

Injecting Transparency & Competition into Equity Markets

The Commission's rule writing calendar may be about to have a meltdown. The agency is considering a number of significant rule writing-proposals covering important areas. A number of those proposals are controversial, covering climate disclosure and ESG.

Nevertheless, Chair Gensler continues to craft new ideas and suggestions for reform. His latest proposals focus on market structure and whether there is a level playing field for retail investors when they trade. The proposals have not been written yet. Yet the SEC staff has been burning the midnight oil based on suggestions from Mr. Gensler about market structure, the national best bid, order execution and similar topics. While none of these topics have the popular appeal of climate and ESG, the to be written market structure proposals, based on recent remarks of the Chair, may well prove to be some of the more significant to come before the Commission. See Chair Gary Gensler, "Market Structure and the Retail Investor," remarks delivered before the Piper Sandler Global Exchange Conference, Washington, D.C. on June 8, 2022 ([here](#)).

Technology has transformed the equity markets, according to Mr. Gensler. The tech infusion into those markets presents new challenges regarding segmentation, concentration and potential inefficiencies. The results can be seen in six key areas which impact retail investors: 1) the minimum pricing increment or tick rule; 2) national best bid and offer (NBBO); 3) disclosure of order execution quality; 4) best execution; 5) disclosure of order execution quality; and 6) payment for order flow.

1. **Minimum price increment – the tick rule:** The question here is "tick size." In the lit markets typically used by retail investors prices are stated to one penny. Orders using this tick size account for the majority today. Yet well over 30% of the orders typically placed by wholesales have a minimum increment of less than one penny with no competition. There is thus a question regarding the impact of the tick size. Staff has been asked to examine this point and fashion a proposed rule requiring a uniform tick size across all markets. Staff will also create a proposal that reduces the tick size to less than one penny.
2. **National best bid --NBBO:** The national best bid is the aggregation of the round lot bids. Over the last several years, however, trading in odd lots (those under 100

Related Capabilities

- Securities & Financial Services Litigation & Enforcement
- Investment Funds
- Investment Management
- FinTech
- Environmental, Social, Governance (ESG)

shares) has increased significantly. While it seems apparent that retail investors would be the ones most likely to trade in odd lots, they cannot see those bids on the trading venues. This issue has been addressed in the past by the Commission. Chair Gensler has asked staff to create a rule that will accelerate the process (which will take several years to complete) and result in a new round lot definition. He also asked staff to address if there should be a new odd lot best bid price.

3. **Execution quality:** Currently, investors have no effective way to assess the execution quality of their broker. Accordingly, staff has been requested to update Rule 605 which addresses this question so that investors receive better information on the point. The request includes fashioning a proposal that would require all reporters to file statistics on execution quality.
4. **Best execution:** FINRA and the MSRB have rules that require broker-dealers to use reasonable diligence so that their customers receive the most favorable prices under prevailing market conditions. Staff has been requested to fashion a similar rule for the Commission.
5. **Order-by Order-Competition:** The listed option exchanges have for years focused on assuring full competition among all market participants to provide the best prices for all retail investors. At the same time in the equity markets where most trade are executed there are questions about competition and gaps in the rules that don't necessarily require it. Staff has been asked to craft a recommendation centered on enhancing competition to get better prices.
6. **Payment for Order Flow:** Payment for order flow and rebates presents conflict of interest issues in the routing and execution of orders. Staff has been asked to assess the manner in which competition for order flow might be enhanced. Staff has also been asked to craft a best execution rule.

In the end, Chair Gensler views the markets as segmented and suffering from a lack of transparency. His proposals above are designed to improve those market conditions by enhancing transparency and competition to aid the retail investors. The debate over the merits of Mr. Gensler's proposals has already begun despite the fact that they have not been written. While there is no deadline for their completion, once they are published there should be little doubt that the real debate will begin.