS. Did it have any effect on their action?

Ms. WACHTER. These questions——

Mr. LUCAS. I ask these kinds of questions because that is what I am curious about.

Ms. WACHTER. Questions about this may be best directed to the Division of Investment Management.

Mr. LUCAS. With that, Madam Chairwoman, I think I have my answer. I yield back.

Chairwoman WAGNER. The gentleman yields back. The gentleman from California, Mr. Vargas, is now recognized for 5 minutes.

Mr. VARGAS. Thank you very much, Madam Chairwoman. I appreciate the opportunity. And thank you for holding this hearing, and I thank the ranking member.

Dr. Zhu, first of all, I would like to thank you for sharing your love for America, for our country. It is always heartwarming to hear a new American say how much they love our country. We are that shining city on the hill. I still believe that, and thank you for that. I appreciate it.

I have to say that this hearing has reminded me of a hearing that I was in about 20 years ago in the Assembly in California, Business and Professions. We decided that we weren't going to bring the usual people who would testify, we would bring world-class experts, and this was on podiatry versus orthopedics to find out how far the orthopedics could go up the ankle and up the leg. And when we brought them in, we asked them very complicated questions that we didn't know were complicated, and they gave us very complicated answers that we didn't understand. We got frustrated. They got frustrated.

It was actually quite interesting to watch because, not that they were stalling or anything like that, but when we would ask a simple question about vascular circulation or bone structure, it wasn't a simple question. It turned out to be a very complicated question, and we wanted a simple answer. There was no simple answer, and I feel a little bit like that today, not frustrated, but just, it is fascinating. And it does take me back a few years.

Climate change presents a direct threat to our nation's capital markets, critical infrastructure, and economic growth. The Office of the Comptroller of the Currency states that climate-related risks can affect the safety and soundness of banks through physical and transition risks, which affect various sectors of the economy and may affect access to financial services and fair treatment of customers.

The Treasury's Climate-related Financial Risk Advisory Committee, "identified climate change as the emerging and increasing threat to the U.S. financial stability." The International Monetary Fund's Office of Finance and Development stated that climate change will affect monetary policy by slowing productivity and growth, and increasing market uncertainty and inflation volatility.

With that in mind, last March the SEC proposed rule changes that would require companies to disclose standardized information about material climate-related risks that will have an impact on business operations. And as Co-Chair of the Sustainable Investment Caucus, I applaud the SEC's listening to thousands of investors, fund managers, industry advocates, legal scholars, and market professionals. These standardized disclosures will provide market participants with clear information to protect themselves from risks and make the best financial decisions for themselves and their families.

Dr. Wachter, thank you for lending your expertise and testifying today as Chief Economist and Director of the Division of Economic and Risk Analysis. You are tasked with integrating financial economics and rigorous data analytics into the SEC's policymaking rule, making enforcement examinations. Pertaining to the upcoming climate disclosure rule, I would like to ask you to discuss your understanding of our capital markets as it pertains to climate-related information.

Ms. WACHTER. Congressman, we have a situation with the climate disclosures in that many companies are voluntarily disclosing climate risks, but these disclosures are not necessarily entirely consistent because there is not some common regulatory framework. And because they are not as consistent, they are not as useful for investors. We can tell that there is investor demand for this information, because companies are providing this information, among other reasons, and yet, we don't have a consistent framework for disclosure, and I think that makes it more costly for everybody.

Mr. VARGAS. I agree with you, and it is, in fact, the case that many investors are asking for this information. They want to be good citizens. They want to be good stewards of the world. And so, they do ask for this information, don't they? Isn't that the reason the companies are putting it out there? I don't have anything against companies, I actually like big companies, but the reason they do that, I assume, is because investors are asking for it.

Ms. WACHTER. I would also assume that is why the companies put it out, because the investors want it, yes.

Mr. VARGAS. Yes. I think that is absolutely the case. A whole bunch of us want to know, is this company a good actor? Is it a good actor environmentally? Is it a good actor, and what is it doing to help climate change in a positive way and not in a negative way? But anyway, again, I thank you for being here. I don't feel the same frustration as some others, but it was certainly entertaining. Thank you very much, and I yield back.

Chairwoman WAGNER. The gentleman yields back, and the gentleman from Wisconsin, Mr. Steil, is now recognized for 5 minutes.

Mr. STEIL. Thank you very much, Chairwoman Wagner. And to the witnesses, I appreciate you being here today. I have to say that some of the conversation is a bit disturbing when we look at the lack of analysis being presented to us. And I don't know how we don't take that into account when we go through the appropriations process with the work that is going on at the Securities and Exchange Commission, whose mission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. Do you agree with that, Mr. Zhu?

Mr. ZHU. It is indeed our mission.

Mr. STEIL. Okay. So, that is the framework we are looking at, and where before us is a pretty radical overhaul of the U.S. equity markets. And I am concerned about the absence of stakeholder input in the rulemaking process, so let me dive in with a couple of questions maybe to provide some clarity to those of us who are trying to understand the rules that you are putting forward.

Some of the narrative I am hearing, Mr. Zhu, is the narrative that is relating to the meme stock activity of 2021, justifying some of the rules that are being put in place. We have had multiple

hearings on this, and previously, then-Chair Waters and Mr. Green published a report laying out the causes of the trading disruptions and making concrete recommendations. And as far as I can tell, nothing the SEC is proposing in the market structure package directly addresses any of the concerns raised by my colleagues or others who studied the issue. So, as we look at the order competition proposal, is that directly related to the meme stock events of 2021?

Mr. ZHU. Congressman, you mentioned the order competition proposal, which is a proposal that aims at promoting competition for a segmented set of order flows from individual investors.

Mr. STEIL. Understood, but is it related to the meme stock issue of 2021, in your opinion? Yes or no?

Mr. ZHU. The meme stock event certainly shows the surge of trading volume.

Mr. STEIL. No, I understand the meme stock. I understand the proposal. I am asking, in your opinion, are they connected? Are they related? Yes or no?

Mr. ZHU. The lack of sufficient competition in retail order handling certainly got exacerbated by the event in the meme stock.

Mr. STEIL. So, do you believe that this rule is in connection to the meme stock?

Mr. ZHU. The meme stock event, as I said, does make the insufficient competition issue in retail order handling.

Mr. STEIL. So, you can't say if they are related. I am just asking if they are related. I am not asking way-in-the-weeds questions here. Is it related to the meme stock event in 2021?

Mr. ZHU. You could say they are related.

Mr. STEIL. I could say it, I understand, but you are the expert in the space. I am asking you if they are related. You are pretty good at this stuff. In your professional opinion, are they related?

Mr. ZHU. I was trying to answer the question by saying that the meme stock event shows the tremendous surge in volume.

Mr. STEIL. I am not trying to be difficult here, sir. You are the expert in this space. I have seen a lot of proposal and rule regulation that say that this rule is because of the meme stock event. I am just asking, as we look at this rule, is it related? I will jump to the other: best execution. Is best execution related to the meme stock event of 2021?

Mr. ZHU. With the best execution, I want to say that best execution is a rule that spans all asset classes, whereas meme stock is only about equities and options. So in that sense, it is partly related, but I wouldn't say that meme stock event is the only driver.

Mr. STEIL. Let me offer, since we are not getting what I think is a clear yes-or-no answer, if implemented, I think it could reduce liquidity in the markets, making the disruptions we saw more likely. Let me shift gears pretty significantly here in the limited time I have left to you, Dr. Wachter, if I can. Do you agree that the order competition rule conflicts with the best execution rule?

Ms. WACHTER. Congressman, I don't believe there is a conflict.

Mr. STEIL. You don't believe that there is a conflict? I would respectfully disagree with you on that. How do you respond to the criticisms that people do believe that there is a conflict there?

Ms. WACHTER. The criticisms of these proposed rules are part of the comment file, so we are going to respond. We are going to read

those and evaluate those very, very carefully. We are concerned about all of these comments, and we are going to do a careful evaluation when we go to adopt these proposals.

Mr. STEIL. Let me just broadly, for the record, state my concern about the conflicts that exist, and the lack of transparency in the analysis that you are providing. The U.S. markets are preeminent in the globe. This is a radical overhaul of the markets. There needs to be significantly more transparency as to the actions the Securities and Exchange Commission is taking. Recognizing my time has expired, Madam Chairwoman, I yield back.

Chairwoman WAGNER. The gentleman yields back, and the gentleman from Illinois, Mr. Casten, is now recognized for 5 minutes.

Mr. CASTEN. Thank you, Madam Chairwoman. Dr. Wachter, thank you for being here today, and I want to follow up on Mr. Vargas' questions about the climate disclosure rule. Do I understand that you were involved in the drafting of the economic analysis of the proposed climate disclosure rule? Is that true?

Ms. WACHTER. Yes, Congressman, that is true.

Mr. CASTEN. Okay. And you had mentioned to Mr. Vargas that the current situation is a lot of voluntary and non-consistent disclosure regimes. Is it safe to say that a part of the motivation was to create a standard set of regimes?

Ms. WACHTER. The motivation was to bring more consistency to the current situation.

Mr. CASTEN. Okay.

Ms. WACHTER. Yes.

Mr. CASTEN. And is it also safe to say that investors currently struggle to compare apples and oranges across various 10-Ks?

Ms. WACHTER. Yes, I think they do. They are currently in sustainability reports, many of the disclosures, which creates a situation where you have some disclosures in the 10-Ks and some in the sustainability reports in a manner that is sometimes inconsistent.

Mr. CASTEN. Okay. And that may relate because I think you had mentioned in your testimony earlier that this creates an information asymmetry problem?

Ms. WACHTER. Yes, there is an information asymmetry problem here.

Mr. CASTEN. And do you believe that the proposed rules will address that concern?

Ms. WACHTER. They are intended to address that and to help with the information asymmetry and thereby improve liquidity and ultimately benefit capital formation.

Mr. CASTEN. To the benefit of investors?

Ms. WACHTER. Yes.

Mr. CASTEN. Great. Some of my colleagues here have raised concerns that this rule would burden small businesses and farmers, and I just want to give you a chance to respond. Before releasing the draft proposal, can you talk about what you have done to look at the economic impact on smaller businesses and farmers, and specifically, how you have seen the tradeoff between, presumably, the gain from reducing information asymmetry to whatever burden might be imposed in additional reporting requirements?

Ms. WACHTER. Yes. Detailing those costs and benefits is one of the goals of the economic analysis, but this is a disclosure rule, and

it is a disclosure rule for reporting companies, most of which are publicly traded. And so unless the small businesses and farmers are a reporting company, they wouldn't have to disclose under this rule. So, the concern may come from the reporting of Scope 3 emissions, if material, which doesn't apply under the proposal to smaller reporter and companies is my understanding. And also any company is allowed to use estimates.

So, the costs for this proposal are borne by the reporting companies. Essentially, it is a cost-benefit tradeoff for the investors because they benefit, but companies they own, if there are compliance costs, would pay those costs, not necessarily the farmers.

Mr. CASTEN. Then I guess, summing up, it is your belief that markets will operate more efficiently with comparable and standardized climate disclosures?

Ms. WACHTER. Yes, that is my belief.

Mr. CASTEN. Okay. We have proposed climate disclosure rules. Obviously, we haven't seen them yet. They are squarely within your authority and your mission to protect investors. You have done the economic analysis. You have had goodness knows how many comments that have come through consistent with your obligation to maintain fair and orderly markets. That is terrific. As we know, the Europeans are ahead of us on all of these things. They are putting out a bunch of rules. Lots of the companies which we all represent or have constituents who work there are often coming to us and saying, my employer is a multinational, so they are being forced to comply with these European rules.

