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The SEC Must Make Markets Work for Investors

By Benjamin Schiffrin | *Director of Securities Policy*

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Introduction

On September 18, the Securities and Exchange Commission (SEC) will host a roundtable to discuss its "Trade-through Rule."[1] The rule restricts the execution of trades on one venue at prices inferior to prices at another venue.[2] So the rule prevents exchanges from executing trades at lower prices than those available at other exchanges.[3] Although the Trade-through Rule stemmed from the laudable goal of ensuring investors receive the best prices on their securities trades, it has had unintended consequences that have fragmented our securities markets and harmed investors. In announcing the roundtable, SEC Chair Paul Atkins said that the rule has "not served investors or broker-dealers well," given that it has led to "market distortion" and "gamesmanship."[4]

In this respect, Chair Atkins is correct. As Joe Saluzzi, partner and co-founder at Themis Trading and one of the participants at the upcoming roundtable said recently, the Trade-through Rule and the rules adopted alongside it caused the number of trading venues to proliferate, which has allowed high-frequency traders (HFTs), aided and abetted by stock exchanges, to "take advantage of latencies between these market centers."[5] And HFTs do so at the expense of regular investors.[6] But this means that the solution cannot be, as some propose, to simply do away with the Trade-through Rule and allow trades at prices that may not represent the best bid or offer.[7] That would not address the market fragmentation and HFT strategies that are the real issue today.

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1 https://www.sec.gov/newsroom/meetings-events/roundtable-trade-through-prohibitions.

2 https://www.sec.gov/spotlight/emsac/memo-rule-611-regulation-nms.pdf.

3 Christina Jaramillo, *The Revolt Against High-Frequency Trading: From Flash Boys to Class Actions, to IEX*, 35 Rev. Banking & Fin. L. 482, 490 (2016).

4 https://www.sec.gov/newsroom/press-releases/2025-99-sec-announces-roundtable-trade-through-prohibitions.

5 Etienne Mercuriali, *SEC tackles "market distortion", "gamesmanship" with Rule 611 review*, Global Trading (July 22, 2025), https://www.globaltrading.net/sec-tackles-market-distortion-gamesmanship-with-rule-611-review/.

6 Jonathan R. Macey, *Securities Regulation and Class Warfare*, 2021 Colum. Bus. L. Rev. 796, 825-26, 828 (2022).

7 Daniel Gallagher, *How to Reform Equity Market Structure: Eliminate "Reg NMS" and Build Venture Exchanges*, The Heritage Foundation (Feb. 23, 2017), https://www.heritage.org/article/how-reform-equity-market-structure-eliminate-reg-nms-and-build-venture-exchanges.

The simple fact is that the way our markets have evolved in the era of electronic trading must be rectified. Stock exchanges no longer exist to "provide 'fair and orderly markets' for long-term investors."[8] Because they are now for-profit corporations, they now exist to make money, and they can profit the most by facilitating HFT strategies. They make their money by selling data to HFTs, who use the data to essentially trade ahead of ordinary investors. This allows these HTFs to profit at the expense of investors who actually want to invest.[9] This is what the SEC must confront.

The Trade-through Rule Caused the Number of Exchanges to Proliferate

As discussed above, the Trade-through Rule was well-intentioned. In addition to seeking to ensure investors received the best prices on their securities trades, the rule sought to foster competition.[10] Indeed, the Trade-through Rule "was designed to *create* fragmented markets."[11]

- The Trade-through Rule allowed smaller exchanges to enter the market and compete with larger exchanges. By "mandating that orders must execute at the best available price regardless of which exchange that price is found at (i.e., if NYSE receives an order but the best available price is on NASDAQ, NYSE must route that order to NASDAQ), a small exchange, so long as it has the best price, is guaranteed order flow."[12] The Trade-through Rule thus "supported fragmentation by offering small exchanges a market toe-hold."[13]

HFTs Take Advantage of the Time it Takes to Create the National Best Bid and Offer (NBBO) to Profit at the Expense of Investors

The Trade-through Rule led to the rise of HFTs by making speed a way to profit from trading securities. By prohibiting trades on one venue at a price less favorable than the price at another venue, the Trade-through Rule meant that there needed to be a central processor (known as a securities information processor, or "SIP") to "receive and collate the quotes from each exchange and then disseminate the best ones as the national best bid/offer (the NBBO) to the market at large."[14] Although the assumption was that this would take place nearly instantaneously, it "gradually became apparent" that the time it took to collect and collate quotes from the various exchanges and then disseminate the NBBO to the market mattered.[15]

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8 Jonathan Macey and David Swensen, *Recovering the Promise of the Orderly and Fair Stock Exchange*, 42 J. Corp. L. 777, 778 (2017).

9 *Id.* at 780 (describing an "unholy alliance in which exchanges and HFTs seek profits at the expense of investors").

