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The SEC Equity Market Proposals: Communication Breakdown

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So it goes. The SEC's equity market proposals are as bewildering as they come, even for those of us who live and breathe market structure.

As the industry digests the proposals and initial reactions morph into responses, the overall tone resembles a food fight. The sell side is concerned about the explicit regulatory, compliance and technology costs. The buy side is eyeing the implicit effects on market quality and liquidity provisioning. Exchanges and venues need a plan to capture market share in a new world of retail auctions, enhanced market data and increased regulatory oversight.

It seems only the providers of compliance and regtech solutions are somewhat cautiously optimistic about the forthcoming changes.

Participants fear that the SEC's holistic and prescriptive approach takes on too much at once in a "big bang" that will cause more harm than good. Many are worried about unintended consequences and say their concerns are falling on deaf ears at the SEC. There’s a communication breakdown.

However, within the proposals themselves there are areas of support. The industry has been calling for more thoughtful tick sizes, reduced access fees and modernized 605 reporting for several years now.

At Coalition Greenwich, we have the privilege of speaking regularly with a variety of market participants—buy side, sell side, exchanges, and even retail investors. Several influential heads will be discussing their support, concerns and suggestions with us in our March 9th Market Structure Matters webinar. Register now, and in the meantime, here is some of what we’ve heard from the industry.

I Know What it is I Like About You ...

Most agree the **Disclosure of Order Execution Information** proposal is long overdue for an update. The rule hasn't seen much change since its adoption in 2000, and many folks in the industry like the Financial Information Forum has been calling for a refresh for years. Some are worried about the costs of implementation for smaller broker-dealers, but it doesn't seem like a huge obstacle.

Accelerating the **implementation of round lot sizing and odd lot transparency** supports the widely-praised Market Data Infrastructure Reform. There are some questions about how odd lots in the quote will affect performance metrics and TCA, but it's nothing that can't be figured out with a little effort.

Tick size reform and lower access fees have been on the industry's wish list for a while. Getting away from tiered-access fee pricing would increase transparency and provide a clearer understanding of execution costs pre-trade.

However, many would like the SEC to conduct a pilot program here. One participant suggests reducing tick sizes on highly liquid, tick-constrained names and lower their access fees to two different levels. This would show how market makers provide liquidity, how much impact fees have on behavior and whether liquidity increases at each price level. Comparing and adjusting segments would allow us to find the optimal levels of tick sizes and access fees in a transparent way that everyone can get behind. We can easily unwind these changes if they have a negative impact on market quality.

Healthy competition is good, and many agree order-by-order competition could make sense for retail orders. A pilot program could be beneficial here as well. Let the market compete and deliver the best price. Venue-by-venue competition gave rise to the wholesaler business, which some are uneasy about due to concentration risk. Regardless of how one feels about that business, most seem to agree less concentration risk would be better. We can at least find some reasonableness here.

Stop What You're Doin'… You'll Drive Me to Ruin …

Despite the areas of commonality, many valid questions and concerns persist. Most market participants we speak with believe the proposed **Order Competition Rule** is too prescriptive and prone to gaming. They ask who determines what’s “fair and open”? A flexible approach that doesn’t force retail order flow in a certain direction would allow for more innovation. The market itself would decide the number and types of venues needed, and overall get to a better and more flexible outcome.

On the buy side, some dispute the SEC's foundational premise that institutions are eager to engage with retail flow in lit auctions. It’s one thing to post hidden liquidity in the dark to provide liquidity, another to aggress or respond to a quote. Retail flow is no longer "dumb money"—it tends to come in waves, and institutions don’t like to be run over either.

Others ask when regulators will focus on the needs of institutions, many largely investing the money of mom-and-pop investors? They also ask who is advocating for these changes? After many conversations, we still find ourselves asking the same.

On the sell side, some worry **Regulation Best Execution** could bring MiFID-like order routing rules to the U.S. Must they prove fee-sensitive routing was suitable? One algo head speculates the SEC may use this to tackle the maker-taker model.

Lastly, some doubt the SEC's $1.5 billion "competitive shortfall" estimate based on Q1 2022 data, wondering if possible commission increases and service reductions will offset any benefits.

I Got Somethin' I Think You Oughta Know …

As we all navigate the ongoing story of SEC proposals and industry concerns, it's important to remember our responsibilities as interested parties and people of influence. Let's strive to be constructive, active players in this process rather than disappointed spectators.

While there may be areas of disagreement beyond our control, we should focus on working together in areas of mutual interest. Maintaining the U.S. equity market is a complex and ongoing task. It's up to all of us to balance political and practical considerations, and while we may not be able to control the final outcome, we can certainly help the process.

It's important to recognize that what we want, what we should have, and what we can get are often different things. And as the old saying goes, a good negotiation is one where everyone leaves a little disappointed.

Market Structure Matters: Finding Common Ground in the Equity Market Structure Proposals

March 9, 2023, 1:00 PM EST

Join Jesse Forster, Head of Equity Market Structure & Technology Research at Coalition Greenwich; Mett Kinak, Global Head of Equity Trading at T. Rowe Price; Michael Masone, Head of North America Market Structure at Citigroup Capital Markets; and Adrian Griffiths, Head of Market Structure at MEMX, for a lively discussion on the communication breakdown, areas of support and, most importantly, a path forward around the SEC's recently released equity market structure proposals.

Click here to register.

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