Contrary to the public narrative, the industry's comment letters demonstrate that there is broad support – especially from investors – for key aspects of the SEC's proposed reforms to U.S. equity markets.

Now that the formal period for comment on the SEC's equity market structure reforms has closed, it is worth taking stock of the industry and investor comment letters that have been submitted thus far. We expect the debate (and additional letters) will no doubt continue for some time. The overall impression created by most of the press coverage is that the reaction overall is highly negative. The general narrative is that industry stakeholders are united in opposing the reforms overall.

In fact, a review of the letters paints a very different, and much more nuanced, picture. At IEX Exchange, we have conducted a summary review of the comments (we do not pretend to have read all of the thousands of pages submitted to date). Our takeaway is that there is broad support for updating the rules in various respects to take account of the profound changes in the equity markets that have transpired since the rules known as Regulation NMS were adopted in 2005.1

To recap, the SEC issued four separate proposals directed to different aspects of the existing market structure:

- A proposal to update and expand the "market quality" data required to be reported by various market venues under SEC Rule 605, and to require broker-dealers handling large numbers of customer accounts to publish these reports ("Rule 605 Changes").2
- A proposal to amend specific Regulation NMS rules concerning minimum tick size and trading increments, exchange fees, and the implementation of new "round lot" sizes and the addition of "odd-lot" quotes in consolidated market data ("Regulation NMS Changes").3
- A proposal dubbed the Order Competition Rule ("OCR"), which would require certain orders from retail investors to be exposed to an auction mechanism before those orders could be "internalized" by wholesaler firms.4
- A proposal to adopt a new SEC rule governing the responsibility of broker-dealers to obtain best execution for their customers' orders ("Best Execution Proposal").5

The Big Picture

A very large number of industry participants, both buy-side and sell-side, have responded in writing to the SEC proposals. Their responses are in addition to the literally thousands of letters submitted by individual retail investors, which include both individualized and "form" letters. The letters from individuals address many topics but most reflect strong opposition to payment for order flow ("PFOF") and exchange rebate practices. It is worth noting that the SEC's proposals did not include a ban or other restriction on PFOF. Nonetheless, the individual letters are an important indicator of the attitudes by many individual investors on the current proposals and where they would like to see the SEC direct its attention.

In terms of industry comments, our high-level conclusions are as follows:

- As expected, the OCR has proved the most controversial of the four, with negative comments focusing both on the requirement to use an auction mechanism and well as various aspects of the specific auction design the Commission proposed.
- At the opposite end of the spectrum, the Rule 605 Changes have been largely non-controversial, and letters that address the proposal have largely focused on technical aspects, not the thrust, of the updated disclosures.
- The Best Execution Proposal has also proved controversial, though comments are more split than on the OCR. A significant number of commenters express openness to a separate SEC best execution standard. In general, letters of this type also express concerns about specific aspects of the proposal, including the potential for conflict or confusion related to other best execution rules and how the rule would treat obligations to institutional, compared to retail, investors.
- On the Regulation NMS Changes, there is substantial support to update the rules, with most of the debate and comment focused on the details of narrower tick sizes.

Drilling Down on Regulation NMS

The proposed Regulation NMS Changes by themselves have the potential to have significant impacts on the pricing and efficiency of trading, competition among venues, and market transparency. For this set of proposals in particular, it is easy to lose the forest in the thicket of trees. IEX previously published a series of blog posts detailing the background and details around each component of the Regulation NMS Changes, along with various alternatives the SEC asked for commenters to weigh in on.6

The remainder of this post revisits each of those components and gives our summary of how the comments break out. IEX Exchange submitted its own letter on the Regulation NMS Changes, with detailed analysis and data to support the views expressed, which are also summarized below.

Tick Increments

The Commission proposed to replace the existing uniform tick size of one cent with a set of four new tick size “tiers,” ranging from one cent down to one-tenth of a cent. Tick sizes would be allocated to individual securities based on the average “spread” between the national best bid and offer prices (“NBBO”) during a prior month’s trading, and the allocation of tiers to stocks would be redone each quarter. For example, a stock with an average spread between .8 cents and 1.6 cents during the month preceding a new quarter would be assigned a tick size of $0.002 (one-fifth of a cent) for that quarter. In general, the purpose was to allow markets, and especially exchanges, more flexibility in quoting stocks where prices are now “tick-constrained,” or could become so constrained, by the one cent tick limitation.

