

Testimony of Tom Wittman
Executive Vice President and
Global Head of Equities,
NASDAQ OMX
Before the Senate Committee on Banking,
Housing and Urban Development

Thank you Chairman Johnson and Ranking Member Crapo for the opportunity to testify today on “The Role of Regulation in Shaping Equity Market Structure and Electronic Trading.”

Thanks to the efforts of SEC Chairman Mary Jo White, the debate as to *whether* we change our equity market structure is over. The SEC has launched an evaluation of what changes are needed and has taken a first step by releasing the guidelines for the creation of special market structures for a range of smaller stocks known as the Tick Size Pilot. We support Chair White’s efforts which also include the launch of a series of efforts to evaluate more holistically the broader market structure and to take action to ensure robust regulation of all participants in the markets. These are all positive developments that NASDAQ OMX absolutely endorses.

Now it is time for us to talk about solutions.

We agree with Chair White that our markets are not rigged, but, are indeed the strongest capital markets in the world. And we at NASDAQ OMX have been dedicated to ensuring fair access to all investors in our marketplace and view fair access as a hallmark of our organization. Let me be clear, NASDAQ OMX endeavors to ensure everyone has a fair and equitable experience with us, and we fully support any effort to ensure that there is fairness and transparency in the market. While we are firm in our belief that the U.S. licensed exchanges provide a fair and highly efficient market platform, we agree with many others that the markets are complex today. And, while that complexity can bring benefits to participants, we agree that

it also brings a need for regular examination. When appropriate, we should move quickly to update the market rules consistent with the Exchange Act principles of fairness and transparency. *As an exchange, we believe that the bedrock principle for well-functioning and fair markets is the need for robust price discovery – and transparent price discovery is at the center of what exchanges do for our economy.*

Special Role of Exchanges:

Companies like Comcast, Cisco, GoPro, Intel, AmGen, Celgene and Mylan use capital they raise from listing on The NASDAQ Stock Market (NASDAQ) to finance their missions of making cutting-edge products that transform lives and industries. The public trading of these companies allows Americans to invest in and participate in the American Dream, and allows companies to understand the value of their company and raise additional capital by issuing new shares. With financing provided by the public markets, these companies create millions of jobs and bolster the American and global economies. We see tangible evidence of this, from Silicon Valley to the Northern Virginia high tech corridor and in my home state of Pennsylvania.

An exchange listing is a valuable asset to a company's livelihood. The iconic public companies that your constituents recognize, such as, Apple, Microsoft, Google, eBay and Amazon, must provide broad and deep transparency regarding their operations; they must satisfy exchanges' listing standards; and they remain continuously subject to exchange rules protecting investors against corporate fraud and abuse. Exchange listed companies have an ongoing responsibility to maintain high financial, operating, and governance standards, which are rigorously enforced by the exchanges, to ensure investor confidence.

Equity exchanges in the U.S. are uniquely entrusted with the important responsibility of being a catalyst for growth and wealth creation. After the IPO, exchanges have a continuing role in fostering price discovery and transparency. By allowing investors to come together in an efficient and open manner, we enable them to discover the price at which these public companies can be bought and sold throughout each trading day. Exchanges, like NASDAQ, then disseminate those prices for your constituents to see on television, on line and in newspapers. Exchange equity quotes create the reliable reference price for all trading. Exchange quotes are a byproduct of the SEC-approved rules and robust regulatory systems that equities exchanges must develop and enforce to protect investors and to provide lit and orderly markets. We fully disclose and seek SEC approval of all of the policies and practices that we use to operate our markets.

Market Structure:

Now we turn to the details regarding the processes and mechanisms within the US market system used to create a transparent market. First, with regard to order types, NASDAQ OMX supports the Chair's call for a thorough review of existing order types, which highlights the difference between exchanges and lighter regulated ATSS. Each venue (exchange or broker owned) has its own systems and procedures and each competes for orders from brokers and ultimately investors. Each venue has its own order types and each is continually talking to market participants to develop new order types that satisfy the needs of the marketplace."

Unlike less-regulated ATS trading venues, including dark pools, when seeking to launch a new order type, NASDAQ was subject to a rigorous process to define, design, evaluate, explain and obtain SEC approval of order types. As an exchange we are required to expose innovative ideas to the market through the notice and comment process. We were subject to public scrutiny

and examination of our ideas by our competitors. This process often undermines the benefits of our innovation, allowing our competitors, particularly those who are less regulated, time to potentially mimic our ideas before we even had our ideas approved. This is one of the costs of maintaining an SRO license. For the sake of transparency and to help members understand our order types, we have posted on our website a list and a plain-language description of all of NASDAQ's order types.