10 Steven McNamara, *The Law and Ethics of High-Frequency Trading*, 17 Minn. J.L. Sci. & Tech. 71, 85 (2016).

11 Macey and Swensen, 42 J. Corp. L. at 783 (emphasis in original).

12 Sue S. Guan, *Benchmark Competition*, 80 Md. L. Rev. 1, 18 n.70 (2020).

13 Hester Peirce, *Meeting Market Structure Challenges Where They Are*, 43 J. Corp. L. 335, 356 (2018).

14 Steven McNamara, *The Stock Exchange as Multi-Sided Platform and the Future of the National Market System*, 2018 B.Y.U. L. Rev. 969, 976 (2018).

15 *Id.* at 976-77.

- HFTs profit from "latency arbitrage"—exploiting the timing gaps between the exchanges and the SIP.[16] The SEC "allows exchanges to disseminate data to their trader clients simultaneously with the provision of such data to the SIP," but the data gets from the exchanges to HFTs faster than the SIP can consolidated the data and disseminate an NBBO.[17] So the development of high-speed transmission technology used by HFTs, and "the corresponding lack of technological development at the SIP," means that by the time the SIP disseminates the NBBO to the market the NBBO is "significantly stale."[18]

- In other words, HFTs obtain quotes directly from the exchanges and figure out what the NBBO is going to be before it is disseminated to the market. Latency arbitrage occurs "when an HFT has posted a quote representing the NBO [national best offer] or NBB [national best bid] on one exchange, and subsequently someone else posts an even better quote on a second exchange, which the HFT learns of before it is reported by the national system."[19] So the "toxic combination of trading the same security on multiple venues combined with a two-tier system with slow data being reported on the NBBO and better quotes existing outside of the exchanges' reporting system creates the opportunity for exploitation by certain HFTs, which have in essence a 'faster NBBO' than the official NBBO."[20]

- Essentially, HFTs can "front-run" other orders.[21] Their "timing advantage" allows them "to earn riskless profits at the expense of the general investing public."[22] HFTs "insert themselves between natural buyers and natural sellers, . . . generating riskless profits" despite doing no research and representing no constituencies other than themselves.[23]

Exchanges Profit by Selling HFTs Proprietary Data Feeds that Allow Them to Calculate the Real NBBO Faster than the Official NBBO

- HFTs can execute this strategy because the exchanges facilitate it.

- The exchanges profit from HFTs in "myriad" ways. That's because they now "operate under a business model that welcomes and caters to the interests of HFTs." HFTs pay the

16 *Id.* at 1027.
17 McNamara, 17 Minn. J.L. Sci. & Tech. at 112.
18 McNamara, 2018 B.Y.U. L. Rev. at 983-84.
19 Merritt B. Fox, Lawrence R. Glosten, and Gabriel V. Rauterberg, *The New Stock Market: Sense and Nonsense*, 65 Duke L.J. 191, 238 (2015).
20 Macey and Swensen, 42 J. Corp. L. at 786.
21 McNamara, 2018 B.Y.U. L. Rev. at 1027-28.
22 McNamara, 17 Minn. J.L. Sci. & Tech. at 108.
23 Macey and Swensen, 42 J. Corp. L. at 781; *see also, e.g.*, Charles R. Korsmo, *High-Frequency Trading: A Regulatory Strategy*, 48 U. Rich. L. Rev. 523, 565 (2014) ("The practice is nonetheless arguably unfair to retail investors. Again, only market participants with the wealth and sophistication required to pay for, receive, and proceed the data feeds in real time will be able to take advantage of such feeds. These traders—HFTs in particular—can gain still more of a speed advantage, receiving information, in a practical manner, before that information is available to the public.").

- exchanges fees for high-speed proprietary data feeds, fees for privileged access to market data, and fees for having their computers "co-located" in the data centers.[24]

- The exchanges offer, and HFTs subscribe to, high-speed proprietary data feeds that reach traders faster than the SIP's data.[25] The fact that the SIP data "lags" behind the exchanges' private data feeds creates opportunities for market participants who pay for the faster exchange data feeds.[26] So the exchanges are able to profit by selling their faster proprietary feeds to the HFTs who are willing and able to pay for them.[27]

- The exchanges also allow HFTs "to place their computer servers physically inside of the exchanges' order execution centers so that their orders will arrive at the exchanges before the orders of other investors." These collocated servers "facilitate a form of micro front-running." "Put simply, HFTs purchase the ability to see a trade occur and react to it before the majority of investors are even aware that the first trade occurred."[28]

- The ability to sell these products to HFTs is enormously profitable for the exchanges. The exchanges "no longer derive a majority of their revenue from transaction-based fees."[29] Instead, the sale of proprietary data feeds and co-location services are now "the most important aspect of their bottom lines," with HFTs their most important customers.[30]

Conclusion

The Trade-through Rule, and the rules adopted with it, have created a system where HFTs and exchanges profit at the expense of ordinary investors. The SEC cannot revise the Trade-through Rule without addressing this system. Eliminating the Trade-through Rule would allow investors for whom quantity mattered more than price to make "the purchase of a large block of shares at a higher price than the best offer (or sale at a lower price than the best bid)."[31] But it would leave investors for whom price is the priority unprotected. And it would leave HFTs free to continue front-running orders and leave exchanges with the incentive to help them to do so. So instead of focusing on the Trade-through Rule itself, the SEC must reform the way exchanges work.