Commenter Views

The comment letters overwhelmingly favor a simpler system that adopts one of the SEC’s proffered alternatives, by adopting one-half cent as the narrowest tick size. This view is expressed by a broad spectrum of sell-side and buy-side (including asset manager and public pension fund) representatives. Some letters suggest that the Commission could consider the use of narrower increments in the future, but only after first gaining experience with the use of half-cent ticks. The arguments against tick sizes narrower than a half-cent are highly consistent. They include concerns around too much complexity, an increase in “flickering quotes,” and negative impacts on institutional investors in being able to provide or access displayed orders, among others.7

A related question is how, and how broadly, to apply the half-cent tick size to individual stocks. Here, views are more mixed. Most letters suggest that half-cent ticks should be applied only to stocks that are “tick-constrained,” but there are differing views on how to define that group. Many letters that are specific on this point would apply the narrower tick to stocks with an average spread of 1.1 cents, while a few letters would apply it to a broader set of stocks. Some letters recommend that the Commission consider additional factors, in addition to average spread, as filters to determine which stocks qualify for the lowest tick size. Another set of comments argue that the Commission should include or consider a wider tick size, for example, two cents or five cents, for relatively illiquid stocks.8

Finally, a significant cross-section of participants, spanning exchanges, sell-side, and buy-side participants, endorse applying an exception to the minimum tick increments, to allow exchange retail liquidity programs (“RLPs”) to fully display the price and size of orders that offer liquidity to retail orders in tenth-cent increments.9

These programs are today limited in how much transparency they can provide by the one-cent tick limitation. A group letter by pension fund representatives supports this idea, in the context of supporting more opportunities for orders of retail and institutional investors to interact.

IEX View

We agree with the general view that the SEC should set a narrower tick increment at one-half cent, and we would apply that increment to all stocks with an average spread of up to two cents. We agree with the proposal to allow exchanges to fully display orders in their retail programs in tenth of a cent increments.10

Trading Increments

The SEC proposed to adopt the four-tier tick increments as harmonized trading increments. All trades, whether on or off exchange, would be required to trade in those increments, subject to specific exemptions, for example, for trades executed at the midpoint of the NBBO.

Commenter Views

One set of letters oppose the use of common trading increments. Many letters, however, support this concept but argue that a common trading increment need not be harmonized with tick increments. Comments from a broad spectrum of participants (exchanges, buy-side and sell-side firms) favor one of two alternatives offered by the SEC. One alternative would adopt a common minimum trading increment of $0.001 for all trading. Another would adopt this same increment for trading with individual retail investors. Either iteration would, in effect, place a floor on the minimum level of price improvement for retail orders of at least one-tenth of a cent better than the NBBO (today, orders traded away from exchanges and ATSs can be executed in one-hundredths of a cent).11

This increment would also align with the tick increments proposed for RLPs, as described above.

IEX View

IEX favors using new tick sizes as trading increments, but would create an exception allowing retail execution systems, including RLPs, to quote and trade in $0.001 increments.12

Exchange Transaction Prices

The Commission proposed to reduce the existing cap on fees to access exchange quotes from $0.003 per share, or "30 mils" to $0.001, or "10 mils", for almost all stocks. The SEC proposed a lower access fee cap of 5 mils for stocks that would be subject to the narrowest of its proposed tick increments. The point of lower cap for that one group was solely to avoid the access fees amounting to more than half the minimum tick size.

Separately, the SEC proposed to require that exchanges set their volume-based pricing "tiers" on the basis of past volume, such that the amount of a fee or rebate attributable to each trade can be determined at the time of the trade.

