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# To Protect Investors and Markets, the SEC Must Finish What It Started

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Chair Gensler arrived at the SEC on April 17, 2021, after four years of deregulation, as well as under-regulation and under-enforcement. That’s why he had ambitious plans to address many key issues facing investors, markets, and capital formation. In addition to robust enforcement, the clearest sign of that was his regulatory agenda, which including rulemakings covering the entire range of issues related to the capital markets. Chair Gensler’s agenda stretched from disclosures about climate risk to the modernization of equity market structure to fund rules, board and workforce diversity, and cybersecurity.

Since then, the agency has done an incredible amount of work. It has finalized 39 rules in an effort to address the issues that currently face investors and the markets. More than 20 additional rules have been proposed, the comment period has closed, and they are in the process of being finalized. Over ten rules remain in the pre-proposal stage. For the SEC to fulfill its mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation, it must continue to undertake vigorous rulemaking.

At the beginning of 2024, we [urged](#) the SEC to finalize some of the most important rules remaining on its regulatory agenda: its Climate Disclosure Rule, its ESG Disclosures for Investment Advisers and Investment Companies rule, and its market structure rules, among others. The SEC did finalize the [Climate Disclosure Rule](#) and one of its four market structure rules—the [Disclosure of Order Execution Information rule](#). Now, with just months to go in President Biden’s first term, it’s imperative for the SEC to finalize a number of the remaining rules. In particular, the SEC should finalize (1) the ESG disclosure rule, (2) the remaining market structure rules, (3) the Predictive Data Analytics rule, (4) the Volume-Based Pricing rule, and (5) the rule amendments to the definition of an exchange.

**Although the substance of these rules varies, they are all important because they are designed to better protect investors, make the markets fairer and more transparent, facilitate capital formation, and reduce systemic risks that could contribute to financial crashes.** Our securities markets are constantly evolving, and the rules that govern those markets must evolve too. Otherwise, Wall Street will profit while Main Street gets left behind. That is what is at stake in the last six months of 2024. The SEC needs to finalize rules that will provide investors with the information that they need to make investment decisions, ensure that investors receive the proper prices for their securities, and protect investors from the risks of artificial intelligence, a lack of competition among

exchanges and brokers, and trading platforms that function as exchanges but are not regulated as exchanges.

## The ESG Disclosure Rule

In May 2022, the SEC proposed a rule to require investment advisers and investment companies to provide enhanced disclosures about their [environmental, social, and governance \(ESG\)](#) investment practices. The rule would establish a standardized ESG disclosure framework that would create more reliable, consistent, and comparable disclosures for ESG funds based on the extent to which a fund considers ESG factors in its investment selection and issuer engagement processes. The proposal falls squarely within the SEC’s authority, and it [should be adopted](#) because it will provide investors with material information to help them make investment decisions and prevent them from being misled.

- **The SEC has the authority to adopt the ESG disclosure rule.** Section 8 of the Investment Company Act of 1940 gives the SEC the authority to promulgate rules requiring that an investment company’s registration statement recite the policy of the fund regarding concentrating investments in a particular industry or group of industries, regarding all other investment policies of the fund that are changeable only if authorized by shareholder vote, and regarding all matters which the fund deems matters of fundamental policy. Section 203(c)(1) of the Investment Advisers Act of 1940 gives the SEC the authority to promulgate rules requiring that an investment adviser include in its registration with the Commission information regarding the nature of the investment adviser’s business. These provisions authorize the SEC to adopt rules that require investment companies and investment advisers to provide investors with specific disclosures regarding their ESG policies and the use of the ESG factors in their business.
- **The ESG disclosure rule will provide investors with material information to help them make investment decisions and prevent them from being misled.** Investors need a way to compare the claims that funds make about the role of ESG in their investment strategies because “the claims that funds or firms make about their ESG characteristics have [significant financial implications](#) for investors.” ESG disclosures are also necessary so that investors are able to identify funds that [align](#) with their perspective on the ESG factors. The SEC’s attempt to provide investors with information about the role of ESG in funds’ investment strategies is especially important because it comes “at a time when investor demand for ESG investment products is rising [exponentially](#).” Indeed, the strong demand for ESG investing “provides a powerful incentive for [greenwashing](#),” which occurs when investment firms attract investors by [misleading](#) them with hype about the environmental or social benefits of their products. In light of the increasing demand for ESG investments, investors need to understand the role that ESG factors play in fund investment strategies so they can make optimal financial judgments and assess the veracity of the claims made by ESG funds.