As a regulator, do you think it is in our interest to have a seat at the table and lead, or are we better off just sitting down and letting other countries take the leadership because, after all, we don't have to work as hard if they do all the work for us.

Ms. WACHTER. Congressman, should any rules in Europe get developed prior to our rule, that will be part of the baseline, to use the technical term again. In terms of what our strategy is in terms of a seat at the table, I am afraid that is out of my lane, so I am not going to speak to that.

Mr. CASTEN. I guess maybe I will just close with the observation that there is a strong push here for you all to do nothing on this, with the assumption that in a global vacuum, no one else is going to act. And I realize that it is easier to stay asleep, but I would like to thank you for staying awake. I yield back.

Chairwoman WAGNER. The gentleman yields back. The gentleman from Pennsylvania, Mr. Meuser, is now recognized for 5 minutes.

Mr. MEUSER. Thank you, Madam Chairwoman. And thank you, Dr. Zhu, and Dr. Wachter.

In the SEC's 2023 regulatory agenda, the SEC listed 29 items in the final rulemaking stage and 23 items in the proposed rulemaking stage, so that is 52 items which the Division of Trading and Markets feels impedes the economy as a whole. Don't you think it might take time to implement one rule at a time in sequence so the industry can respond back before the comment period ends? Is that something that has come to you, Mr. Zhu, that the industry feels that you are moving too rapidly with new regula-

tions that they don't have time to comment on? If you would comment?

Mr. ZHU. Congressman, you raised a really important issue. We take industry and market participant comments very seriously. Of the proposals, at least out of Trading and Markets, we received thousands of——

Mr. MEUSER. Those you claim to be serving don't feel that way. You must hear that from the industry as a whole, the securities industry, the stock market, right? They feel that the new rules are coming out far too rapidly.

Mr. ZHU. Sir, with all due respect, what we are trying to do is keep our rule books updated so that they remain free for purpose, for investor protection, for fair, orderly, and efficient markets. The market evolved fast, and as a result, I think we need to also act expeditiously to update our rules.

Mr. MEUSER. Okay. Rule 605 has come up a couple of times. Why not let that be implemented, get some feedback, get an understanding, and build off of it, rather than just have so many new rules in what we know is a rattled economy?

Mr. ZHU. You mentioned——

Mr. MEUSER. No? You're just going to keep moving at that pace?

Mr. ZHU. Rule 605 is about the public disclosure of execution quality. Some of the other rules we propose solve a different purpose for transparency, for example, or for competition, so they solve different aspects of the market structure problems. We believe it is reasonable to think about them.

Mr. MEUSER. It makes sense to, I think, everybody that it would be, lay it out, get a feel for it, see how it works, and build from there. So, I am not sure what the goal is in just moving as rapidly as you are, but it is not making your industry pleased. It is making them very, very anxious actually, and it is making their lives more difficult.

Let me just move on to something else. Dr. Wachter, last year, Commissioner Uyeda pointed out that for a long time, the SEC used a figure of $400-an-hour to estimate the cost on companies they paid outside counsel. It was updated to $600 or certain figures that the SEC quietly updated last year to $600 only after he pointed out the absurdity of the low $400. Was this being done? What was the point of holding that back? Was it just to keep costs artificially low that were being estimated, or what was the thinking behind that?

Ms. WACHTER. I think you are talking about the cost estimates in the paperwork production section.

Mr. MEUSER. Right.

Ms. WACHTER. And we very much appreciated Commissioner Uyeda's bringing that to our attention. My understanding—this was in the Division of Corporation Finance—is that it was just a simple oversight.

Mr. MEUSER. Okay. Fair enough. That can happen. As Chief Economist for the SEC, do you inform the SEC that the economy is quite fragile, that monetizing of the heavy debt, the enormous, huge debt by the Fed, along with the escalated energy costs that are being borne, which have led to inflation, which, in turn, have led to higher interest rates which burden banks, families, small

businesses, company performance, tax revenues, U.S. commerce in general, do you inform that under these circumstances, we should try to avoid other regulations that also rattle and impede the overall industry and businesses as a whole?

Ms. WACHTER. Congressman, we are very cognizant of the comments in the comment file about concerns of regulations that may increase regulatory uncertainty. We have seen those comments. And those comments, like other comments, are those that we would address upon adoption of the rules.

Mr. MEUSER. It just seems that it is more of an attempt to control than it is to allow them to run efficiently on their own. Is that a macro view of things? My time has expired, so I yield back, Madam Chairwoman.

Chairwoman WAGNER. Perhaps, Dr. Wachter could respond in writing? Thank you.

The gentleman from North Carolina, Mr. Nickel, is now recognized for 5 minutes.

Mr. NICKEL. Thank you so much, and thanks to our witnesses for being with us today.

North Carolina's 13th Congressional District is home to many exciting, early-stage biotech companies working on critical life-changing technologies. These companies frequently have just a few employees. They rely on our equity markets to raise capital, often at the early stages of the company's formation, and often to fund clinical trials or to conduct critical research on the next groundbreaking medical treatments.

I am hearing from small R&D-focused companies in my district that they are concerned that the suite of equity market structure proposals, and the order competition rule, in particular, may have serious negative effects on their ability to raise capital. Without effective markets, it will be harder for the biotech industry to deliver critical drugs to patients.

Director Wachter, do you agree that under the proposed rule, retail orders for smaller, less-liquid stock are going to receive worse execution quality compared to the current status quo if nobody shows up for an auction?

Ms. WACHTER. Congressman, evaluating the effects on capital formation, which is what you are describing, is part of what we do for every rulemaking, including the order competition proposal. And should this proposal add liquidity or lead to greater liquidity, we believe that it would improve price efficiency and could help capital formation. Our economic analysis shows that if you look at the companies that are not part of the S&P 500, for those companies, the stocks actually experience greater gains, under our analysis, from our proposal than the companies that are in the S&P 500. And in our economic analysis, we are carefully evaluating comments, but the proposal in the economic analysis would indicate that this might not be a concern.

Mr. NICKEL. Unfortunately, it doesn't seem that the SEC did a comprehensive analysis of the proposal's impact on capital formation and, particularly, on smaller public companies.

Director Zhu, can you comment on why the Commission didn't do a deeper dive into the capital formation for these critical small

companies? And, again, we are talking about very small companies, like the ones in my district.

Mr. ZHU. Congressman, the way that Trading and Markets works is that we ensure that the trading of securities is well-protected so that it is efficient, it is orderly, and that is a way for small companies to get incentive to get listed and eventually come to the market. About the capital formation, I would defer to my colleagues in the Division of Corporation Finance about their role.

Mr. NICKEL. Since the rules were proposed, several new academic studies have come out with the evidence that the proposed rules would do the opposite of what the SEC claims. That means increasing costs for everyday retail investors. I am especially concerned about reports that commission-free trading could cease to exist. Any increased costs on my constituents looking to save for retirement concerns me greatly.

Director Wachter, has the SEC considered constituents like mine who are saving their hard-earned money for retirement and how these proposals may increase costs for them?

Ms. WACHTER. Absolutely, Congressman. We consider smaller investors and potential costs for smaller investors. In the economic analysis, we address concerns about the reduction in commission-free trading. That is something that we discuss. I, personally, always remember my grandfather, who didn't go to college or high school but he invested in the stocks, and he always told me, in America, nobody can erase your name from the list of stockholders. I always think about him when I think about investors, so absolutely, this is something that we talk about and we consider.

Mr. NICKEL. The National Association of Securities Professionals, which exists to support increased opportunities for securities professionals of color and fair access to investors of color, has expressed concerns that the SEC's proposals could, "result in the lack of access to the stock market for underserved demographics, which could further widen the existing diversity gap in investing."

Director Wachter, will the SEC conduct an economic analysis available to the public that evaluates the potential disproportionate impacts of these reforms on low-income and minority investors like the ones that I represent in North Carolina's 13th District?

Ms. WACHTER. Congressman, I am afraid that is something I am going to have to get back to you on.

We are following our time-tested proposal that is laid out in our policies and procedures on our website, that we developed based on best practices from Congress and from the courts and from the Executive Branch in terms of cost-benefit analysis.

Mr. NICKEL. My time has expired, so I yield back.

Chairwoman WAGNER. The gentleman yields back. The gentleman from Texas, Mr. Sessions, is now recognized for 5 minutes.

Mr. SESSIONS. Madam Chairwoman, thank you very much. I have a sneaking suspicion that you have called this hearing with an understanding that members of this committee and subcommittee didn't beg you, but asked you for exactly what we are doing today. We are trying to provide feedback, and we are trying to listen. And one of my colleagues just stated that he believes that this committee sees things exactly the opposite as the SEC does,

from feedback that we receive from people in our congressional districts.

Job creators, investors, people who are trying to make a good idea work and to make this country better, that is part of capital formation. I don't have to ask you, I am going to tell you that we believe that what the SEC is doing is destroying capital formation. We believe that rulemaking, oversight, and legal authority that you many times call discretion has become weaponized. It is not helpful to capital formation. And I would intend to offer to Chairman Gensler and you—we heard from the General Counsel this morning—that you simply take off what you are not going to be supportive of, and that is that one of the things that the SEC sees about is capital formation. You are destroying new opportunities, IPOs, people who would wish to come into the marketplace.

The big arm of government, which the SEC has, is unprofessional, and I think could care less about the capital formation. They view themselves as, they have a role to do, and by God, they are going to go do it, rather than effectively understanding the marketplace, understanding costs, understanding timeframes, and understanding how important the growth of America is.

We have, since 2010, more than doubled the revenue that comes in to the Federal Government, so Uncle Sam is doing quite well. In 2010, we had about $2.4 trillion worth of revenue by the Federal Government. The free enterprise system, not the government, produced almost $5 trillion last year. It is growing. It keeps America the capitalist market that other countries want to emulate.

That is your job. Your job is to review and look at things, not to get in the way, not to take all the time of hundreds of days before you respond back to someone who is in your sights. It is to listen to America, not the world. It is to come up with a firm definition and come back to this committee and a Senate committee, to talk to people who are in the marketplace, to hear their ideas about how we grow capitalism in the world. Over and over and over today, all I have heard Members do is say that you are out of touch. Those are not my words. That was almost every single person who has spoken today. It is not just a frustration; it is a reality.

I would hope, Madam Chairwoman, as we thank our witnesses who have taken the time to be our guests today, that we would remind them in some summary form, because they will get a letter from me, and Mr. Lucas, and I know, Mr. Huizenga. We want to send them a letter and say, thank you so much for taking time to come see us. We would like to offer our feedback, which is that we believe that the SEC does not live up to the term of understanding capital formation to the positive benefit of capitalism to support the United States of America and small business to make it work in this country. Madam Chairwoman, I yield back.

Chairwoman WAGNER. The gentleman yields back. The gentleman from Massachusetts, Mr. Lynch, is now recognized for 5 minutes.

Mr. LYNCH. Thank you, Madam Chairwoman. First of all, I want to thank Dr. Zhu and Dr. Wachter. Thank you for your willingness to come before the committee and help us with our work. I, too, am concerned about capitalism, but I want to remind my colleagues

that I was here in 2008, and Dodd-Frank, when it was passed, required about 300 rulemakings, many of those directed to the SEC. And the reason they were passed was because back in 2008 and years after that, Congress passed the Troubled Asset Relief Program (TARP), which gave $700 billion to the banks because they had so screwed up this economy. They took the economy down, so we reverted to socialism when we took $700 billion from the people, taxpayer money, and gave it to the banks. That is not capitalism; that is socialism.

