IEX APPROVED & YES, CEOs MAKE A LOT

"The last thing the SEC wanted was to be seen as making a decision that would benefit powerful entities at the cost of retail investors."

As we were putting the August issue of *Modern Trader* to bed the Securities and Exchange Commission (SEC) announced that it had approved Investors Exchange LLC's (IEX) application as a national securities exchange. IEX has deeply split the trading community. In the past year we have discussed the value proposition of IEX with its founder Brad Katsuyama and looked at the objections to IEX's application, mainly from established exchanges and some high-frequency trading (HFT) advocates.

The decision was telegraphed in the spring when the SEC put out a rule interpretation that stated "delays of less than a millisecond (1,000 microseconds, IEX's speed bump is 350 microseconds) in quotation response times may be at a *de minimis* level."

The argument turned on the meaning of "immediate," which is the requirement under Reg NMS. The phrase "de minimis" is troubling here because the "speed bump" is the magic bullet that the founders and backers of IEX say makes it a fairer platform for retail traders, and it's what takes away the unfair advantage of certain high- frequency traders. How can it be considered insignificant?

This required some fancy footwork by the SEC.

The popularity of Michael Lewis' book "Flash Boys: A Wall Street Revolt" has made IEX a dragon slayer on the side of light, whereas the established exchanges and HFTs are on the side of darkness, the script goes.

Faced with the decision between a popular upstart thought to even the playing field and established players thought to be defending a "rigged" market, the SEC was in a bit of a pickle. The last thing the SEC wanted was to be seen as siding with powerful entities at the cost of retail investors. It is understandable, but an anonymous comment letter filed two days before the announcement points out an inconvenient truth. It states: "… the comment letters opposing IEX becoming an exchange have specific examples, data driven analysis and rule references while the comment letters in favor of IEX becoming an exchange are unsurprisingly void of those very same things."

This is not to say that IEX should not be approved, but we should consider the logical gymnastics it took the SEC to come to its decision and acknowledge that the regulators are too involved. The exchanges and brokerages involved in executing and matching orders all have fiduciary responsibilities, so it should not be necessary for the SEC to sign off on every innovation or new structure. This is an unintended consequence of Reg NMS. IEX will roll out as an exchange and other exchanges will likely adopt similar speed bumps, particularly if IEX's market share grows. They all should be free to do it without hundreds of lawyers chiming in.

The battle over IEX is related to our August issue theme because they both wrestle with the perception — rightly or wrongly — that the entire financial system is rigged in favor of the powerful.

Nothing engenders anger as much as the subject of CEO compensation. The reasons are pretty simple. We are still mired in a slow recovery from the 2008 credit crisis, which pushed unemployment above 10% and nearly cratered the entire economy. A couple years later the heads of the large investment banks arguably responsible for the crisis were back to collecting multi-billion compensation packages as the rest of the economy struggled with slow growth. Also, a major driver of increased CEO pay is merger and acquisition activity where an acquisition results in higher CEO payouts based on the efficiency of getting rid of thousands of jobs. The scenario has played out over and over again, which spawned the occupy movement and is probably why an avowed Socialist made a serious run for the nomination of one of our major political parties.

In **"Is CEO compensation rational" (page 18)** Garrett Baldwin delves deep into factors affecting CEO pay and the controversy over golden parachutes. One point highlighted is that efforts to rein in high compensation packages may, in fact, have had unintended consequence. It is a lesson regulators need to learn.

A more standard lesson is provided in "**This strategy is up 100% over the S&P in the last 10 years" (page 32).** Joe Cornell, founder of Spin-Off Advisors, discusses how he turned an obscure niche of the investment universe into a thriving business.

Our monthly market focus looks at the retail sector. In **"Transforming the retail experience" (page 38)** IHL Group Analyst Jerry Sheldon examines how e-commerce and IT spending are changing the retail landscape. ∆

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