BETTER MARKETS

SEC FACT SHEET

SEC Market Structure Reforms

The Gamestop and meme-stock trading frenzies in early 2021 highlighted longstanding market integrity and investor protection issues in the U.S. equities markets, including the increasingly fragmented state of our markets, practices such as payment for order flow, and the weak and seldom enforced rule requiring broker-dealers to obtain the best execution for their clients. The market breakdowns during this volatile time period damaged public confidence in our markets and inflicted hundreds of millions, if not billions, of dollars of losses on everyday investors.

On December 14, 2022, the SEC took a major step in addressing long-standing equity market structure issues by proposing a set of reforms intended to improve the way securities trades are routed and executed. These four separate proposals include: Regulation Best Execution; Order Competition; Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders; and Disclosure of Order Execution Information.

Taken together, these proposed reforms have the potential to improve the fairness and transparency of our securities markets and ensure retail investors are not unfairly exploited by their brokers and other financial intermediaries.

At a Glance

Once finalized, these rules will

1) strengthen the obligation of all brokers to get the best available prices for their clients;
2) make sure that most retail orders are sent through auctions where they'll be exposed to open and competitive bidding;
3) reduce the trading increments or "tick sizes" to help improve buy and sell prices, while also reducing the fees that create harmful trade-routing incentives; and
4) increase transparency by expanding the reporting requirements that shed light on the quality of trade executions that brokers have achieved for their clients.

In our comment letters, Better Markets has detailed the reforms, identified areas where they can be improved, and countered the attacks anticipated from industry.

Regulation Best Execution

This proposed rule would establish a duty of best execution under the SEC's own rules, requiring broker-dealers to execute customer orders at the most favorable price given market conditions.

Why It Matters: The U.S. financial markets have become enormously fragmented and largely opaque, including 24 exchanges, dozens of ATSs, and a cadre of wholesalers—market participants that for their own benefit, attract and execute a huge percentage of retail order volume. As a result, finding the best prices poses challenges. There are huge conflicts of interest in play when it comes to order execution, and that profit motive induces some market participants to route orders for execution in ways that do not yield best execution for clients. Specifically, sophisticated market participants such as the wholesalers can game the system through the process of PFOF—paying brokers for retail order flow, executing those orders internally at prices that reflect apparent price improvement over the NBBO benchmark, and then, in turn, engaging in offsetting trades at better prices for their own gain.

What We Said: The proposed rule represents an important step forward in the effort to ensure that retail investors obtain something closer to the best available prices for their securities trade, instead of being taken advantage of by broker-dealers who sell their customers' order flow to large, sophisticated wholesalers that execute orders at less than the best available price. Having a Commission rule in place—not only an SRO rule—will by itself confer a number of important advantages, enabling the Commission to use the rule in its examination efforts and enforcement actions. And the proposed rule sets forth more granular factors that brokers must consider as they determine the best available prices for their clients' trade. However, it is not sufficient by itself to address the problems surrounding retail order execution and it therefore cannot be viewed in isolation. It is part of a set of market structure rule proposals that will require greater retail order competition, reduced tick sizes, and enhanced disclosure about execution quality. It is important that all of these reforms take effect to maximize the improvements to retail order routing and execution practices that the Commission is appropriately seeking to achieve. Moreover, the Commission should consider additional reforms, including banning the incentives—notably PFOF—that are largely responsible for the conflicts of interest that degrade order routing and execution practices to the detriment of retail investors.

Bottom Line: The SEC's proposed rule to establish Regulation Best Execution would increase regulatory oversight and enforcement of a broker-dealer's duty to execute their customer orders at the best price given market conditions. While the proposed rule stops short of banning the harmful practice of PFOF (which we advocate for eliminating in the comment letter), the heightened policies and procedures for conflicted transactions such as PFOF should root out the most egregious instances of broker-dealers acting against the best interests of their customers in executing their trades.

Read our full [Comment Letter here].

Order Competition Rule:

Under this proposal, stock orders submitted by retail investors to their brokers must be sent to public auctions where market makers, institutional investors, and others can compete to provide the best price.

Why It Matters: When an ordinary investor asks his broker to buy or sell stock, that broker has the option of sending the order to one of several venues to be executed. Most investors probably expect their brokers to send orders onto the well-known national exchanges like NYSE or NASDAQ. But, in fact, a small group of powerful high-frequency trading firms, called "wholesalers," scoop up and execute the vast majority of orders from retail-focused brokers. The wholesalers do this largely through "payment for order flow" or PFOF given to the brokers; they don't necessarily earn that order flow by always executing the investor's order at the best price. Most retail orders never make it to broader markets.

The SEC, several academic studies, and Better Markets all believe that ordinary investors leave money on the table under current market practices. The auction mechanism in the Order Competition Rule would ensure that wholesalers face price-based competition for retail orders, and that competition will produce better prices for each transaction. While those savings might be small on any individual order, they are enormous in the aggregate.

What We Said: We strongly support the central thrust of the Order Competition Rule. A few dominant firms have cornered the market for retail investor orders for far too long, and they have done so by creating conflicts of interest at the major stockbrokers. These conflicts have hurt not only the financial interests of ordinary investors but have made the overall stock market worse for mutual funds, pension funds, and the other vehicles that help convert Americans' savings into financial security. And the best part is that the rule does this by promoting market competition itself.

We know that the big incumbents will fling plenty of criticism at the SEC's proposal to protect their monopoly profits. But the SEC shouldn't worry about these typically exaggerated claims. Forcing wholesalers to compete on even terms won't mean that ordinary investors pay higher costs; they'll only benefit from better execution of their trading strategies. And the new rule should create more liquidity for a wide variety of stocks across the national exchanges and other trading venues. These benefits are captured in the SEC's extensive economic analysis, and outside experts have corroborated the SEC's projections.

