Securities Regulation Daily Wrap Up, SEC NEWS AND SPEECHES—SEC proposes rule to enhance competition for investor orders, end 'competitive shortfall', (Dec. 15, 2022)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By Suzanne Cosgrove

The proposed Rule 615 would require certain orders placed by individual investors be exposed to competition in open auctions before being executed internally by trading centers that restrict order-by-order competition.

In one of four proposals and one final rule that are expected to have a material effect on the U.S. equity markets, the SEC on Wednesday approved a rule proposal that attempts to open up competition for orders by prohibiting restricted competition trading centers from executing certain orders of individual investors unless the orders are first exposed to competition in a qualified auction (Order Competition Rule, Release No. 34-96495, December 14, 2022).

Currently, broker-dealers route more than 90 percent of marketable orders of individual investors in National Market System (NMS) stocks to a small group of six off-exchange dealers, often referred to as wholesalers, the SEC said in a release. The wholesalers typically execute the marketable orders of individual investors internally, without providing an opportunity for other market participants to provide better prices. As a result, the orders are not just segmented, they are isolated from order-by-order competition, the agency said.

"Today's markets are not as fair and competitive as possible for individual investors—everyday retail investors. This is in part because there isn't a level playing field among different parts of the market: wholesalers, dark pools, and lit exchanges," said SEC Chairman Gary Gensler in a statement. "Further, the markets have become increasingly hidden from view, especially for individual investors. … (who) don't have the full benefit of various market participants competing to execute their marketable orders at the best price possible."

Shortfall's estimated price tag. While wholesalers provide some price improvement to these orders relative to prices available on national securities exchanges for unsegmented order flow, the SEC said its data analysis suggests that price improvement falls short of what would be expected if these orders were subjected to order-by-order competition. The Commission estimated the "competitive shortfall" is 1.08 basis points per dollar traded by wholesalers, for a total annual amount of $1.5 billion.

If adopted, Rule 615 proposed to amend the regulation governing the national market system (NMS) under the Securities Exchange Act of 1934. Generally, it would prohibit a wholesaler from internally executing "segmented orders" for NMS stocks for clients who have an average number of trades of less than 40 in each of the six preceding calendar months—unless the orders are first exposed to competition in a qualified auction operated by an open competition trading center.

The rule includes some exceptions to this prohibition, such as for segmented orders received and executed when no qualified auction was available, segmented orders with market values of at least $200,000, and segmented orders executed at prices equal to or more favorable for the orders than the midpoint of the national best bid and offer (NBBO) when the orders were received.

Dissenting responses. Rule 615 was passed by the Commission in a 3-2 vote. In a statement voicing her objections to the rule, Commissioner Hester Peirce said the "competitive shortfall," referenced in the Rule "ignores the fact that the current market is not static."

Peirce suggested the Commission take a lighter touch, saying issuing decrees about how each order should be routed was outside its role. "As new competitors come into the markets, retail orders will likely enjoy even more

© 2025 CCH Incorporated and its affiliates and licensors. All rights reserved.

price improvement than they already do, and wholesalers' profits will fall," she said. "If the market for retail order flow is as profitable for wholesalers as the proposing release suggests, we should expect to see more entrants," she said.

Also taking issue with the proposed rule, SEC Commissioner Mark Uyeda said since the last update of Regulation NMS in 2005, trading fees have declined and "spreads are tighter than ever."

"In the securities markets, orders do not compete; venues compete to facilitate transactions that their clients desire with best execution," Uyeda said. "A focus on order-by-order competition, without accounting for the costs of providing the venue that provides this service, may be fine in the theoretical world of academia, but will not work in the real world."

Along with the three other rules proposed by the SEC, Rule 615 is open for comment through March 31, or 60 days after it is published in the Federal Register, whichever is later.

The release is No. 34-96495.

RegulatoryActivity: BrokerDealers CorporateGovernance ExchangesMarketRegulation GCNNews SECNewsSpeeches SecuritiesOfferings

© 2025 CCH Incorporated and its affiliates and licensors. All rights reserved.