We didn't let the banks fail. We took $700 billion. Some of my constituents didn't even have a bank account, and yet they were held responsible to bail out the banks, many of whose CEOs took bonuses for actually putting America's economy in the toilet. And that is why we are here, because it wasn't capitalism. It was socialism that we were trying to address, and we don't want to revisi it. The United States capital markets are the envy of the world because of the work the SEC does, because you are there to protect investors with the rule of law, you are there to maintain fair and orderly markets, and you are there to make sure that everyone has a fair opportunity to engage in those markets.

Director Wachter, at the beginning of this, we got off on the wrong foot, and I think you were shut down on some of your answers, but if you would take some time and just walk us through the rulemaking process. I know that the industry uses cost-benefit analysis as a weapon against rulemaking. They go into court and they challenge it. They also, in some cases, insert provisions in legislation requiring what I think are needless obstructions and additional burdens for the SEC. But if you could walk us through that, talk about setting a baseline, talk about the process for rulemaking and how that has worked in the normal operation of the SEC where you work?

Ms. WACHTER. I would be happy to talk about the process by which we do economic analysis. And I will just say to your point that the economic analysis is how we make sure that the rule has its desired effects and promotes the kind of outcomes that we want to avoid the kinds of situations that you describe, so a number of the rules that we are working on do have a resiliency measure. Our economic analysis has five components, generally speaking, and one of them is, why are we doing the rule? So, we do always have to answer that question, why, and communicate the why to the American public.

The other part is the world as it is because you want to be measuring with a common yardstick, and that is what we call the baseline. Then, we talk about the costs and benefits of the rule, alternative approaches, including less-burdensome ones for industry, and finally, we have to talk about the effects on efficiency, competition, and, yes, capital formation. That is in the statute, so we have to consider those. So we do that, perform that economic analysis on every proposal. It goes out for public comments. Many of these questions are reflected in the comment file. That is how the process works, and then we incorporate the comments when we go, if we go to adopt the rule.

Mr. LYNCH. Thank you. It is ironic that when we passed Dodd-Frank and gave the SEC the responsibility for restoring trust in

the markets, that the industry is pushing back. They are pushing back on the measures that Congress passed to make sure that type of disaster never happens again. And I just want to thank you for the work that you do each and every day and on behalf of the American people. Thank you, and I yield back.

Chairwoman WAGNER. The gentleman yields back. The gentleman from Iowa, Mr. Nunn, is now recognized for 5 minutes.

Mr. NUNN. Thank you, Madam Chairwoman. I appreciate you convening this committee today. I want to also get right to the point here with my 5 minutes.

I will be candid. I have some grave concerns right now about what is happening at the SEC under Chair Gensler, and on both of your watches. From my understanding, U.S. capital markets are the most liquid and cost-efficient of any in the world. They are highly competitive and traded across a variety of market centers, both public and private venues. Colleagues on both sides of the aisle today have talked about your best practices.

Dr. Zhu, I want to begin with you. Is it best practice to hone regulations to improve the market?

Mr. ZHU. We are trying to improve the market as much as we can.

Mr. NUNN. So that is a, yes. Two, is it best practice to solicit feedback from the public?

Mr. ZHU. We consider public feedback extremely seriously.

Mr. NUNN. As do I. Three, is it best practice to improve capital formation?

Mr. ZHU. It is part of our mission.

Mr. NUNN. Good. Traditionally, when regulatory agencies introduce new regulations, they follow these best practices in response to the market failures or when directed by this body in Congress. However, there is a 1,600-page proposal in which the SEC does not clearly identify either a specific problem it aims to address or a compelling reason why such market changes are underway. This is a direct reflection of Chair Gensler's direction on where these proposals are going. Additionally, Congress has no way to mandate such sweeping reforms, but the SEC has taken it upon themselves.

Director Zhu, this past February, the SEC's Investment Management Division proposed the Enhanced Safeguarding Rule for Registered Investment Advisers, under the guise of enhancing the protection of customer asset management by registered investment advisors. I think we all agree it is important to protect our customers' assets. In fact, it is essential. But this rule goes well beyond that stated intent, and in some instances would impose new rules that are impossible to comply with, thus potentially preventing the use of risk management tools, which are so essential by the end user and important to States like my own, Iowa, in everything from the agriculture industry to the energy industry.

Are you aware that under the new SEC proposal, the registered investment advisors would be required to use qualified custodians for client assets, including their derivative contracts?

Mr. ZHU. Sir, the rule you referred to is issued under the Investment Advisers Act. It is outside the remit of the Division of Trading and Markets, but we will be happy to——

Mr. NUNN. Are you aware of it or not?

Mr. ZHU. I am aware of that rulemaking.

Mr. NUNN. Are you aware that there is no framework to allow for the custody of a derivative?

Mr. ZHU. But again, sir, this is under the remit of Advisers Act, and I have to defer to my colleagues in the Division of U.S. Management.

Mr. NUNN. Dr. Wachter, are you aware of it?

Ms. WACHTER. Aware of the rule of the custody proposal? Yes, I am aware of it.

Mr. NUNN. And are you aware then of the derivative custody portion of it?

Ms. WACHTER. Yes, I am aware of the derivative portion of it.

Mr. NUNN. Good. Perhaps, I will direct most of my questions to you going forward here. Given that this rule has a direct impact on the markets, were either of you consulted in this rulemaking?

Ms. WACHTER. We performed an economic analysis as we do in every rulemaking.

Mr. NUNN. And you provided that back to the SEC?

Ms. WACHTER. Yes, we did.

Mr. NUNN. Prior to the proposed rulemaking, did you consult with the CFTC about the potential impact on the future commissions, merchants, and their end-user clients, like my agriculture producers?

Ms. WACHTER. My understanding is that there were conversations with the CFTC prior to the proposal.

Mr. NUNN. Do you know whom at the CFTC was consulted on that?

Ms. WACHTER. No, I don't.

Mr. NUNN. Dr. Zhu, do you have any idea?

Mr. ZHU. I don't.

Mr. NUNN. Okay. With my remaining time, the Commission acknowledged that the best execution proposal, if adopted, this best execution regulation could actually result in increased costs and commissions for retail investors when, today, Iowan investors enjoy commission-free trading.

Dr. Zhu, do you think it is in a retail customer's best interest to pay more for services that today, they are already getting for free?

Mr. ZHU. Congressman, we consider the cost to retail investors very seriously, and the cost, of course, includes commission, but then there is also a component, which is the bid-offer spread.

Mr. NUNN. Today, they are getting it for free. Under the new rules, they would be paying for it, right?

Mr. ZHU. We have no reason to believe that a commission would come back under the new order.

Mr. NUNN. For the record, Dr. Zhu, is it true the SEC acknowledges that orders are also more likely to receive price improvement and, with that, receive greater price improvement when routed to the wholesalers as compared to exchanges?

Mr. ZHU. Currently, wholesalers have a first right of refusal to interact with retail orders. This segmentation is the main reason why investors currently are sending the orders there.

Mr. NUNN. Madam Chairwoman, thank you. I yield back, and I will send my questions directly to Chair Gensler, since I am not getting what I need here.

Chairwoman WAGNER. The ranking member of the Full Committee, the gentlewoman from California, Ranking Member Waters, is now recognized for 5 minutes.

Ms. WATERS. Thank you very much. Director Wachter, the Division of Economic and Risk Analysis conducts cost-benefit analysis for the various rulemakings put forth by the Commission. However, critics have pointed out that such analysis can have substantial shortcomings and is used by opponents of a regulation to either dilute or strike down regulations. For example, critics have asserted that cost-benefit analysis is inherently biased in favor of the regulated industry since costs of compliance are generally much easier to quantify in dollar terms than the benefits of regulations, such as improved investor confidence and market stability, which have a comparatively larger non-monetary component.

What are your thoughts on the risk associated with biased data? Shouldn't regulators view the quantitative cost of underregulation just as highly as the quantitative costs of regulations, and qualitative just as highly as the quantitative cost of regulations?

Ms. WACHTER. Congresswoman, thank you for your question about the cost-benefit analysis and the qualitative versus the quantitative, and we are aware of that criticism of cost-benefit analysis and of economic analysis. Let me just say that I am very proud to be leading the Division of Economic and Risk Analysis, and I am also very proud of the work that our staff does. You are referring to the problem of biased data. Data comes into us all the time. Data is just a measurement of something, and the data could be noisy, as we call it, so that is statistical noise. Bias is when the data all tends to be noisy in one way, and that is a problem if the data has bias, absolutely.

Ms. WATERS. Let me just stray for a moment from further asking you information about that issue. Let me just say that I appreciate your appearance here today. I also appreciate the appearance of your colleagues today in our Oversight and Investigations Subcommittee. You all have been taking a beating from our colleagues on the opposite side of the aisle. You are our cop on the block, and Chair Gensler is highly qualified and is doing an excellent job. I want you to continue to do the work that you are doing, the work that you are mandated to do, and I do not wish you to be intimidated at all by unreasonable requests or questions.

I have heard the information today about the kind of documents and information that is being required, rings, millions of documents, et cetera, et cetera. And if you are expected to turn them around in a short period of time or to disregard your mandate and your responsibility, you have to resist that. So, on behalf of those on this side of the aisle who appreciate the enormity and the complications that you are dealing with, continue to do what you are doing. You are on the right track. Again, I can't say it enough, you are our cop on the block, and what we need to do is make sure that you have more resources with which to work.

Members on the opposite side of the aisle have insisted on starving you to death and not giving you the resources that you need. You need more resources, you need more personnel, but you keep doing what you are doing. There are some of us who are very ap-

preciative of your work, and we are going to always support you in every way that we can. And I yield back the balance of my time.

Chairwoman WAGNER. The gentleman from New York, Mr. Garbarino, is now recognized for 5 minutes.

Mr. GARBARINO. Thank you, Madam Chairwoman, and thank you so much for having this hearing and having these witnesses here. And witnesses, thank you so much for being here.

Director Zhu, I would like to follow up on an issue that I raised with Chair Gensler in April related to an inconsistency between two rule proposals you have pending. The first is your proposal on short-sale disclosure, which, it seems to me, prudently excludes individual position reporting to avoid negative consequences such as copycatting and herd behavior. This disclosure contemplated here is only on a monthly basis. By contrast, the proposal on securities-based swaps disclosure, Rule 10B-1, explicitly requires individual position reporting at a relatively low threshold versus the market cap of many stocks and on a very aggressive timeline of one day after the trade is placed.

I want to understand the distinction. Has the Commission made a determination that concerns related to front-running, copycatting, and herd behavior, which are clearly risks associated with the short-sale disclosure, do not exist in the case of security-based swaps disclosure? And if so, how did the Commission come to that conclusion, and what type of cost-benefit analysis was performed in drawing that determination?

Mr. ZHU. Thank you, Congressman, for that question. Both of the rules that you mentioned—one is about short-sale disclosure, and the other is about security-based swap disclosure—are authorized by different segments of the Dodd-Frank Act, and we are working currently to evaluate the comments received. As you pointed out, in the short-sale disclosure proposed rule, we have the data come in, and they are anonymized and aggregated. So, that is sort of partly in the congressional mandate, sort of providing the data and transparency in an aggregated fashion.

I think 10B-1 serves a slightly different purpose, which is to provide transparency of large concentrated positions, so they come from slightly different segments of the statute. And we are working very actively to evaluate the comments, including the one you mentioned today, which is also shared by some commenters.