Bottom Line: The SEC estimates that its auction mechanism could save ordinary investors up to $2.35 billion each year. The Order Competition Rule can and should ensure those savings are realized.

Read our full Comment Letter here.

Minimum Pricing Increments:

This proposal would (1) reduce the minimum pricing increments, or "tick sizes," of certain eligible stocks; (2) reduce certain fees charged by exchanges for traders seeking to execute orders; and (3) accelerate the transparency of the best-priced orders available in the market by revising its definition of "round-lots" and "odd-lots."

Why It Matters: Our securities markets have become increasingly unfair to everyday investors, and one reason is that the rulebook hasn't kept up with the huge changes in the markets. Those changes include the rise of sophisticated trading firms that specialize in taking small increments of profit from everyday investors; the increase in conflicts of interest that corrupt the duty of brokers to get the best possible prices for their clients; and the fragmentation of the markets into dozens of different trading venues, many of which are not transparent. And one particular problem is that the minimum trade size established under a twenty-year old rule is now outdated with the advances in technology and the increase in trading volume. As a result, investors aren't able to trade in the increments that would enable them to get optimal prices. In other words, although market forces appear willing and able to price certain stocks in increments of less than one penny, longstanding SEC rules prevent exchanges from displaying prices for most stocks in increments—or "ticks"—below a penny. This prevents bid-ask spreads from becoming narrower than one cent, meaning that traders may not be getting as good a deal as they should. Meanwhile, in off-exchange trading venues known as "dark markets," sophisticated, highly resourced traders are freely able to make such sub-penny trades, affording them unique benefits denied to most ordinary investors. The SEC's proposal would help solve this problem by reducing the minimum tick size to less than a penny, improve the trading environment for retail investors, and level the playing field.

What We Said: We strongly support the central thrust of the proposal, although we urge the SEC to strike a better balance and reduce tick sizes to a half-penny increment rather than a smaller tenth or two tenths of a cent. And by harmonizing sub-penny tick sizes among all trading venues, as proposed, all investors will be on a more even playing field and operating under the same rules in terms of the increments at which they can trade. Better Markets similarly supports the Commission proposal to reduce access fees from the current level of $0.003 per share, or 30 mils, to $0.001 per share, or 10 mils. Technology and financial markets have evolved dramatically over the past two decades when Regulation NMS was first adopted, but our rules have not kept pace. The current access fee levels at $0.003 are long outdated and fail to correspond to any reasonable approximation of the relative costs incurred by exchanges. Updating these fees is a commonsense approach that will save investors money and increase market transparency. In the same vein, the SEC's proposed revisions to the treatment of odd-lots and round-lots will provide important information to markets and investors, making trading more fair and efficient.

Bottom Line: The SEC's proposed amendments to the market structure rules are important and necessary reforms that will help level the playing field for the benefit of retail investors, save investors their hard-earned money by reducing trading costs and improving market conditions, and produce a better informed, more transparent equities market. The SEC should proceed to finalize the proposal, with the enhancements we urge in our comment letter.

Read our full Comment Letter here.

Disclosure of Order Execution Information

This proposal seeks to expand the quantity and quality of disclosure pursuant to Rule 605 of Regulation NMS by, among other things, requiring that certain broker-dealers disclose information on a monthly basis about how investor orders are actually executed in the markets and by allowing market participants to better compare and evaluate execution quality, as measured by several factors such as price and speed.

Why It Matters: Rule 605 and the reports it calls for, have not had a substantive revision since it was first issued over twenty years ago. But during that time the technological nature of trading has changed immensely. The SEC's proposal seeks to modernize this important disclosure. The simple fact is that in today's securities markets, many investors—especially retail investors—are not getting the best available prices for their orders to buy and sell stock because of unfair trading practices and structural features that have become ingrained in the markets, including conflicts of interest, payments for order flow, minimal order competition, poor execution prices, limited transparency into order routing practices, predatory high-frequency trading, severe trading venue fragmentation, and increased trading on dark markets. This state of affairs has arisen from a number of inter-related factors, but prominent among them is a lack of transparency regarding the way orders are routed in today's complex and fragmented markets, where incentives and conflicts of interest between brokers, wholesalers, and other market participants abound. Along with the other market structure reforms proposed by the SEC, the increased disclosure contained in the Disclosure of Order Execution Information Rule can shine new light into the opaque and complex world of securities trading, and ultimately help retail investors receive better prices and save money.

What We Said: We strongly support the Disclosure of Order Execution Information Rule and suggest some modest improvements. The Proposal will provide sorely needed updates and enhancements to Rule 605 for the benefit of retail investors and the market overall. Better Markets agrees that modernized and enhanced execution quality reporting as proposed would improve the public's ability to compare and evaluate execution quality among different market centers and broker-dealers. In short, these reforms will increase transparency of order execution quality, ultimately improve execution quality, and help promote fair competition among market centers and broker-dealers.

Bottom Line: The Disclosure of Order Execution Information Rule will expand the quantity and quality of disclosure regarding order execution pursuant to Rule 605, including, for the first time, data from large broker-dealers if they take orders from customers for execution and then route those orders to execution venues. Securities trading involves conflicts of interest that can undermine the quality of executions, especially for retail investors. Collectively, inefficiencies such as these in the structure of the U.S. stock markets take billions of dollars out of Americans' pockets every year in incremental losses due to subpar order executions. Greater transparency can help expose and address these inequities.

Read our full Comment Letter here.

Better Banks | Better Businesses

Better Jobs | Better Economic Growth

Better Lives | Better Communities

Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

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