Turning to the issue of dark pools, many of our concerns with today's fragmented market structure are the direct result of layers of iterative market structure decisions that have built up through the years when SEC approval was based upon the technological and market needs at the time these rules were proposed and approved. Many current problems with our markets stem from well-intentioned regulations like Regulation ATS and Regulation NMS, which sought to promote competition and to resolve tensions between electronic and floor-based trading. But, regulations cannot be adopted and forgotten; they must evolve as conditions change. Regretfully, over time Regulation ATS and Regulation NMS have led to a significant increase in dark trading, which denies market participants a clear view of trading interest in a given stock – preventing the full strength of supply and demand to determine price. The latest dark trading data available to us from Rosenblatt for June indicates that almost 40% of all trading in our markets was done away from the lit exchanges.

While alternative trading venues certainly have an appropriate role within a well-functioning market, we strongly believe that the current trend towards dark trading as the market's default setting is an unhealthy phenomenon. The US is not alone in its challenges with dark trading. Other countries are adapting their rules to address the concern that dark trading reduces the fairness and transparency of the markets. Specifically, Canada modified its market

structure to limit dark trading and to maximize price discovery and the EU has included a regime for capping the level of dark trading in its recent MIFID policy changes. It's time for the US to update Regulation NMS, and we can benefit from examining other countries' efforts to determine a structure that could work within our own markets.

On the topic of high frequency trading, NASDAQ supports Chair White's call to have all high frequency trading firms register. While we have not seen the details, we believe there are benefits in the SEC assuming a broader role and to lay the groundwork for greater transparency into all trading activity. Many in the public arena have attacked high frequency trading as a business model. We encourage and support a thorough analysis of the subject in order to reach a rational conclusion. In our view, high-frequency firms that are registered broker-dealers - whose primary function is as a regulated market-maker - offer the valuable service of providing liquidity throughout the trading day, which stabilizes pricing in the market and aids in price discovery. However, what we know from experience is that our industry, no matter the business model, will always attract individual players who cross the line. They forget the true purpose of the markets, and they find opportunities to exploit them. The role of NASDAQ, the other licensed, regulated exchanges, FINRA (the Financial Industry Regulatory Authority), and the SEC is to surveil the market and identify those individual 'bad actors.' We will continue to be vigilant in serving that critical industry function.

Systems Resiliency:

Another area of focus in recent years has been the resiliency of the systems that underpin the US markets. At NASDAQ OMX we are focused every day on how to improve our markets and make them more resilient and robust. We recognize that past events across the markets, including our own, may have harmed investors' confidence in the U.S. markets. We are

extremely focused on identifying and mitigating risks in our systems and infrastructure, as well as in the interconnectivity across the markets. Providing resilient and robust markets is critical for efficient capital formation, investor confidence, and job creation. We are confident we can provide that resiliency. In this area we are engaged in many efforts to be a catalyst for positive change. For example, we recently implemented so called “Kill Switch” to provide another backstop against a computer incident going from a localized issue to a market-wide problem.

The role of exchanges is more important than ever in today’s challenging environment. And yet, market complexity continues to create new risks that we are constantly working with other market participants and the SEC to address. Investor demand and the nature of regulatory complexity have made U.S. markets lightning fast, fragmented and deeply inter-connected. This complexity has added many more friction points where mistakes can occur.

That’s why NASDAQ OMX favors the adoption of Regulation SCI, which the Chair highlighted in her recent public remarks. The U.S. market is only as strong as its weakest link. To protect investors, all market participants and trading venues – not just exchanges – must be subject to rigorous standards of technology design, testing, and implementation. While NASDAQ OMX favors the expansion of protections that Regulation SCI will bring to some ATSS and brokers, in our view the obligation should be expanded further to include all ATSS because every ATS poses a systemic risk to a tightly linked market.

The SEC deserves credit for its leadership through recent, challenging times. In the aftermath of the May 6th Flash Crash, the SEC and the exchanges worked quickly and cooperatively to devise new protections to keep trading errors from spreading too rapidly or inflicting unacceptable harm on the overall market. The exchanges reformed their rules for breaking trades, instituted single stock circuit breakers, updated market-wide circuit breakers,



and implemented the Limit Up/Limit Down mechanism. NASDAQ OMX has also, on its own, developed tools to help broker-dealers manage their obligations under the Market Access Rule.

At NASDAQ OMX we are passionate about and steadfast in the role we play in capital formation and improving the performance of the economies we serve. We think that the SRO model and U.S. market structure have been effective in protecting investors over many decades. But as technology and the inter-relation among all traded asset classes evolve, so too must the regulatory environment in which the markets operate. If it does, we will continue to protect investors, transparently set prices for the stocks of our listed companies, and support our economy through highly efficient capital formation and job creation. All of our employees, including our CEO work hard to deliver a dependable, fair and safe environment for investors and to fuel the U.S. economy. We look forward to working with this committee. Thank you for your invitation to testify. I look forward to your questions.