Mr. GARBARINO. But I would think that copycatting and herd behavior would be consistent with both, and I don't think it is a very large position under the new 10B-1 proposal that is being considered, so I don't understand. Was there a cost-benefit analysis done for the 10B-1 proposed rule?

Ms. WACHTER. Congressman, since it is my division that does the cost-benefit analysis, does the economic analysis, yes, there was an economic analysis for the proposed rule 10B.

Mr. GARBARINO. Okay. I would like to know how that cost-benefit analysis could differ from the other proposal dealing with the short sales, because I would think if it is good for one, it is good for the other. And right now, I understand that under short sales, copycatting and herd behavior could be very dangerous, so I would think that would also apply to the 10B-1. So, I appreciate that.

Director Zhu, I also have significant concerns about recent developments with the proposed Consolidated Audit Trail, a substantial database with personal information of millions of Americans to which only the SEC will have access. My concern specifically is about the costs associated with this database, which has gone way over budget. For instance, the current tab for work already done is estimated to be roughly $350 million, and annual operation costs are projected to be roughly $250 million, more than 5 times what was originally projected, and this is all going to be paid for by everyday Americans. Why has the cost to build and maintain this government database spiraled out of control, and what is the SEC doing to rein in the costs?

Mr. ZHU. Congressman, you mentioned about the data security there and also the funding. Let me just start by saying that we take the protection of customer data very seriously. The SEC has issued exempt relief so that the most-sensitive personal information, Social Security Numbers, full date of birth, and account numbers, do not come into CAT at all. Regarding funding, I guess SRO's have submitted a few rounds of funding proposals, and we are currently in the process evaluating the latest one.

Mr. GARBARINO. Can you describe what interaction you have already had to date with the committee responsible for implementing CAT? Can you provide the committee with your communications with the operating committee of CAT?

Mr. ZHU. The Commission has regular discussions with the Operating Committee of CAT.

Mr. GARBARINO. Okay. I appreciate it. I have another question, but I don't think I have the time to get to it, so I yield back.

Chairwoman WAGNER. The gentleman can submit it in writing, if he would like.

Mr. GARBARINO. Thank you.

Chairwoman WAGNER. The gentleman yields back, and the gentleman from Missouri, Mr. Cleaver, is now recognized for 5 minutes.

Mr. CLEAVER. Thank you. Thank you, Madam Chairwoman. And thank you for being with us, Dr. Wachter and Dr. Zhu. Thank you very kindly for showing up today.

I believe unapologetically in diversity. Sam Brownback—some of you may remember his name, he served in the Senate from the neighboring State of Kansas—delivered a speech once, and I remember his words. He said, "A democracy thrives on diversity and tyranny oppresses it," and I thought, boy, that was powerful and very real. And in the words of the great Mahatma Gandhi, "No culture can live if it attempts to be exclusive."

I was mayor in Kansas City, and we had six firefighters killed one morning. Long story, I won't go into it, but it was intentional. And as I was meeting with Local 42, the firefighters, weeks after the explosion, I asked them, what is the tool you need most? What do you need most? And they said, a working ladder. And I embraced what they told me because I think that is also the thing we need in society, a working ladder. And that is why I am very much concerned about and interested in inclusion, and the lack of inclusion in the financial services industry is prevalent at just about every level.

Just one example: women- and minority-owned asset management firms in the U.S. currently control a whopping 1.4 percent of the over $82 trillion, with a "T," in managed assets in the United States, compared to the 98.6 percent of assets controlled by firms owned by men. And an increasing racial and gender representation in financial services is something that I have sought to address and continued to pursue since I have been elected.

Today, for example, Senator Cory Booker and I are introducing a bill, the Endowment Transparency Act, which requires certain institutional investors receiving Federal subsidies to report on their businesses with diverse firms. Some college endowments to this day, to this day, are too embarrassed or scared to even disclose the fact that their billion-dollar endowments are doing very little business with women or minorities. In a word, pathetic. I would like to know, having wrangled with this issue, whether the SEC is doing the work necessary to come up with some better numbers in the future?

Ms. WACHTER. Congressman, I can try to answer the question. Competition is one of the elements of our statute, and what competition allows is, I think it really goes back to the quote that you said that we really need to bring the most-diverse set of talents to bear. And that is just really important for any business and any country to thrive, so I think competition is at the core of our mission. We consider it carefully in every rulemaking, including the private funds rulemaking, for example.

Mr. CLEAVER. Yes. Some of the most-prominent universities in this country are almost like barely an inch above progress in terms of this issue. Thank you, Madam Chairwoman.

Chairwoman WAGNER. The gentleman from New York, Mr. Lawler, is now recognized for 5 minutes.

Mr. LAWLER. Director Zhu, the Office of Interpretation and Guidance within the Commission's Division of Trading and Markets is responsible for determining Section 31 fee rates, correct?

Mr. ZHU. Congressman, I believe Section 31 fee rates is joint work between TM and DERA. My colleagues should weigh in here.

Ms. WACHTER. That may be my division, Congressman.

Mr. LAWLER. Your division determines the fee rate?

Ms. WACHTER. 31-B. We may need to get——

Mr. LAWLER. The Section 31 fee rate.

Ms. WACHTER. Section 31-B fee rates.

Mr. LAWLER. You determine them?

Ms. WACHTER. We may need to get back to you on that.

Mr. LAWLER. I'm sorry. Neither of you knows who determines them?

Ms. WACHTER. Congressman, perhaps if you could say a little more about Section 31-B.

Mr. LAWLER. Okay. Section 31 fees are transaction fees paid to the SEC based on the volume of securities that are sold on various markets. These fees are intended to recover costs incurred while supervising and regulating the securities market. The SEC's Section 31 fee collections are used to offset the money appropriated annually to the SEC by Congress, and as collections are received, the appropriated authority is returned to the U.S. Treasury General fund. The intent behind using funds collected from Section 31 fees

is to offset annual appropriations so the SEC's funding can be deficit neutral. Do you agree with that statement? Either of you? Both of you?

Ms. WACHTER. My understanding is that the SEC collects the fees from the industry for its costs, yes.

Mr. LAWLER. Right, to be deficit neutral, correct? Fiscal year 2022 appropriations established the SEC's budget authority at $2 billion. However, in the SEC's Fiscal Year 2022 Agency Financial Report released last November, the Commission reported that the SEC collected $1.586 billion in Section 31 transaction fees in Fiscal Year 2022. That is $414 million shy of its budget authority, meaning that the SEC failed to repay $414 million of its appropriations back to the Treasury. And for clarity, that is more than the entire amount appropriated to the CFTC that same year.

For either of you, since the SEC undercollected on Section 31 fees and couldn't repay Treasury $414 million in Fiscal Year 2022, have you done anything to evaluate or modify the Section 31 fee rates since then?

Ms. WACHTER. Congressman, my understanding is that sometimes we overpay, sometimes we underpay, and that this calculation is determined through——

Mr. LAWLER. In Fiscal Year 2022, you underpaid. Are you doing anything to adjust based on the fact that you underpaid, or is the SEC going to under-collect from Section 31 fees again this year? What is the plan?

Ms. WACHTER. Congressman, I believe the long-run plan is what you expressed, which is that we collect the fees to fund our operations.

Mr. LAWLER. Right, but you undercollected, so what are you doing to compensate for that? Are you looking at the fee structure? Are you going to make any changes, or are we going to plan on under-collecting again so that when you submit a nonsense report to us that says, as the SEC's funding is deficit neutral, any amount appropriated to the agency will be offset by transaction fees. It was not offset, so what are you doing to deal with that?

Ms. WACHTER. Congressman, I don't believe that there is ever a plan for us to under-collect. I think that sometimes, there is undercollection, and sometimes, there is overcollection.

Mr. LAWLER. Right, but in this instance, you undercollected, so have you made any adjustments or even looked at it? It is a yes or no question. Have you even looked at how to deal with the fact that you undercollected last year? Yes or no?

Mr. ZHU. We periodically adjust the fee. I believe there was a new adjustment earlier this year. We would be happy to send you the details.

Mr. LAWLER. That would be wonderful, if you could.

By coming up $414 million short in paying back Treasury, the SEC is failing to be a good steward of U.S. tax dollars. The claim that the SEC's funding is deficit neutral is highly questionable when you under-collect by that much, so you need to come back to us with a plan for how you are going to rectify that.

The SEC recently proposed amendments to expand and update Regulation Systems Compliance and Integrity (SCI). The proposal would expand the scope of SCI entities to include certain registered

broker-dealers for the first time. Feedback from market participants on this proposal suggests that the actual costs for this proposal are in the billions of dollars as a result of the SEC's attempting to micromanage the technology set-up of individual firms. Yet, these enormous compliance costs are conveniently absent from the SEC's cost-benefit analysis. Why did the Commission fail to acknowledge these costs in its economic analysis?

Chairwoman WAGNER. I'm sorry, the gentleman's time has expired. I am going to ask the witnesses to respond in writing to the gentleman from New York.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This is just the first of many hearings that we will be having with you and your colleagues from the other Divisions of the SEC, and I hope that they will be more transparent and forthcoming in their responses than what we experienced today.

This hearing is now adjourned.

[Whereupon, at 12:36 p.m., the hearing was adjourned.]

A P P E N D I X

June 22, 2023

STATEMENT OF JESSICA WACHTER, CHIEF ECONOMIST AND DIRECTOR, DIVISION OF ECONOMIC AND RISK ANALYSIS, U.S. SECURITIES AND EXCHANGE COMMISSION

Thank you and good morning, Chairman Wagner, Ranking Member Sherman, and members of the subcommittee. It is my pleasure to be here today. I am the Commission's Chief Economist and the Director of the Division of Economic and Risk Analysis, or DERA as we call it. Today, I am testifying in my official capacity as the Chief Economist and Director of DERA, but my testimony does not necessarily reflect the views of the Commission, the Commissioners, or other members of the staff.

I know that many are not familiar with my division's work so I wanted to give you a little information about who we are and what we do. DERA was established in 2009 from a merger of the Office of Risk Assessment and the Office of the Chief Economist. DERA is made up of over 170 economists, statisticians, data scientists and engineers, attorneys, accountants, and other staff. These experts provide support to every aspect of the Commission's mission from rulewriting to enforcement. As of May 31, DERA had over 100 PhD economists working on rulewriting, litigation support, and risk analysis.

High-quality economic analysis is an essential part of SEC rulemaking. It helps ensure, among other things, that decisions to propose and adopt rules are informed by the best available information about a rule's likely economic consequences and it allows the Commission to consider a rule's potential benefits and costs when determining if a rule is in the public interest. As a result, DERA is actively involved in the Commission's policy and rulemaking function. In Commission rulemakings, DERA's Office of Policy Economics conducts an economic analysis that examines the costs and benefits, as well as effects on efficiency, competition, and capital formation of that rulemaking. As a general matter, the economic analysis contains: (1) a statement of the need for the proposed action; (2) a baseline against which to measure the likely economic consequences of the proposed regulation; (3) alternative regulatory approaches; (4) an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives; and (5) an analysis of the effects on efficiency, competition, and capital formation. In conducting the economic analysis, DERA staff work closely with staff from the policy divisions, including the Division of Trading and Markets, from the earliest stages of policy development through the finalization of a particular rule.