## The Market Structure Proposals

In December 2022, the SEC proposed both new [Regulation Best Execution](#) and [amendments to its Regulation NMS](#). Taken together, these proposed reforms have the potential to vastly improve the fairness and transparency of the securities markets and ensure that retail investors are not exploited by their brokers and other financial intermediaries. The SEC has specific statutory authority to adopt these rules, and it should [finalize these rules](#) so that retail investors receive the significant benefits that they would confer.

- **Regulation Best Execution.** The SEC should quickly [adopt](#) Regulation Best Execution. Broker-dealers should be required to exercise reasonable diligence to obtain the most favorable prices for their customers under prevailing market conditions.
  - **The SEC has the authority to adopt Regulation Best Execution.** Section 11A of the Securities Exchange Act of 1934 provides the SEC with the authority to promulgate rules to assure the practicability of brokers executing investors' orders in the best market. A rule that requires brokers to use reasonable diligence to ascertain the best market for a security and buy or sell in that market so the price the customer receives is as favorable as possible under prevailing market conditions is consistent with this authority.
  - **The SEC should adopt the strongest possible version of Regulation Best Execution.** A duty of best execution that applies whenever broker-dealers handle customer orders and that requires that they document their compliance on an order-by-order basis is necessary and easily doable in today's marketplace. It would counteract the current practice of brokers simply routing retail orders to wholesalers in return for payment for order flow without a valid, factual basis for believing that those routing decisions will actually yield the most favorable prices. Only real time order-by-order data—information which the brokers already readily have—should be used to determine if brokers are in fact providing their customers with best execution.
- **Regulation NMS.** The SEC should also [adopt](#) the amendments to Regulation NMS. The proposal to amend Regulation NMS by lowering the minimum pricing increments, or “tick sizes,” at which a stock's price can be quoted and traded would benefit investors.
  - **The SEC has the authority to adopt the amendments to Regulation NMS.** Section 11A of the Securities Exchange Act of 1934 provides the SEC with the authority to promulgate rules to assure the economically efficient execution of securities transactions. A rule that allows market participants, including investors, to better determine the prices at which they would bid or offer is consistent with this authority.
  - **The SEC should adopt the amendments to Regulation NMS because the current \$0.01 minimum tick size for most stocks prevents traders from quoting the prices that reflect true supply and demand.** Lowering the minimum tick size would allow investors to determine the prices at which they would bid or offer without being impeded by a fixed minimum tick size that is too large and that prevents stocks from reaching a natural price that would be within a penny spread. Lowering the minimum tick size by an

appropriate amount mitigates the diversion of order flow to over-the-counter market makers who can trade in sub-penny increments. But a minimum tick size of \$0.001, as proposed, raises the risk that at each price point there will be less liquidity and less stability in the quotes. Tick sizes should be lowered, but the appropriate amount would be to reduce the minimum tick size to \$0.005.

## Predictive Data Analytics

In July 2023, the SEC proposed a rule to require broker-dealers and investment advisers to eliminate, or neutralize the effects of, certain conflicts of interest associated with their use of [artificial intelligence-like technologies](#) in their interactions with investors. The rule is an essential response to the increasing use of artificial intelligence in the securities industry and a necessary measure to ensure that the securities laws keep pace with technological innovations. The SEC has the authority to adopt the rule, and it should do so [because](#) the rule would prevent firms from using technology in a way that benefits firms but harms investors—including by leading investors to engage in excessive trading and become addicted to trading, which can destroy their careers, finances, and lives.

- **The SEC has the authority to adopt the Predictive Data Analytics rule.** Section 15(l)(2) of the Exchange Act and Section 211(h)(2) of the Advisers Act authorize the SEC to promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors. These provisions authorize the SEC to adopt rules requiring firms to identify and eliminate, or neutralize the effect of, certain conflicts of interest associated with their use of artificial intelligence-like technologies that result in investor interactions that place the interests of the firm and its associated persons ahead of the interests of investors.
- **The SEC should adopt the rule so that firms do not use predictive analytics, digital engagement practices, and gamification to harm investors.** Although some existing rules discuss conflicts of interest, those rules only apply when brokers are making recommendations. The problem is that artificial intelligence-like technologies allow securities professionals to prompt investors to trade without making a specific recommendation of a security. The rule is necessary to prevent securities professionals from using predictive analytics, digital engagement practices, and gamification in a way that induces investors to engage in a series of transactions that are not in their own interest and that have the potential to turn retail investors into investing addicts.

