Equity Market Structure Rules – March 30th, 2023

1. Best Execution: Best execution refers to the obligation of broker-dealers to execute orders on behalf of their clients in a manner that maximizes the client's benefit, taking into consideration factors such as price, speed, and likelihood of execution. The SEC already requires broker-dealers to have policies and procedures in place to ensure best execution. However, the proposal is to set a best execution standard and framework for broker-dealers to follow. This could include requiring broker-dealers to use technology to route orders to the best possible venue for execution and to regularly monitor execution quality.

The example provided was the 2018 fine of Wells Fargo Advisors for failing to provide best execution to clients. The SEC found that Wells Fargo Advisors had failed to implement policies and procedures to ensure that its clients received the best possible execution. Specifically, Wells Fargo Advisors had used a third-party vendor to execute certain trades, but had not ensured that the vendor was obtaining best execution for its clients. The SEC's enforcement action highlights the need for stricter regulations to ensure broker-dealers are fulfilling their obligation to seek best execution.

2. Order Competition: The proposal to require all orders of individual investors to be placed in a central order book would promote fair competition and prevent certain market participants from having an unfair advantage. Currently, orders can be placed in dark pools or internalizers, where they are not visible to other market participants. This can give certain participants an unfair advantage, as they are able to see orders that others cannot. By requiring all orders to be placed in a central order book, all market participants would have equal access to the orders and the opportunity to compete fairly for them.

The example provided was the London Stock Exchange's implementation of a central order book in 2007. The central order book, called the London Stock Exchange's SETS (Stock Exchange Electronic Trading Service), consolidated all orders and provided real-time trading information to market participants. The implementation of SETS resulted in a significant increase in trading volume and liquidity, demonstrating the effectiveness of a central order book in promoting fair competition.

3. Tick Sizes: Tick sizes refer to the minimum price increment at which a security can be quoted or traded. The proposal to set standard tick sizes for all securities would level the playing field for retail and institutional investors. Historically, market makers have taken advantage of small price differences to trade in odd-lots, which can be more expensive for retail investors. Standard tick sizes would prevent this from happening and ensure that all investors are trading at the same price increment.

The example provided was the SEC's reduction of tick sizes for certain small-cap stocks in 2016. The SEC reduced the tick size from $0.01 to $0.05 for stocks with a share price of less than $2.50. The change resulted in narrower bid-ask spreads and increased liquidity, benefitting both retail and institutional investors. This example demonstrates the effectiveness of setting standard tick sizes in reducing trading costs and promoting liquidity.

4. Order Execution: The proposal to enhance disclosure requirements for order execution quality would increase transparency and competition in the market. Currently, brokers are required to disclose certain information about their order execution practices, such as how they handle orders and the venues to which they route orders. However, the proposal is to require brokers to disclose more detailed information, such as the quality of the execution obtained for different types of orders.

The example provided was the 2018 fine of Merrill Lynch for failing to provide accurate information on its order execution practices. The SEC found that Merrill Lynch had provided misleading information to its clients about the quality of the execution it had obtained for certain orders. Specifically, Merrill Lynch had provided data that made its execution quality appear better than it actually was