In addition to working on rulemaking and policy matters, DERA economists also support the Commission's examination and enforcement functions by providing rigorous economic analysis and data analytics. We help identify securities law violations, quantify harm to investors, calculate ill-gotten gains, and assist enforcement with returning funds to harmed investors. DERA's Office of Litigation Economics also provides expert testimony in enforcement matters. DERA staff also perform risk analyses of the capital markets to inform the Commission and those outside of it.

High-quality data greatly facilitate our economic analyses. Indeed, data and data analytics are becoming increasingly important to the successful accomplishment of the SEC's mission. To meet the increased demand for data analytics, DERA's data scientists and engineers develop tools and perform

analyses in support of the entire Commission. This includes working with the SEC's other divisions and offices to design data structuring approaches for required disclosures, validation rules, and data quality assessments, as well as advanced machine learning algorithms.

In sum, DERA staff deliver high-quality, data-driven analyses that are critical to the SEC's mission of protecting investors, facilitating capital formation, and ensuring fair, orderly, and efficient markets. It is my great pleasure to serve at the SEC. I have been privileged to study financial markets and to teach the new leaders of our financial industry for more than 20 years. Our markets are the deepest and most liquid in the world and I am honored that I am able to help them continue to grow and to thrive. Thank you again for inviting me, and I look forward to answering your questions.

Testimony of Securities and Exchange Commission Director of the Division of Trading and Markets Haoxiang Zhu Before the United States House of Representatives Committee on Financial Services, Subcommittee on Capital Markets

June 22, 2023

Good morning, Chairman Wagner, ranking member Sherman, and members of the subcommittee:

My name is Haoxiang Zhu, the Director of the Division of Trading and Markets at the Securities and Exchange Commission. It is my honor and pleasure to appear in front of you today to discuss the Division's work. I am testifying in my official capacity as the Director of the Division of Trading and Markets, but my testimony does not necessarily reflect the views of the Commission, the Commissioners, or other members of the staff.

The Division of Trading and Markets

The Division of Trading and Markets was one of the original divisions of the SEC when it was established in 1934. Back then, it was known as the Division of Trading and Exchange. As the name implies, the primary task of the Division is to oversee the trading of securities. As technology and market practices evolve, the role of the Division evolves with it. Today, there are, broadly speaking, three layers of market activities and intermediaries that come under the remit of the Division.

The first layer is marketplaces. This broad category includes national securities exchanges, as well as alternative trading systems and security-based swap execution facilities. Generally, if a marketplace trades any security—stocks, bonds, options, security-based swaps, among others—it is in the remit of Trading and Markets.

The second layer is broker-dealers.[1] Because broker-dealers are key intermediaries for investors to access the market, they are subject to rigorous regulatory requirements about net capital, customer protection, recordkeeping, sales practices, and investment recommendations, among other activities.

The third and last layer is clearing agencies, including clearinghouses and central securities depositories. They are important for the efficient clearance and settlement of securities transactions. The Division also oversees transfer agents, which maintain the issuer's security holder records, among other functions.

I should add that exchanges, FINRA, and clearing agencies are all self-regulatory organizations (SROs). Securities laws require that SROs file their proposed rules and rule changes with the Commission, and the filings are subject to Commission review and notice and comment.

Based on the most recent data, the Division of Trading and Markets oversees 24 national securities exchanges, about 100 alternative trading systems, over 3500 broker-dealers, 48 security-based swap dealers, 7 registered clearing agencies, and over 300 transfer agents. In fiscal year 2022, the Division processed about 2000 filings from SROs, including exchanges, FINRA, and clearing agencies. Behind

[1] This category includes all types of broker dealers, including "government securities brokers", "government securities dealers", and "security-based swap dealers," among others. But I refer to all of them as broker-dealers for simplicity.

these numbers are the approximately 270 staff members in the Division who spend countless hours reviewing documents, writing Commission releases and orders, and meeting with registrants and market participants.

Updating Our Rules for Evolving Markets and Technology

Our day-to-day regulatory work produces another dividend, which is that Division staff identify market evolutions that are significant enough to warrant updates to our rulebooks. Of course, if Congress decides to update securities laws, we implement Congressional mandates. Under Chair Gensler, over 60% of rule proposals and adoptions recommended by the Division of Trading and Markets received unanimous votes from the Commission. Our current rulemaking work falls into four broad areas.

The first area is to finish the mandates from the Dodd-Frank Act of 2010. Two weeks ago, the Commission voted to adopt two sets of Dodd-Frank rules about antifraud in securities-based swaps market and the removal of reference to credit ratings in Regulation M. We are currently evaluating comments received on four other Dodd-Frank Act proposals: reporting of securities loans, reporting of short positions, reporting of large security-based swap positions, and rules relating to security-based swap execution facilities.

The second area focuses on strengthening the U.S. Treasuries market in all three layers I discussed: marketplaces, broker-dealers, and clearing agencies. The Commission has proposed to scope in trading platforms for government securities under Regulation ATS and Regulation SCI. The Commission also proposed to further define "dealer" and "government securities dealer" so that intermediaries that act like dealers in the Treasuries market would comply with Federal securities laws and rules. Another proposal would require broker-dealers to register with FINRA, with narrow exceptions. Finally, the Commission proposed to expand central clearing of Treasury securities transactions and Treasury repo transactions, while enhancing standards of risk management of Treasury clearing agencies and facilitating customer access to clearing. Two additional proposals would strengthen the governance structure and the recovery and winddown planning of clearing agencies.

The third area is to update our rules on equity market structure. The proposed updates to Rule 605 would require broker-dealers to disclose execution quality publicly. Other proposed updates to Regulation NMS would narrow the minimum trading and quoting increment for certain liquid stocks, reduce access fees on exchanges, and adjust round lot definition and odd lot information. The proposed order competition rule aims at enhancing competition for the handling of marketable orders from individual investors. Finally, proposed Regulation Best Execution—which applies to all securities—would create the first SEC-established rule concerning best execution.

The fourth area focuses on the interaction between financial regulation and technology infrastructure. The Commission has already adopted two rules in this space regarding the recordkeeping requirements of broker-dealers and the transition to one-day settlement cycle, or T+1. The Commission has proposed rules regarding customer notifications about data breaches, cybersecurity enhancements for broker-dealers, and heightened standards for Regulation SCI. The Commission also proposed a rule to require electronic filings or submission of certain forms and other information.

In all areas of rulemakings, the staff in the Division thoroughly consider comment letters received and actively engage with market participants before making policy recommendations for the Commission to

consider. We closely collaborate with colleagues in the Division of Economic and Risk Analysis, the Office of General Counsel, and other divisions and offices. We are working hard to fulfill the mission: protect investors; promote fair, orderly, and efficient markets; and facilitate capital formation.

Conclusion

I'd like to conclude with a personal note. 16 years ago, I set foot in this great country to pursue a better life. I'm grateful that the United States took me in as one of its 330 million proud citizens. I had a good career as a financial economist before coming to public service. It's been my honor and privilege to serve at the Commission for the past 18 months. Our work is deeply technical, but underneath it is a far simpler and more profound goal: to keep the U.S. capital markets—and indeed the United States—as the envy of the world.

06.22.2023 House Financial Services Subcommittee on Capital Markets

Questions for the Record

Rep. Wiley Nickel

1. **During the House Financial Services Committee's June 22, 2023 hearing titled, "Oversight of the SEC's Division of Trading and Markets," Dr. Wachter committed to getting back to the me and the Committee regarding whether and how the SEC analyzed (or will analyze) the potential impacts of its proposed equity market structure rules on historically underserved communities. Is there any additional information regarding this analysis? This analysis is critical to ensuring that the SEC's proposals don't have the unintended consequence of making it more challenging or impossible for these communities to invest when most would agree they need broad, affordable access to the stock market's long-term opportunities to create and build generational wealth.**

   In the economic analyses on the equity market structure proposals, the Commission considered the impact that these proposals could have on individual investors. The Commission received thousands of comments on the proposals, including comments relating to the impact of the proposed rule on individual investors and underserved communities. The staff is in the process of analyzing these comments and will carefully consider all comments received in developing their recommendations for any final rules.

Rep. Zach Nunn

1. **Has the Commission considered how it can promote on-exchange competition for retail order flow without requiring that market participants use particular venues, i.e., qualified auctions, designed by the agency without any input from the industry?**

   The economic analysis for the Order Competition proposal includes a discussion of several reasonable alternatives that would be designed to promote on-exchange competition for retail order flow.

2. **For example, last year, the Division of Trading and Markets (the "Division") disapproved a proposal from one exchange to implement a retail midpoint program designed to improve price improvement opportunities for retail investors and facilitate institutional interaction with this order flow. That proposal is currently pending Commission review. However, the justification given by the Division for disapproval – that the exchange's proposed priority rules "unfairly discriminate" against non-displayed orders resting on the exchange's continuous order book that would cede priority to orders entered into the retail midpoint program – conflicts with the Commission's analysis of equivalent rules in the order competition proposal.**

a. Has the Commission analyzed this conflict or how the Division's decisions may be contributing to the problem the equity market structure rules are ostensibly attempting to solve?

As your question notes, the Division of Trading and Markets has taken action, pursuant to delegated authority, disapproving the proposed rule change by MEMX LLC to establish a retail midpoint liquidity program. *Order Disapproving a Proposed Rule Change, as Modified by Amendment No. 1, to Establish a Retail Midpoint Liquidity Program, Securities Exchange Act Release No. 94866 (May 6, 2022)*. The matter is currently pending Commission review, and we will be happy to brief your staff once the Commission makes a final decision.

Finders Rule

1. In October 2020, the Commission proposed an order that would permit natural persons to engage in certain limited "finders" activities involving accredited investors without registering with the Commission as brokers. The Commission has not taken further action on the proposal and providing regulatory clarity for finders is not on the Commission's current regulatory agenda.

The lack of a clear framework makes it easier for unscrupulous intermediaries to solicit investors without disclosing hidden conflicts of interest. Further, to the extent an intermediary engages in unregistered broker-dealer activity, it could expose the company to rescission rights, which would require the company to return to investors their investment plus interest. Market participants have asked for clarity about the legal obligations of finders. Please explain why the SEC has not taken further action on the October 2020 proposal and how and when it plans to provide additional regulatory clarity to finders.

Broker-dealers play an important role as an intermediary between customers and the securities markets and are subject to comprehensive regulation under the Exchange Act and under the rules of each SRO of which the broker-dealer is a member, including a number of obligations that attach when a broker-dealer makes recommendations to a customer, as well as general and specific requirements aimed at addressing certain conflicts of interest.

A long-standing issue in the area of broker-dealer regulation concerns the treatment of so-called unregistered "finders" that play a discrete role in bridging the gap between small businesses and investors. The Commission has not recognized a "finders" exemption or exception from broker-dealer registration, and there is ample precedent regarding the facts and circumstances determination of whether a person is acting as an unregistered broker or dealer. As the Commission has explained, a person who identifies and solicits potential investors for an issuer or other party could be viewed as engaging in activity that indicates broker status. Also, while it is not in itself determinative of broker status, the receipt of transaction-based compensation in connection with securities activities, such as solicitation of potential investors, has been considered by courts as a factor indicating that registration as a broker may be required.

As you note, in 2020 the Commission proposed to exempt from broker-dealer registration two classes of natural person "finders" that perform limited activities on behalf of issuers, based on the types of activities in which they would be permitted to engage, and with conditions tailored to the scope of their activities.

The Commission received nearly 100 comments on the proposed "finders" exemptions. The staff continues to evaluate broker-dealer regulatory status issues, taking into consideration the concerns raised.

