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Hearing Examining the Role of Regulation in

Shaping Equity Market Structure and High Frequency Trading

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Thank you, Chairman Johnson, Ranking Member Crapo and members of the Senate Committee on Banking, Housing and Urban Affairs for the opportunity to speak here today. I am pleased to participate on behalf of Invesco at this hearing examining U.S. equity market structure. Invesco is a leading independent global asset management firm with operations in over 20 countries and assets under management of approximately $790 billion. Many of the investors served by Invesco are individuals who are saving for their retirement and other personal financial needs, including U.S. investors in defined benefit and defined contribution plans, such as 401(k) plans, IRAs and similar savings vehicles.

Through its investment advisor affiliates, Invesco manages money for investors worldwide who seek professional participation in the markets, both directly and through vehicles such as mutual funds and ETFs. These are long-term investors who are saving for their retirements, to purchase a home or send their kids to college. These long-term investors are the cornerstone of our nation's capital formation process, and retaining their confidence is fundamental to well-functioning U.S. securities markets, which are the envy of the world. To ensure long-term investor confidence, it is incumbent upon regulators and market participants to address issues raised by developments in the structure and operation of the U.S. equity markets, and we are grateful to this Committee for its attention to these important issues today.

All who seek to maintain our U.S. equity markets as the most respected in the world should have a strong interest in ensuring that those markets are highly liquid, transparent, fair, stable and efficient. Those qualities create a level playing field for all

investors, including ordinary American savers served by Invesco. In order to foster investor confidence and preserve robust liquidity, the regulatory structure governing our financial markets should promote, and not impede, those qualities.

Today, due in large part to regulatory changes and developments in technology in recent years, there is robust competition among exchanges and alternative execution venues. These changes have spurred trading innovation and enhanced investor access to markets. Market participants, including Invesco, now have much greater choice and a higher degree of control in how and where to execute our trades. These changes have materially benefited investors in the form of lower commissions, spreads and implicit transaction costs, which in turn have enhanced the all-important liquidity of the equity markets.

Unfortunately, some of these regulatory, competitive and technological changes have also brought unintended consequences, which have included un-leveling the playing field to a degree where certain sophisticated market participants can reap benefits at the expense of ordinary savers. We also are concerned that the one-size-fits-all approach of the current market structure fails to recognize the very real differences between trading large-cap stocks versus trading mid-cap and small-cap stocks. These developments challenge investor confidence in the liquidity, transparency, fairness, stability and efficiency of the markets. These unintended consequences include the following:

<u>Market Complexity and Fragmentation Have Negatively Impacted Investor Confidence</u>

Many investors, including Invesco, believe markets have become too complex and fragmented, not because they need to be but rather because we have allowed them to become so. This complexity has contributed to a number of the technological mishaps over the past several years. These mishaps shake investor confidence in markets. While we commend the Securities and Exchange Commission ("SEC") for the actions it has taken to address many of the structural issues relating to these events, it is important to

recognize that today there are underlying structural issues that can give sophisticated participants an unfair advantage over ordinary investors.

For example, exchanges sell co-location services to market participants that allow those participants to locate their servers in the same facility as the exchange's order matching engines and offer these participants direct data feeds from the exchange. These direct data feeds are faster than the indirect data feeds that other participants get from the Securities Information Processor. Because of this speed differential, co-located participants with direct data feeds can gain an unfair advantage over those participants that are not co-located and do not receive direct data feeds, allowing the former to react more quickly to trading information. In our opinion, there is nothing more corrosive to investor confidence than allowing some market participants to have an unfair advantage over others.

Today in the U.S., there are 11 exchanges and over 40 alternative trading systems in which investors can trade equities. The rules governing the exchanges are very different from those governing the alternative trading systems (e.g., "dark pools"), a difference that can be very confusing to market participants. These different rules also have facilitated an un-level playing field that unfairly favors sophisticated participants over ordinary investors. Many of these execution venues offer economic inducements to broker-dealers and high-frequency traders to route their orders to them. A number of these destinations offer high-frequency trading participants complex order types (e.g., "conditional orders") that may enable them to detect the trading interests of other participants and then use that information to their advantage. In such a complex and fragmented environment, determining which execution venue will lead to the best trading outcome can be very difficult even for a firm like Invesco.

Conflicts of Interest Have Impacted Market Transparency and Fairness

The robust price discovery that historically has defined our markets has been weakened as a result of the amount of trading activity occurring away from exchanges. It

is believed that as much as 35-40% of all trading activity in U.S. equities now takes place away from the exchanges. Much of the movement away from the exchange markets is a result of broker-dealer order routing practices including "internalization" and the proliferation of specialized alternative trading venues, including "dark pools."

The order routing practices of some broker-dealers raise a number of concerns for investors. For example, investors are not provided the information from broker-dealers needed to determine if they are receiving best execution within these dark pools. They are also given only limited insight into how and where broker-dealers route their orders. As a consequence, it is very difficult for investors to make informed decisions about the quality of executions they have received.

