Policy Spotlight

BlackRock's take on the SEC's proposed equity market structure reforms

In December 2022, the U.S. Securities and Exchange Commission (SEC) proposed four separate rulemakings related to U.S. equity market structure.[1]

BlackRock is supportive of efforts to ensure that the rules underpinning the objectives of the U.S. national market system meet the statutory and regulatory aims of creating efficient, fair, and orderly markets. As a fiduciary to its clients, BlackRock is also supportive of regulatory measures that reinforce central tenets to market integrity and investor protection, and we commend the SEC for their continued attention to these important matters.

To support the SEC's rulemaking process, BlackRock contributed a comment letter that addressed various aspects of each of the proposed rulemakings (available here).

A summary of BlackRock's views on certain key provisions of the proposed rules follows:

1 The proposals should not be considered in isolation and implementation dates should be sequenced

- We believe that the market structure changes contemplated under each proposal are inextricably linked
- As such, these proposals must be considered individually as well as in relation to one another for any potential effects on markets, investors, and other market participants to be well understood
- The interaction between these proposals and other recent SEC proposals that impact market structure should also be examined[2]
- We recommend that the SEC sequence the implementation dates of the proposals so that the Commission (and market participants) can effectively identify and address any externalities created by the rule changes
- Due to the far-reaching and consequential nature of these proposals, we also recommend that the SEC staff produce detailed analyses on the cumulative and individual effects of the proposals no later than 24 months after implementation

2 We support updated, centralized disclosure of order execution information

- We are generally supportive of amendments that would update the disclosure required under Rule 605 of Regulation NMS for order executions in stocks listed on a national securities exchange[3]
- We believe that the order execution disclosures required by Rule 605 are a valuable source of information for investors to compare and evaluate executions and that improvements to the quality of the data would enhance its utility
- We recommend, however, that the SEC consider revising the proposed rule to leverage data collected by the Consolidated Audit Trail ("CAT") to generate Rule 605 reports
- We believe using a centralized processor would be more cost-effective and less burdensome for market participants, and could eliminate inconsistences or errors that may arise from reporting firms each compiling their own reports[4]
- Additionally, we support the proposal to centralize Rule 605 data in an electronic system as we believe it would not only substantially improve investors' ability to efficiently access this data, but also drive greater utilization of the data

All source information can be found in the Endnotes section. The opinions expressed are as of April 2023 and may change as subsequent conditions vary.

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3 We support the adoption of a tiered and targeted minimum pricing increment (“tick size”) framework for quoted spreads

- We believe that when properly calibrated, tick sizes—the minimum pricing increment of a trading instrument—can foster price discovery and market quality and encourage liquidity formation
- We agree with the SEC that a “one-size-fits-all” approach to tick sizes would likely result in market inefficiencies that impose unnecessary costs on investors
- However, we have proposed recommendations that we believe would help the SEC to better determine the criteria for each pricing increment and avoid assigning tick sizes that are either too small or too large
- We believe that introducing a sub-penny tick size for tick-constrained securities (i.e., those stocks that consistently trade with a penny increment) is likely to boost competition and opportunities for price improvement, resulting in a better trading environment for investors[5]
- However, we believe it would be prudent to refrain from introducing multiple sub-penny increments until an empirical analysis can be conducted to better understand the full effects of these increments on market quality
- As such, we recommend that the SEC limit tick sizes for securities priced greater than $1.00 per share to three increments initially set at $0.05, $0.01, and $0.005[6]
- We suggest that the SEC adopt a tick size larger than $0.01 to improve market quality for securities with wide spreads where a penny pricing increment is diminutive
- Additionally, we recommend that the SEC eliminate its proposed amendments to apply the minimum pricing increments to trading as well as quoting (also known as “tick harmonization”) as we believe this could eliminate price improvements that investors benefit from today[7]

4 The SEC should consider implementing a tiered access fee cap structure[8]

- We recognize that access fees and the rebates that they fund serve an important function in incentivizing liquidity provision for thinly traded securities and compensating liquidity providers for adverse selection; however, we agree with the SEC that access fees are outdated and oversized relative to other trading costs
- Analogous to our position on tick sizes, we believe that markets would be best served by a tiered access fee cap framework where fees for the most liquid securities are reduced, but fees (and, consequently, rebates) for illiquid securities are kept constant or increased

5 Competition for retail orders should be fostered through more flexible mechanisms

- Markets become more efficient and price discovery is enhanced when a wide range of buyers and sellers with diverse perspectives can interact with one another
- As such, we support market structure modifications that better enable market participants to engage with and compete for retail orders because we believe that a more inclusive and competitive market translates to better execution for investors
- However, we have concerns around the complex, highly prescriptive nature of the qualified auction framework proposed by the SEC as part of the Order Competition Proposal[9]
- As an efficient and effective alternative, we propose fostering the development of existing Retail Liquidity Programs (“RLPs”) and midpoint matching facilities by eliminating structural impediments to the broader adoption of these mechanisms
- We believe that reforms that remove obstacles preventing retail orders from effortlessly accessing midpoint liquidity may be easier to implement and less disruptive than establishing qualified auctions

6 Best execution requirements provide important protections for investors

- Best execution has long been a crucial obligation of broker-dealers, which protects investors and ensures fair and equitable dealings in less transparent markets or where there may be conflicts of interest
- We believe that the Financial Industry Regulatory Authority (FINRA) and Municipal Securities Rulemaking Board (MSRB) best execution rules have served investors and markets well
- Should the SEC decide to promulgate its own best execution rule, we recommend explicitly incorporating additional determinants of best execution by replicating the well-ingrained considerations in FINRA and MSRB rules
- While price is one primary consideration, there are many other factors that drive best execution; we believe that the SEC's proposed language for a best execution standard insufficiently addresses these other factors and places undue emphasis on price
- We also recommend that the SEC eliminate the proposed exemption for institutional customers executing an order against a broker-dealer's quotation, as we believe this is antithetical to the need for best execution in less transparent markets
- For example, as proposed, Regulation Best Execution would largely not apply for institutional investors trading fixed income securities; however, market participants in fixed income benefit more from a best execution rule because they do not have access to the same amount of price transparency as stocks listed on national exchanges
- As such, we believe that in a best execution rule would continue to serve as an invaluable investor protection in scenarios where an institutional investor executes against a single dealer's quotation

Endnotes

1. For more on these proposals, see the SEC's Press Releases: Proposed Regulation Best Execution, Proposed Rule to Enhance Order Competition, Tick Sizes, Access Fees, and Transparency of Better Priced Orders, and Disclosure of Order Execution Information.
2. For example, Amendments Regarding the Definition of "Exchange" and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities *available at* https://www.sec.gov/rules/proposed/2022/34-94062.pdf and Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer *available at* https://www.sec.gov/rules/proposed/2022/34-94524.pdf.
3. See Disclosure of Order Execution Information
4. According to SEC estimates, there are 272 existing report firms, as well as 103 new entities that would have to comply with the expanded scope of the proposal. Source: Proposed Rule: Disclosure of Order Execution Information (sec.gov)
5. Today, the minimum price increment for national market securities priced greater than $1.00 is $0.01
6. We would support a potential reduction to as small as $0.002 if warranted after observing the effects of a $0.005 tier
7. The SEC observes that investors receive approximately $3 billion of price improvement annually due to sub-penny executions which are currently permitted under Rule 612. Source: Proposed Rule: Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better (sec.gov)
8. Access fees are fees charged by an exchange for the execution of an order; they are frequently used to fund rebates to broker-dealers that provide liquidity on the exchange
9. See Proposed rule: Order Competition Rule (sec.gov)

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