Order Competition Rule

2. **In May 2022, your staff rejected MEMX's midpoint liquidity proposal, arguing that the priority requirements for MEMX's proposal were "unfairly discriminatory." What was considered unfairly discriminatory was that the MEMX proposal would have provided priority to Retail Midpoint Liquidity Orders by institutional investors that publicly signaled their willingness to trade with incoming retail orders ahead of the nontransparent midpoint peg orders entered on the continuous order book that are willing to trade with any counterparty but are fully non-displayed.**
    a. **Is it true that you rejected this proposal because its priority requirements were "unfairly" discriminatory"?**
        i. **If so, why do you think it was unfairly discriminatory?**
    b. **When you force an order to go to one entity over another, do you think that stifles the potential for innovation and choice for market participants?**
    c. **Do you think the MEMX proposal would have provided a valuable service to retail investors?**
    d. **Do you think the MEMX proposal would have provided an opportunity for institutional investors to trade with retail investors?**

As your question notes, the Division of Trading and Markets has taken action, pursuant to delegated authority, disapproving the proposed rule change by MEMX LLC to establish a retail midpoint liquidity program. *Order Disapproving a Proposed Rule Change, as Modified by Amendment No. 1, to Establish a Retail Midpoint Liquidity Program, Securities Exchange Act Release No. 94866 (May 6, 2022).* The matter is currently pending Commission review, and we will be happy to brief your staff once the Commission makes a final decision.

3. **Under Section 11A of the Securities Exchange Act of 1934, the Commission is mandated to ensure "fair competition" and "equal regulation" in the capital markets. In the order competition rule, you are attempting to mandate that certain orders go to a specified location to be executed, inherently discriminating against other venues.**
    a. **How is this mandated order routing not in direct contradiction to the 1934 Exchange Act's mandate of ensuring fair competition?**
    b. **Given how fundamentally the order competition rule would alter our markets, why are you not introducing a pilot program first to study its effects?**

The Order Competition proposal would not mandate that segmented orders go to any specified location. Rather, orders could be routed to any open competition trading center, as defined in the proposal to include exchanges and Alternative Trading Systems that, among other things, offer fair access to market participants.

Commission is reviewing comments on the Order Competition proposal.

4. **The SEC states in the Best Execution proposal that wholesalers owe a duty of best execution to the customers of retail broker-dealers. It also states that wholesalers compare favorably to exchanges in providing better execution quality, certainty, and consistency as well as other valuable services to retail investors. Why do you think retail investors will be better served sending orders to exchanges that don't owe them a duty of best execution?**

   Under proposed Regulation Best Execution, broker-dealers (including wholesalers and retail broker-dealers) would be required to comply with the proposed best execution standard in any transaction for or with a customer or a customer of another broker-dealer. That proposed standard would require the broker-dealer to "use reasonable diligence to ascertain the best market for the security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions." This standard would not require broker-dealers to send customer orders to any specific market, including exchanges. While exchanges are not broker-dealers and therefore would not be subject to the proposed best execution standard, broker-dealers that handle and route customer orders would be subject to the proposed best execution standard and would be required to use reasonable diligence to ascertain the best market for the security, which may or may not be an exchange.

5. **The auction process, as contemplated in the order Competition proposal, would give sophisticated trading firms important information about unexecuted retail orders, including information about the security, size of the order, side (buy, sell, or sell short), price, and originating broker via auction announcements that those firms are free to trade in front of or against. This auction process would essentially make all retail orders "flash orders" which the SEC proposed banning in 2009. Why has the SEC moved from attempting to ban flash orders in 2009 to attempting to mandate them today?**

   Qualified auctions under the Order Competition proposal differ in many important respects from "flash orders," as practiced by certain trading venues years ago. As one example, proposed qualified auctions are designed primarily to obtain better prices for segmented orders than the national best bid and offer ("NBBO"). In contrast, a trading venue tended to "flash" a flash order after the trading venue was unable to execute the order at the NBBO and, to prevent the order being executed elsewhere, flashed the order to attract additional liquidity.

6. **The SEC states in the proposal that wholesalers owe a duty of best execution to the customers of retail broker-dealers. It also states that wholesalers compare favorably to**

exchanges in providing better execution quality, certainty, and consistency as well as other valuable services to retail investors. Why do you think retail investors will be better served sending orders to exchanges that don't owe them a duty of best execution?

Under proposed Regulation Best Execution, broker-dealers (including wholesalers and retail broker-dealers) would be required to comply with the proposed best execution standard in any transaction for or with a customer or a customer of another broker-dealer. That proposed standard would require the broker-dealer to "use reasonable diligence to ascertain the best market for the security, and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions." This standard would not require broker-dealers to send customer orders to any specific market, including exchanges. While exchanges are not broker-dealers and therefore would not be subject to the proposed best execution standard, broker-dealers that handle and route customer orders would be subject to the proposed best execution standard and would be required to use reasonable diligence to ascertain the best market for the security, which may or may not be an exchange.

Dealer Definition Rule

7. **In the proposed dealer definition rule, you would capture hedge funds, even though investment advisers to hedge funds are already subject to an extensive regulatory framework under the Advisers Act.**
    a. **Why did staff conclude that hedge funds should be included within the scope of the proposed rule when the release itself acknowledges that the benefits of subjecting hedge funds to the dealer regulatory regime "might be very small"?**
    b. **How do you envision a private fund, which isn't an operating company but an asset holding vehicle, to comply with the dealer operational and capital rules?**
    c. **Are you worried that investors in these funds, which are public pensions and endowments, will incur significant costs if the funds in which they invest are required to be registered as dealers?**

    In March 2022, the Commission proposed two rules that would require market participants, such as proprietary (or principal) trading firms (also known as PTFs), who assume certain dealer functions, in particular those who as act as liquidity providers, to register with the SEC, become members of a self-regulatory organization, and comply with applicable federal securities laws and regulatory obligations. The proposed rules would further define "dealer" and "government securities dealer" under the Exchange Act by identifying certain activities that would require registration.

    As the Commission stated in the proposing release, any person that meets the activity-based standards identified in the proposed rules would be a dealer or government securities dealer required to register, absent an otherwise available and applicable statutory or regulatory exemption or exception. In the proposing release, the Commission explained that the identification and registration of market participants that engage in liquidity providing activities similar to those traditionally performed by dealers, including

those that are not currently regulated as dealers, would provide regulators with a more comprehensive view of the markets through regulatory oversight and would enhance market stability and investor protection.

As the proposed rules focus on activity rather than label, they would potentially scope in market participants, such as private funds or hedge funds, depending on the activities in which they engage. The Commission explained in the proposing release that it did not exclude private funds from the proposed rules because it sought to take a consistent approach to regulating dealing activity regardless of the label or type of market participants that engage in dealing activity.

The Commission has received many comments from market participants, including those in the asset management industry, that raise questions regarding the potential application of the dealer regime to private funds. The staff is in the process of analyzing these comments and will carefully consider all comments received in developing their recommendations for any final rules.

8. **The proposed rule would require any person to register as a government securities dealer if that person trades $25 billion or more of Treasury securities in four out of the prior six months.**
    a. **Why did the staff include a quantitative standard for Treasury securities when the exchange Act does not include a quantitative metric for determining whether a market participant is a dealer?**
    b. **Could this new standard potentially lead to reduced liquidity and competition in Treasury markets or lead to less depth and breadth in Treasury markets?**

Determining whether a person is acting as a dealer under the Exchange Act is a fact-specific inquiry and involves a two-prong analysis of whether the person: (1) buys and sells securities for his own account and (2) engages in those activities as part of a *regular business*. A key factor in determining whether a person or entity is engaged in the business is the regularity with which a person purchases and sells securities.

In March 2022, the Commission proposed two rules that would further identify certain activities that would require registration as a "dealer" or "government securities dealer." Specifically, both rules would set forth identical qualitative standards designed to identify market participants who assume certain dealer-like roles, in particular acting as liquidity providers in the markets.

The Commission also proposed a quantitative standard that would establish a bright-line test under which persons engaging in certain specified levels of activity in the U.S. Treasury market would be defined to be buying and selling government securities "as a part of a regular business," regardless of whether they meet any of the qualitative standards. The proposed quantitative standard was intended to capture the most significant market participants that are regularly buying and selling U.S. Treasury Securities, and subject these participants that are not already registered as dealers or government securities dealers to a regulatory regime designed to minimize the risks they

may pose to the U.S. Treasury market and provide regulators with appropriate oversight of their activities.

The Commission sought comment in the proposing release on all aspects of the quantitative threshold. The staff is in the process of analyzing these comments and will carefully consider all comments received in developing their recommendations for any final rules.

Position Reporting Rules

9. **The Commission has issued a trio of new reporting rules for short sales, security-based swaps, and securities loans. Each contemplates a different form of public disclosure, ranging from next-day, granular disclosure of security-based swaps positions to aggregated and anonymized short sale positions. In its short sale rule, the Commission goes to great lengths to highlight the negative effects too much position disclosure can have on markets and market participants.**
    a. **Why did the Commission propose conflicting sets of disclosure requirements for these three rules when the same justifications for aggregating and anonymizing short sale positions also apply to security-based swaps and security loans?**
    b. **Will the Commission commit to aggregating and anonymizing security-based swap positions?**

    Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Title VII) was enacted in part to reduce risk, increase transparency, and promote market integrity within the financial system, including for swaps and security-based swaps. Title VII gave the Commission responsibility and several important tools – including Section 10B of the Exchange Act – to increase transparency, oversee the security-based swap markets, and better protect investors in the security-based swap markets. Pursuant to Section 10B of the Exchange Act the Commission proposed Exchange Act Rule 10B-1 (Proposed Rule 10B-1), which would require reporting of a position only when its size exceeds a specific threshold. The Dodd-Frank Act in Title IX also added Section 10(c) requiring the Commission to adopt rules to enhance the transparency of securities loans, and Section 13(f)(2) requiring the Commission to adopt rules to make certain short sale data publicly available no less frequently than monthly. As a result, the Commission proposed Exchange Act Rules 10c-1 (Proposed Rule 10c-1) and 13f-2 (Proposed Rule 13f-2).

    Each of the rules serves a different purpose. First, Proposed Rule 10B-1 is intended to increase transparency involving large security-based swap positions by providing market participants and regulators with access to information that indicates that a person is building up a large, concentrated security-based swap position. This information helps market participant to better manage risks. Second, Proposed Rule 13f-2 is intended to provide greater transparency to investors and regulators by increasing the public availability of short sale related data. This new data would supplement the short sale data that is currently publicly available from FINRA and stock exchanges. Third, Proposed Rule 10c-1 is intended to provide market participants with comprehensive and timely information about the material terms of securities lending transactions, as well as provide

regulators with certain nonpublic information about such loans. This information would help market participants assess information regarding securities loans, such as the competitiveness of rates, as well as provide regulators with insight into the securities loan market.

Each proposal received robust comments, including with respect to calibrating reporting thresholds, as well as with regard to aggregating and public reporting of data. The staff is in the process of analyzing these comments and will carefully consider all comments received in developing their recommendations for any final rules.

The Commission reopened the comment period for the Rule 10B-1 on June 20, 2023, and, among other things, requested comment on a memo prepared by the Division of Economic and Risk Analysis regarding proposed reporting thresholds that would trigger the 10B-1 reporting requirements. There is a robust comment file, including with respect to aggregating and anonymizing large security-based swap positions. The staff is in the process of analyzing these comments and will carefully consider all comments received in developing their recommendations for any final rules.