Much of the problem can be traced to two inherent conflicts of interest. The first is a broker-dealer's interest in maximizing economic inducements by capturing liquidity rebates associated with the so-called "maker-taker" pricing model and by receiving payment for order flow from off-exchange market makers. The second is a broker-dealer's interest in avoiding paying access fees to take liquidity from other trading venues. Under the current regulatory structure, a broker is incented to keep as many trades as possible within its own internalized systems, including within its own dark pools. These problems are not well-disclosed to clients, and yet they can drive brokers' order routing decisions that may be at odds with their clients' interest in obtaining best execution.

High-Frequency Trading and Market Liquidity

There has been much discussion about high-frequency trading and its impact on trading markets. Today, there are a number of different types of participants within the marketplace who could be referred to as high-frequency traders. It is our view that high-frequency trading is not bad in and of itself, but there are certain trading strategies performed in connection with high-frequency trading that have the effect of being manipulative or disruptive. These can include using an information and speed advantage

to trade ahead of other market participants. These strategies have arisen as a result of enabling technology, the fragmented structure of the markets and a lack of uniform regulation and market practices among trading venues.

Changes to market structure have had a pronounced impact on the role of traditional market-makers and the evolution of electronic market-making. While there are today a number of market-makers and high-frequency market-making strategies that make markets in a number of securities, much of this appears to be focused on large-cap securities. While it is true that these high-frequency market-making strategies have increased trading volumes in many of these stocks, it is less clear that they are creating real liquidity. Moreover, the area of the market where market-makers have historically provided the most valuable liquidity—mid-cap and small-cap stocks—have not benefited from the evolution of market structure and the move to electronic market-making.

To restore a level playing field in the markets—and, thereby, restore investors' confidence in the fairness and transparency of the markets—we believe it is time for regulators and market participants to address these issues. Invesco recommends the following improvements:

1. Require broker-dealers to provide much greater disclosure about their order routing activities, their dark pool operations, order types used and all other data required for investors to make accurate determinations of execution quality. If there is greater disclosure about how and where clients' orders are routed and other necessary data for investors to make accurate best execution determinations, investors will be able to make much better informed decisions about how their brokers are performing and, consequently, which brokers they should choose to use.

2. Ensure that the dissemination of market data is fair to all market participants. This could be achieved in a number of different ways, including by eliminating direct data feeds, slowing down the direct data feeds or through greatly enhancing

the Securities Information Processor's infrastructure to allow it to transmit market data to participants at substantially the same speed as the direct data feeds. It is in the nature of competition that some participants will be able to process information much faster than others, but these participants should not be given unequal access to allow them to front-run other investors' orders.

3. Eliminate the maker-taker pricing model and substantially reduce access fee caps. We believe eliminating the maker-taker pricing model—and, more specifically, the liquidity rebates provided therein—and substantially reducing market access fee caps, would remove certain inherent conflicts faced by broker-dealers. This would make it more likely that broker-dealer activities will be performed in a manner and with an outcome more consistent with their clients' best execution objectives rather than their own pecuniary interests.

4. Harmonize the regulation of exchanges, alternative trading systems and other trading venues. This will level the playing field between ordinary investors and other participants and ensure fairness, consistency and integrity to the trading markets.

5. Require registration for all high-frequency trading participants and the establishment of a uniform regulatory regime. The activities and strategies employed by high-frequency traders are sufficiently disparate, non-transparent and complex that a reasonable first step in regulation would be to ensure that all entities that engage in high-frequency trading be required to register under a uniform regulatory regime that has the resources and capabilities to detect and, where appropriate, take action against any trading strategies that are deemed manipulative or predatory.

6. Institute a comprehensive "trade-at" rule pilot program. The trade-at rule would require any orders internalized by broker-dealers to provide meaningful price improvement. If material price improvement cannot be provided, then those

orders would be routed to more transparent markets. Such a rule would reduce broker-dealer conflicts and may result in much more robust price discovery for investors. We recommend that the SEC work with exchanges, investors and other market participants to structure this pilot program.

7. Market-making participants, exchanges, issuers and investors should work with regulators to facilitate market-making activities by creating sensible, transparent incentives and obligations for making markets generally, but for mid-cap and small-cap stocks in particular.

Invesco believes that these recommendations, if acted upon, will result in less complicated and more robust, highly liquid, transparent, fair, stable and efficient markets. They would address concerns of ordinary savers that otherwise threaten confidence in the integrity of the U.S. equity markets. We are highly encouraged by Chair White's recent speech outlining a number of initiatives that the SEC is considering to improve U.S. equity market structure. These initiatives will address many of the issues we have raised historically and are raising again here today. We also would like to commend the SEC for its recent action to establish a thoughtful pilot program to assess tick sizes for small company stocks.

Thank you again for your attention to these important issues here today. I look forward to answering any questions you may have.