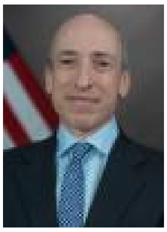
Statement

Statement on Proposal to Enhance Order Competition



Chair Gary Gensler

Dec. 14, 2022

Today, the Commission will consider a proposal to require a certain segment of the equity market — marketable orders of individual investors — to be exposed to competition in fair and open auctions. I am pleased to support this proposal because, if adopted, it would promote competition for the orders of individual investors, to the benefit of these investors and our capital markets as a whole.

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. Further, the markets have become increasingly hidden from view, especially for individual investors.

These everyday individual investors don't have the full benefit of various market participants competing to execute their marketable orders at the best price possible. For example, individual investors don't necessarily get the best prices that they could get if institutional investors, like pension funds, could systematically and directly compete for their orders.

Many of the rules governing the national market system haven't been updated since 2005. In the meantime, developments in the in the markets have resulted in a market structure that is less competitive, less transparent, and more concentrated than it should be for individual orders. As the release notes, "Broker-dealers route more than 90% of marketable orders of individual investors in [National Market System] stocks to a small group of six off-exchange dealers, often referred to as 'wholesalers.'"

Some suggest that this segmentation and isolation of orders allows retail investors to receive slightly better prices than they could otherwise. As the release notes, though, "Wholesalers do not display or otherwise reveal the prices at which they are willing to execute individual investor orders internally." The release later notes, "In other words, wholesalers generally do not compete for order flow by posting competitive prices the way exchanges do." Thus, price improvement without order-by-order competition isn't necessarily the best price improvement.

Why are retail market orders so attractive to wholesalers? Such retail orders have lower adverse selection risk — meaning, there's a lower possibility that share prices will move in response to executing against these individual market orders. One major reason for this is that individual investors, making small numbers of trades, don't typically generate larger price movements. In other words, these retail orders are attractive to wholesalers because, compared with other types of order flow, they have lower adverse selection risks. The Commission's data analysis shows that wholesalers do not provide the level of price improvement that one might expect from a fully competitive market given the lower adverse selection risk of their segmented orders. Further, as I mentioned, wholesalers operate in the dark market.

Thus, today's proposal is designed to bring greater competition in the marketplace for retail market orders. Right now, a concentrated group of wholesalers earns significant revenues from this market. They're willing to pay for this order flow, but as the release notes, investors may not be getting the benefit of full competition in this market, despite the attractiveness of their orders.

As the release notes, "opening up individual investor orders to order-by-order competition would lead to significantly better prices for those investors." The competitive shortfall could be worth about $1.5 billion annually, compared with current practice — money that could go back into retail investors' pockets or portfolios.

I think it makes sense for the market, and for everyday individual investors, to allow the broader market to compete for their attractive orders.

As my colleagues have discussed, the proposal would require marketable orders of individual orders to be exposed to competition on an order-by-order basis in qualified auctions prior to being internalized off-exchange. These auctions would apply to marketable orders made by or on behalf of natural persons who are making trades of less than $200,000 and trade on average fewer than 40 times per day. There's also an exception for trades internalized at midpoint or better.

Thus, I am pleased to support today's proposal and, subject to Commission approval, look forward to the public's feedback. I'd like to thank the members of the SEC staff who worked on this rule, including:

- Dan Gray, Haoxiang Zhu, David Saltiel, Andrea Orr, Roni Bergoffen, Marilyn Parker, David Shillman, Eric Juzenas, Jennifer Dodd, Stacia Sowerby, Keegan Murphy, Alex Jadin, Mark Donohue, Yue Ding, Jennifer Colihan, and Will Miller in the Division of Trading and Markets;
- Benjamin Liebman, John Ritter, Jessica Wachter, Oliver Richard, Lauren Moore, Charles Woodworth, Amy Edwards, Jill Henderson, Julia Reynolds, Patti Vegella, Paul Hughes, Qiyu Liu, Daniel Bresler, Yashar Barardehi, and Don Edmond in the Division of Economic and Risk Analysis;
- Dan Berkowitz, Megan Barbero, Meridith Mitchell, Malou Huth, Robert Teply, Janice Mitnick, Cynthia Ginsberg, Ronesha Butler, Tracey Hardin, Brooke Wagner, and Daniel Staroselsky in the Office of the General Counsel;
- Jean Minarick in the Division of Investment Management; and
- Constance Kiggins and Michael Hershaft in the Division of Examinations.