Tick Size Rule

10. There seems to be near unanimous support for a simpler reduction in quoting tick sizes to half-a-penny for tick-constrained symbols, and almost no support for the 1/10th and 2/10ths of a penny increments as the SEC proposed. Broadly speaking, commenters suggest this simpler approach reduces the risk of harming investors and issuers from reduced liquidity and wider displayed spreads. Do you think it would be reasonable to start with half-a-penny for tick constrained symbols and then look at the data to reassess whether further tick reductions are worth exploring?

The Commission received many comments on the proposal to amend Rule 612 of Regulation NMS, which would reduce the minimum pricing increment for certain NMS stocks. The staff is in the process of analyzing these comments and will carefully consider all comments received in developing their recommendations for any final rules.

11. The tick size proposal imposes a one-size-fits-all rule on issuers. Why not allow small companies to work with the exchanges where they are listed to implement a tick size that is appropriately tailored to their market characteristics, such as liquidity, research coverage, and market cap?

The Commission proposed to amend Rule 612 by reducing the minimum pricing increment for certain NMS stocks. The proposal would move away from the current single minimum pricing increment for orders in NMS stocks priced $1.00 or more. The proposal also would consider the trading characteristics of NMS stocks by determining the relevant minimum pricing increment based upon an NMS stock's time-weighted average quoted spread. The Commission has received many comments on its proposal to amend Rule 612. The staff is in the process of analyzing them and will carefully consider all comments received in developing their recommendations for any final rules.

Other Questions

12. **According to the SEC's Fiscal Year 2022 Inspector General Report, over 20% of the SEC's senior officers have departed during Chair Gensler's term. Given the lack of industry knowledge and experience at the SEC currently, is it best to continue plowing forward with rulemakings that do not demonstrate the intricacies of the industry you are supposed to be regulating? Would it not be best to first engage with industry participants, fill-in the knowledge lost by the historic turnover under Chair Gensler's term, and craft narrowly tailored rules as required by the Administrative Procedures Act?**

Technology, markets, and business models constantly change. Thus, the nature of the SEC's work must evolve as the markets we oversee evolve. The agenda of SEC rulemakings reflects a long tradition of updating our rulesets to meet new challenges. Further, the agenda includes rulemaking items that we have been directed by Congress to implement. Our ability to meet our mission depends on having an up-to-date rulebook—consistent with our mandate from Congress, guided by economic analysis, and shaped by public input. The Division of Trading and Markets has engaged and will continue to engage with market participants on rulemaking.

Consolidated Audit Trail (CAT)

13. The current cost of operating CAT is growing well past levels contemplated when it was originally proposed in 2010. As the costs of operating CAT are inevitably passed to investors, what processes or systems are in place to manage the ongoing expense of operating CAT?

Even though CAT implementation is not fully complete, CAT Data has already proved immensely helpful to regulators. Commission staff are currently using CAT Data to better understand trading activities and to conduct investigations, including data analyses to inform rulemaking.

The Commission and the Participants have taken a number of steps to manage the ongoing expense of implementing and operating the CAT:

- In May 2020, the Commission adopted amendments to the CAT NMS Plan that established four Financial Accountability Milestones and set target deadlines by which these Milestones must be achieved. These amendments reduce the amount of any CAT fees, costs, and expenses that the Participants may recover from Industry Members if the deadlines are missed.
- The CAT NMS Plan requires both Participants and Industry Members to fund the CAT. In September 2023, the Commission approved a funding model for the CAT that allocates fees among both Participants and Industry Members. Pursuant to the funding model, CAT fees must be based on reasonably budgeted CAT costs.

- The Participants will be required to file with the Commission, pursuant to Section 19(b) of the Exchange Act, proposed rules for the CAT Fees to be charged to Industry Members, which will provide the public an opportunity to comment. Those filings must include certain information, including descriptions of the line items of the budget. Additionally, the budgeted CAT costs described in the fee filings must provide sufficient details to demonstrate that the budget is reasonable and appropriate.

1. **In your economic analysis of the order competition rule, you include several types of orders, including non-marketable limit orders, when calculating purported savings to retail orders. However, the rule only requires retail marketable orders to be sent to an auction.**
    a. **What is your basis for including other types of orders? By including other order types, would this not inflate the estimated volume of retail orders to action?**

In the economic analysis of the proposal, the Commission considered the potential effect of the proposal on retail orders. Under the proposal, non-marketable limit orders that meet the proposed definition of a segmented order would be required to be exposed in qualified auctions before they could be executed at a restricted competition trading center, unless they met one of the proposed exceptions. One exception would allow a restricted competition trading center to execute a segmented non-marketable limit order without first exposing it in a qualified auction if the segmented order is a limit order with a limit price selected by the customer that is equal to or more favorable for the segmented order than the midpoint of the national best bid and national best offer when the segmented order is received by the restricted competition trading center. The economic analysis considered a range of retail trading volume estimates when calculating the competitive shortfall estimates, including retail trading volume that only included market and marketable limit orders. The Commission has received over five thousand comments on the proposal, including comments on costs and benefits to retail investors. The staff is in the process of analyzing the comments and will carefully consider all comments received in developing their recommendations for any final rules.

2. **In your economic analysis, you state that you "would expect [wholesale broker dealer] realized spreads to be similar to the realized spreads earned by liquidity providers of similar orders routed to exchanges." However, the Proposal does not compare similar orders at all. Instead, the Proposal compares retail market orders executed off-exchange with non-retail marketable limit orders executed on exchange.**
    a. **Did you ever compare on-exchange and off-exchange quality for market orders?**
        i. **Based on your data and methodology, wouldn't this rule potentially cost retail investors billions of dollars a year?**

The Commission conducted an economic analysis that examined the costs, benefits, and other economic effects of that particular proposed rulemaking. For instance, in the economic analysis of the proposal, CAT data was analyzed to look at the execution quality of marketable orders of individual investors in NMS Common Stocks and ETFs that were less than $200,000 in value and that executed and were handled by wholesalers during Q1 2022. This was compared to a sample of CAT data examining the execution quality of executed

market and marketable limit orders in NMS Common Stocks and ETFs received by exchanges that were less than $200,000 in value over the same time period. The economic analysis also discusses the different characteristics of the order flow and the use of realized spreads in comparing marketable orders of different types. Furthermore, the Commission discussed the costs that retail investors could incur, including the potential return of commissions and the potential greater volatility stemming from a failed qualified auction. The Commission has received over five thousand comments on the proposal, including comments on its methodology and on costs and benefits to retail investors and realized spreads. The staff will carefully consider all comments received in developing their recommendations for any final rules.

3. **Considering the overwhelming consensus that the four equity market structure rules are deeply interconnected, should the SEC conduct a new economic analysis to provide the Commission and the public more information about these broad changes to the market?**

   In Commission rulemakings, the SEC conducts an economic analysis that examines the costs, benefits, and other economic effects of that particular rulemaking. The Commission's economic analysis of a proposed regulatory action compares the current state of the world, including existing adopted rules and the problem that the rule is designed to address, with the expected state of the world with the proposed regulation (or regulatory alternatives) in effect. To the extent that rules that are adopted are relevant for the baseline or the costs and benefits of the rule under consideration, this impact is incorporated in the economic analysis. The Commission has received thousands of comments on the equity market structure proposals. The staff is in the process of analyzing the comments and will carefully consider all comments received in developing their recommendations for any final rules.

4. **The SEC's economic analyses in the equity market structure proposals are improperly based on non-public data. The Administrative Procedure Act requires that an agency "give interested persons an opportunity to participate in the rulemaking through submission of written data, views, or arguments." An integral part of this right "is the agency's duty to identify and make available technical studies and data that it has employed in reaching the decisions to propose particular rules." However, the SEC throughout its proposals repeatedly cites Consolidated Audit Trail ("CAT") data, which is not publicly available, resulting in serious procedural errors by the SEC. In addition, the SEC subjectively adjusted some of the data, making it impossible for stakeholders to scrutinize its work, also resulting in serious procedural errors by the SEC. How are stakeholders supposed to provide feedback when they do not have access to the data to properly analyze the proposals and the SEC's economic analyses?**

   The SEC conducted an economic analysis in each of the equity market structure proposals that examined the costs, benefits, and other economic effects of each of the proposals. As part of the analysis, the Commission provided the methodologies and underlying assumptions of its analyses. The proposals have received thousands of comments, including comments on the analyses and assumptions in the proposals. The staff is in the process of analyzing the

comments and will carefully consider all comments received in developing their recommendations for any final rules.

5. **The SEC mentions the lack of data available numerous times in the equity market structure proposals. You have not proposed a way to gather additional data or test your hypotheses before implementing the rules. Wouldn't a better approach be to gather data and conduct testing before undertaking significant changes to market structure? What happens if, for example, the proposals end up harming retail investors? How do you put the genie back in the bottle – so to speak?**

   In the proposing equity market structure releases, the SEC conducted an economic analysis that examined the costs, benefits, and other economic effects of each proposal, including the effect the proposals could have on investors and market quality. The Commission also requested comment including requests for additional data. In response, the Commission received thousands of comments on the proposals, including additional data and comments on the economic analysis. The staff is in the process of analyzing the comments and will carefully consider all comments received in developing their recommendations for any final rules.

6. **Last March, the SEC issued a proposal that would further amend the definition of "dealer" and "government securities dealer" under the Exchange Act. Commenters have raised significant concerns that the SEC's approach is overly broad, does not appropriately capture true "dealing" activity, and would characterize common trading strategies as "dealing" with harmful consequences to investors and the markets. Does the SEC's economic analysis fully take into consideration the unintended consequences that this proposal, if adopted, would have for investors and market quality?**

   In the proposing release, the SEC conducted an economic analysis that examined the costs, benefits, and other economic effects of the proposal, including the effect the proposal would have on investors and market quality. The proposal discussed the number of market participants that would have passed the quantitative threshold for government securities by examining monthly trading volume. Further, the proposal provided data on the number of entities routinely making roughly comparable purchases and sales of the same or substantially similar securities in a day. The economic analysis acknowledged that the proposed rule may influence patterns of market participation, which may in turn affect competition among liquidity providers, market efficiency, and capital formation. The Commission received comments on the proposal, including comments on the consequences of this proposal for investors and market quality. The staff is in the process of analyzing them and will carefully consider all comments received in developing their recommendations for any final rules.

7. **The SEC issued twice as many rule proposals in Chair Gensler's first two years in office (53) as the first two years under Chair Mary Jo White (23) and Chair Jay Clayton (26). Many of these new rules would affect the same or interconnected financial products and market sectors, while others are likely to have the same or similar negative effects, such as increasing risk and investors' costs. Yet your economic analyses assess each rule**

independently and in isolation from the others, which completely ignores the obvious linkages between many of them.

Failing to analyze the cumulative and compounding effects of the many proposals creates heightened risk of unintended consequences that could add additional stress and uncertainty to our economy. Last September, 12 Democratic Senators raised this concern with the Chair in a letter.

Has the SEC conducted any publicly available analysis of the cumulative impacts across multiple rule proposals? If not, why not? And can you commit to conducting a publicly available economic analysis of the cumulative effects of all the rules that the SEC has proposed during Chair Gensler's tenure before the SEC moves to adopt them?

In Commission rulemakings, the SEC conducts an economic analysis that examines the costs, benefits, and other economic effects of that particular rulemaking. The Commission's economic analysis of a proposed regulatory action compares the current state of the world, including existing adopted rules and the problem that the rule is designed to address, with the expected state of the world with the proposed regulation (or regulatory alternatives) in effect. To the extent that rules that are adopted are relevant for the baseline or the costs and benefits of the rule under consideration, this impact is incorporated in the economic analysis.