The problem is that while historically exchanges "were run as not-for-profit utilities," they are now for-profit corporations that exist to make money,[32] and they can make the most money by aiding and abetting HFTs. Exchanges used to serve investors who wanted to "purchase and sell securities for investment purposes to take advantage of fundamental research into a company

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24 Macey and Swensen, 42 J. Corp. L. at 786.

25 Paul G. Mahoney, *Equity Market Structure Regulation: Time to Start Over*, 10 Mich. Bus. & Entrepreneurial L. Rev. 1, 22 (2020).

26 Peirce, 43 J. Corp. L. at 357.

27 *Id.*

28 Macey and Swensen, 42 J. Corp. L. at 786.

29 Alexander Abedine, *The Symbiosis of High Frequency Trades and Stock Exchanges: A Macro Perspective*, 14 N.Y.U. J.L. & Bus. 595, 622 (2018).

30 *Id.*

31 Macey and Swensen, 42 J. Corp. L. at 784.

32 *Id.* at 778, 780.

or to engage in portfolio management."[33] But now they serve HFTs, who "purchase and sell on the basis of unfair information or unfair advantages regarding what *other traders* intend to do in the future, and therefore subtract value from markets by extracting parasitic profits."[34]

So what can be done? The SEC should implement a central limit order book ("CLOB").[35] Although the exchanges previously have expressed "vociferous opposition" to a CLOB because they viewed it as a precursor to their elimination,[36] "an updated proposal should not abolish the individual exchanges but should instead develop a routing service" that leaves the exchanges intact.[37] A CLOB, "if it were used for all securities trading, could create the near equivalent in the securities industry to what economists call 'perfect competition.'"[38] As a result, the SEC should finally implement a CLOB if it is serious about enacting reforms that serve investors well.

- A CLOB would eliminate the need to collect and collate quotes and form an NBBO. Instead, a "routing service would collect the entire book of quotes in each stock from the various exchanges" and compile them into a "national consolidated order book." This "system-wide order book would be made available to traders," and orders would be executed "on the basis of the consolidated order book"; an order that hit an existing quote would go to the host exchange to be executed.[39]

- A central routing service would therefore "function as the single determinative node in the system." This would eliminate the problems from fragmentation. It would also "by definition do away with the need for the [Trade-through] Rule."[40]

- "Along with the implementation of a single routing service would come a single source of trading information. Since the information presented by the virtual CLOB would be the single source of determinative information on stock quotes, there would be no need for a separate SIP. . . . With a central routing service offering a national order book, the problem of stale quotes and the NBBO would vanish."[41]

- A CLOB would also eliminate arbitrage activity generated by the timing gaps between the exchanges. Although it would not eliminate all arbitrage, "arbitrage solely between different American stock markets would be eliminated."[42]

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33 *Id.* at 778.
34 *Id.*
35 McNamara, 2018 B.Y.U. L. Rev. at 1022-23.
36 *Id.* at 1025.
37 *Id.*
38 Joel Seligman, *Payment for Order Flow and the Great Missed Opportunity*, 18 Hastings Bus. L.J. 3, 14 (2021).
39 McNamara, 2018 B.Y.U. L. Rev. at 1023; *see also* Seligman, 18 Hastings Bus. L.J. at 14 ("For investors this would mean "all bids and offers in the computer system could interact, with best bid always able to meet best offer, and with the greatest possible competition among marketmakers.").
40 McNamara, 2018 B.Y.U. L. Rev. at 1023.
41 *Id.* at 1027.
42 *Id.* at 1028.

- Exchanges would no longer need to cater to HFTs or have an incentive to maximize profits through the sale of propriety data feeds and co-location services to HFTs.

The SEC exists to protect investors. But it has allowed our markets to evolve in a way that lets HFTs profit at ordinary investors' expense. And exchanges help HFTs implement their strategies because by doing so they can profit along with the HFTs. So the SEC must adopt reforms that eliminate the advantages HFTs have over ordinary investors. A central limit order book is one such reform because a "single location for trading an individual stock" would "eliminate the fragmentation and complexity that interfere with the effective operation of today's markets" and cause long-term investors to "benefit from deeper, fairer, more transparent markets."[43]

[43] Macey and Swensen, 42 J. Corp. L. at 791.

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