## Volume-Based Pricing

In October 2023, the SEC proposed a rule to prohibit national securities exchanges from offering [volume-based transaction pricing](#) in connection with the execution of agency-only orders in National Market System stocks. The use of volume-based transaction pricing harms competition by preventing smaller exchanges from competing with larger exchanges and by preventing smaller brokers from competing with larger brokers. The SEC has the authority to adopt the rule, and it

[should do so](#) to bring exchange pricing models into compliance with the law and foster competition in the markets.

- **The SEC has the authority to prohibit volume-based pricing by national securities exchanges.** Section 23 of the Exchange Act authorizes the SEC to promulgate rules as may be necessary or appropriate to implement the provisions of the Exchange Act for which it is responsible. Section 6 provides that an exchange shall not be registered as a national securities exchange unless the Commission determines that the rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities; the rules of the exchange not permit unfair discrimination between customers, issuers, brokers, or dealers; and the rules of the exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. One of the purposes of the Exchange Act is to ensure fair competition among brokers and dealers and exchange markets. Under these provisions, the SEC has ample authority to prohibit national securities exchanges from offering volume-based transaction pricing.
- **The SEC should prohibit volume-based pricing by national securities exchanges to ensure fair competition among exchange markets and brokers and dealers.** Volume-based discounts stifle competition by allowing established exchanges to offer preferential pricing to their existing customers so long as those customers send the exchanges an increasingly large volume of order flow. This preferential pricing prevents newer or less established exchanges from obtaining the customer order flow necessary to grow their businesses. Volume-based discounts therefore present a barrier to entry for competing exchanges. The preferential pricing that results from volume-based discounts also prevents smaller brokers from competing with larger brokers for customer orders because they will not be able to pass on the savings from volume-based discounts to their customers. So the rule fosters competition by preventing smaller brokers from being unable to offer their customers competitive pricing. This benefits investors, because investors may not be able to trade in their preferred manner if large brokers can take advantage of preferential pricing to curtail the ability of smaller brokers to compete and therefore offer investors more choices.

## Definition of Exchange

In January 2022, the SEC proposed a rule to update how trading systems that bring together buyers and sellers of securities could be considered an “[exchange](#)” within the meaning of the Exchange Act’s definition of an “exchange.” In April 2023, the SEC [supplemented](#) its rule proposal with a release clarifying that trading systems that brought together buyers and sellers of crypto asset securities in the manner contemplated by the proposed rule would be considered to be an “exchange” within the meaning of the Exchange Act. The proposal falls squarely within the SEC’s authority, and the SEC should [finalize the rule](#) so that trading systems that in effect function as exchanges are treated as exchanges.

- **The SEC has the authority to update how a trading system falls within the meaning of an exchange.** Section 3(a)(1) of the Exchange Act defines an “exchange” as an organization, association, or group of persons that constitutes, maintains, or provides a marketplace or facilities for bringing together purchasers and sellers of securities. Section 3(b) gives the SEC the authority to define the terms in that definition. So the SEC has the authority to adopt a rule that provides that an organization, association, or group of persons shall be considered to constitute, maintain, or provide a marketplace or facilities for bringing together purchasers and sellers of securities if it brings together buyers and sellers of securities using trading interest and makes available established, non-discretionary methods—whether by providing a trading facility or communication protocols, or by setting rules—under which buyers and sellers can interact and agree to the terms of a trade.
- **The SEC should adopt the rule so that trading systems that function as exchanges are treated as exchanges.** The rule appropriately updates the ways in which a trading system may be considered to be an exchange to account for the rapidly evolving nature of electronic trading venues. The increasing use of electronic trading venues and related innovations in the purchasing and selling of securities have enabled markets and market participants to trade securities in ways not previously envisioned. The rule ensures that trading systems that function as exchanges are treated as exchanges and subject to the investor protections that the Exchange Act provides for exchanges. The rule also clarifies that trading platforms trading digital assets that qualify as crypto asset securities will also be treated as exchanges. This clarification is especially important, as the crypto industry is rife with fraud and abuse and crypto investors need the protections that apply to trading platforms that qualify as exchanges.

## Conclusion

The SEC’s mission since 1934 has been to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The rules that the SEC has thus far adopted under Chair Gensler, and the rules that have been proposed but not yet adopted, are designed to ensure that the SEC is equipped to fulfill its mission in our current era. The SEC must finalize the rules discussed above so that today’s investors can receive the information that matters to them, obtain the best prices for their securities trades, and withstand unprecedented threats such as the use of artificial intelligence in modern trading.



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