8. **One of the SEC's four equity market structure proposals would modernize Rule 605 data. This is important because 605 data is the best tool we have to measure retail investors' order execution quality, especially price improvement. But it is now so outdated that it's no longer accurate. A recent study by Robert Battalio estimated that 605 data <u>understates by at least $3.7 billion per year</u> the financial benefits retail investors receive from wholesalers today.**

Chair Gensler could have updated 605 data when he first got into office in 2021. But he didn't. He waited nearly two years and released it at the same time as three highly controversial equity market structure proposals. As a result, the baseline scenario used in the economic analysis for those three proposals is based on today's outdated 605 data.

Using 20-year-old data to conduct an economic analysis of today's market is clearly absurd. And in this case, it led the SEC's analysis to grossly <u>overestimate</u> the benefits of Chair Gensler's equity market structure proposals. The SEC cannot simply dismiss credible research that challenges the foundations of its proposed rules. Will you commit to making public the full data set used by the SEC in its economic analysis and re-opening the comment period to allow outside economists a fair shot at providing meaningful feedback on your equity market proposals? If not, why are you opposed?

Current Rule 605 requires market centers that execute investor orders to make monthly disclosures of basic information concerning the quality of their executions. The required disclosures have provided significant insight into execution quality at different market centers; however, both the scope and the content of Rule 605 reports have not kept pace with technological and market developments. As part of the economic analyses of the equity

market structure proposals, the Commission provided the methodologies and underlying assumptions of its analyses. The Commission has received thousands of comments on the equity market structure proposals, including comments on the benefits retail investors receive from wholesalers. The staff is in the process of analyzing them and will carefully consider all comments received in developing their recommendations for any final rules.

9. **You have defended the SEC's Regulation Best Execution proposal by pointing to the proposal's analysis of hidden liquidity contained in non-public data from the Consolidated Audit Trail. On the basis of that analysis, you claimed in the proposal that a large portion of trading interest (75% of the shares for individual investors) that executes at a price worse than the midpoint of the NBBO could have received a better price by executing against hidden liquidity resting at the midpoint.**

   However, this claim is misleading because the analysis incorrectly assumed that individual investors have complete and unfettered access to this hidden liquidity without accounting for minimum quantity conditions or other common restrictions that would prohibit trading with individual investors.

   Why did you make this assumption in the analysis? Do you know how the assumption impacted the results of the analysis? And given the assumption's fundamental role in the analysis, will you recommend that the SEC reconsider and repropose the Best Ex proposal with an updated analysis that does not rely on assumptions that are clearly inconsistent with market realities?

   In the proposing release, the SEC conducted an economic analysis that examined the costs, benefits, and other economic effects of the proposal. This included an analysis that looked at the total shares available at the NBBO midpoint that originate from hidden midpoint pegged orders on exchanges and NMS Stock ATSs. The analysis compared the size of an individual investor marketable order that was internalized in a principal capacity by a wholesaler at a price less favorable than the NBBO midpoint (measured at the time the wholesaler received the order) to the total shares of midpoint liquidity (originating from midpoint peg orders) at the NBBO midpoint on exchanges and NMS Stock ATSs at the time the individual investor order was executed in order to hypothetically see how many additional shares could have gotten price improvement if they had executed against the hidden liquidity available at the NBBO midpoint. The economic analysis acknowledged that this midpoint liquidity was not displayed and wholesalers may not have been aware of this liquidity and able to execute the individual investor marketable orders against it. The economic analysis also acknowledged that if wholesalers wanted to detect this hidden liquidity, they would have had to ping each individual exchange or NMS Stock ATS to see if midpoint liquidity was available on that venue. The Commission received over seventeen hundred comments on the proposal, including comments on the analysis of hidden liquidity. The staff is in the process of analyzing them and will carefully consider all comments received in developing their recommendations for any final rules.

10. **Women and diverse managers are one of the fastest growing segments in new fund creation—providing an important source of capital for small businesses in their**

respective communities. You have proposed several new rules which will have a significant impact on private funds, including an outsized impact on smaller and emerging funds. These same stakeholders have expressed grave concerns to the SEC in not being able to manage these regulations. What they find so highly concerning is that these new requirements come with steeper compliance costs and demands that will hurt smaller funds and increased risk that will keep people from leaving old firms to create their own opportunities. Robert Greene, the President of the National Association of Investment Companies, framed your proposal's impact on emerging fund managers this way: *"The current regulations are potentially pushing logs down a hill just as people of color and women are starting to climb up the hill."* The SEC has clearly not conducted sufficient economic analysis of the impact of new regulations on these new and emerging fund managers, and the women and diverse-owned small businesses they invest in, and financially underserved communities. That is a big problem.

In fact, in last year's omnibus appropriations bill, Congress "strongly encouraged" the SEC to reconduct the rule's economic analysis, on a bipartisan basis. To date, there is no evidence the SEC has provided feedback to Congress on how it plans to address the request. Doing so would not only improve the quality of proposed rules, but also help to increase public confidence in the SEC's regulatory process.

In addition to the Congressional directive, requests to reconduct the economic analysis have been consistently called for in writing and during hearings by Members on both sides of the aisle and in both Chambers. In fact, in our hearing, you stated that the Commission is currently working on reconducting the economic analysis as part of the final adoption of the private funds rule. Failure to provide the analysis before the rule is finalized will harm the rulemaking and public confidence in ensuring the best policy was put forth.

a. **Will you adhere to Congress's request to reconduct the economic analysis before adoption of the final rule? Specifically, will you include an analysis of the disparate impact on women-owned private funds, including with regard to capital formation, efficiencies, and competition, and an analysis of the disparate impact on capital formation for women and small businesses?**

On August 23, the Commission voted to approve the Private Fund Advisers final rule. *See Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Release No. IA-6383. In the adopting release, the Commission conducted an economic analysis that examined the costs, benefits, and other economic effects of the rule, including the potential economic effects on small, women-owned, and minority-owned advisers. The Commission's economic analysis can be found on pp. 320-589 of the adopting release for the final rule. Economic impacts also may be addressed elsewhere in the release.

b. **Will you commit to providing the list of stakeholders that were contacted and consulted before issuance of the proposed rule and provide a plan for additional**

outreach before the issuance of any final rule, especially given the comments related to limited stakeholder engagement the SEC has already received?

Engagement with interested parties is a critical component of our rulemaking process, and we take the feedback we receive on our proposed rules very seriously. As reflected in the comment file for the proposed rule, the Commissioners and Commission staff held more than 100 meetings with interested stakeholders regarding the rule proposal. On August 23, the Commission voted to approve the Private Fund Advisers final rule. *See Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Release No. IA-6383.

11. **On February 9, 2022, the SEC proposed new rules applicable to private fund advisers, designed to increase the regulation of investment advisers. The rule has received criticism from a broad set of industry stakeholders, including concerns from limited partner investors (such as public pension funds), who the rule was purported to help. The American Investment Council summed it up this way: *"It is extraordinary, in our experience, for the intended beneficiaries of a proposed rule to express reservations about so many of the proposal's terms."***

As the U.S. enters a recession, the SEC regulatory overlay and threat of proposed rules is already affecting capital formation. The SEC is clearly going against the statutory mandate for capital formation by not taking into account how the proposed regulations are unnecessary and onerous. The effect is cutting off access to capital for small businesses. Benefits of SEC rules generally lower the cost of the capital—these proposals will do the opposite. These aggregated economic impacts have not been quantified and should be evaluated on a comprehensive basis.

Based on the questioning from the hearing, there is clearly a major concern that you're not taking into consideration the full aggregate impact of all of the SEC's proposed rulemakings on stakeholders. You are proposing four—five—six—or more—new rules on different parts of the capital markets. For instance, there are currently 7 new proposed rules for investment advisers and private funds.

It's unclear if the SEC understands the consequences that this new set of regulation will have on the small businesses and pension plans that benefit from private funds, let alone the hundreds of new and emerging funds that are trying to get started, settled and secure in this space. The SEC has not provided any analysis of the combined aggregate impact of the private funds proposals. Again, that's a serious problem.

a. **Will you adhere to Congress's request to reconduct the economic analysis before adoption of the final rule? Specifically, will you include an analysis of aggregated economic impacts evaluated on a comprehensive basis, that have not been quantified by prior analysis?**
b. **As recent testimony has shown the SEC is inclined to ignore Congressional directives on economic analysis before the finalization of the Private Fund Adviser rulemaking, I request your commitment to provide an interim report**

showing you are comporting with the SEC's own internal guidance standards of sufficiency for economic analysis. I have attached as an appendix the current internal guidance on Economic Analysis in SEC Rulemakings. Specifically, this interim report should be submitted to Congress and include an additional analysis within the report demonstrating the new quantitative cost measures specifically accounting aggregated impact.

c. Will you commit to this?

In Commission rulemakings, the SEC conducts an economic analysis that examines the costs, benefits, and other economic effects of that particular rulemaking. The Commission's economic analysis of a proposed regulatory action compares the current state of the world, including existing adopted rules and the problem that the rule is designed to address, with the expected state of the world with the proposed regulation (or regulatory alternatives) in effect. To the extent that rules that are adopted are relevant for the baseline or the costs and benefits of the rule under consideration, this impact is incorporated in the economic analysis. On August 23, the Commission voted to approve the Private Fund Advisers final rule. *See Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Release No. IA-6383. The Commission's economic analysis can be found on pp. 320-589 of the adopting release for the final rule. Economic impacts also may be addressed elsewhere in the release.

12. Two former SEC economists provided written comment on the proposed private fund advisor rule's economic analysis, Mark Flannery, Chief Economist under the Obama Administration, and S.P. Kothari, Chief Economist under the Trump Administration. The bipartisan duo deemed the economic analysis insufficient and concluded that it failed to meet the statutory requirements, that the SEC failed to follow internal guidance, and failed to comport with common criteria.

Cost-benefit analyses in SEC rulemaking are subject to several legal requirements from the Administrative Procedure Act of 1946; Executive Order 12866; the Congressional Review Act; and applicable case law. The current SEC internal guidance memo titled; "Current Guidance on Economic Analysis in SEC Rulemakings" also summarizes many of these requirements.

Specific to economic analysis, there is a critical section of those requirements on the development of a baseline in measuring benefits and costs. According to the requirements, the baseline should be the best assessment of the way the world would look absent the proposed action. Critically, choosing an appropriate baseline may require consideration of potential factors, including pending changes in regulations promulgated by the agency or other government entities.

Many of these rules are directly related, and you have acted against your own rulemaking requirements by assuming a status quo baseline. This is not a quiet regulatory year with one, single, small, SEC rule being proposed in a vacuum. To date, the SEC has proposed nearly 60 new significant rules—many of which interact with

each other—against the backdrop of the Commission publicly declared their intent to finalize their long list of proposals.

a. Doctor Wachter, will you commit to setting an appropriate baseline which accounts for the long list of pending regulations, which, as Chairman Gensler has generally described, are designed to fundamentally change, and overhaul our private and public markets?

In Commission rulemakings, the SEC conducts an economic analysis that examines the costs, benefits, and other economic effects of that particular rulemaking. The Commission's economic analysis of a proposed regulatory action compares the current state of the world, including existing adopted rules and the problem that the rule is designed to address, with the expected state of the world with the proposed regulation (or regulatory alternatives) in effect. To the extent that rules that are adopted are relevant for the baseline or the costs and benefits of the rule under consideration, this impact is incorporated in the economic analysis.