Commenter Views

Virtually all the commenters addressing access fees support a reduction in the access fee cap for some or all securities. A substantial majority of letters from institutional investors favor an across-the board reduction in the access fee cap to 10 mils for all NMS securities, which largely aligns with the SEC proposal. This includes joint letters from a group of 15 large asset manager firms and from a group of 13 public pension plans, collectively responsible for trillions of dollars of individuals' managed and retirement assets. It also includes individual letters from firms such as Capital Group, Vanguard, and Invesco and from buy-side associations Healthy Markets Association and the Council of Institutional Investors, as well as from the public interest association Better Markets.13

Some sell-side letters also support a reduction in the cap to 10 mils, including letters from JP Morgan, BMO Capital Markets, and the American Securities Association.14

In general, letters taking this position point to: (i) the cost burden of high access fees imposed on institutional investors who need to access exchange quotes; (ii) the disconnect between high access fees, which have stayed static, and processing costs, commission rates, and spreads, which have all substantially contracted since the fee cap was set in 2005; (iii) an incidental benefit in reducing conflicts and inequities associated with rebates, which are typically funded from access fees; and (iv) the preference for a single cap, rather than the added complexity of multiple fee caps.

Another set of letters, primarily from other sell-side firms and large exchange companies, propose that the access fee cap be reduced, but only for stocks that are assigned a narrower tick size, and only in proportion to the reduction in the tick size.15

The letters generally do not specifically explain why access fees should be set in proportion to tick sizes. Often, this set of letters argues that sharply reducing access fees will reduce the ability of exchanges to pay rebates, which, the letters assert, are necessary to maintain liquidity for at least some types of stocks. The letters do not address the potential that exchanges could use financial resources other than access fees to pay rebates if they chose to do so.

On the provision to change the way that exchanges set volume-based tiers, all of the letters we have seen that specifically address this part of the proposal support it. Many letters urge the SEC to go further to prohibit or restrict the use of volume-based rebate tiers, based on concerns about their anti-competitive impact.

IEX View

IEX supports reducing the access fee cap to 10 mils for all NMS securities. We also support further action by the SEC to prohibit the use of tiers tied to consolidated average daily volume measures.16

Round Lots and Odd Lots

In 2020, as part of its Market Data Infrastructure Rule ("MDIR") reforms, the SEC ordered changes to the way that "round lots," which establish standard units of trading and affect which quotes are protected, is determined. The Commission ordered a move from a single standard of 100 shares, which applies to almost all stocks today, to a set of four different round lot sizes, based on the price of each security. At the same time, the SEC required that new competing consolidators, which would distribute data under the MDIR, be able to obtain and provide odd-lot quotes equal to or better than the NBBO.

As part of the Regulation NMS Changes, the SEC proposed to speed up the implementation of these reforms by requiring the existing securities information processors to incorporate the changes on existing consolidated data feeds, before the rest of the MDIR is implemented. The SEC also proposed to require that a new best odd lot bid and offer ("BOLO") be added to those data feeds.

Commenter Views

The letters addressing this aspect (including IEX's letter) reflect near-universal support for these changes in general. A few letters express concerns related to the addition of the BOLO component. In addition, the data processors and members of the operating committee for the data plans submitted a letter opining that implementation will require substantially more time than 90 days following adoption of the proposal, which was the timeline proposed by the Commission.

Conclusion

A review of industry comments on the Regulation NMS Changes reveals substantial support for many specific and impactful changes. These are the conclusions that emerge from our review:

- There is a general consensus in favor of reducing the tick size to one-half cent for some subset of securities, with varying views on how to define the stocks subject to that narrower tick size.
- There is substantial support for a common trading increment of $0.001, either as applied to all trading or to trading involving retail orders.
- There is substantial support to allow exchanges to fully display their orders that provide liquidity to retail investors, in increments of $0.001. Many participants, including buy-side investors, also support exploring other ways to incentivize orders of institutional and retail investors, to trade with each other.
- There is general support for reducing the access fee cap for some or all securities. There is also substantial support, especially from institutional investors, for a simple reduction in the cap to $0.001 for trading in all securities.
- There is a general consensus in favor of the proposal to limit the way that exchanges set pricing tiers.
- There is a general consensus in favor of the proposal to fast-track implementation of the round lot and odd-lot changes.

It is not surprising that there are many differing views on the individual aspects of regulatory proposals that are this broad and impactful. But we think it is fair to conclude that there is a great deal of support for individual changes that correspond either to the SEC proposals or to alternatives it laid out. That conclusion does not align with the prevailing narrative that the industry is united in opposition. But we believe it does align much more closely to the facts.

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1. See Securities Exchange Act Release No. 58108, 70 FR37496 (June 29, 2005).
2. See Securities Exchange Act Release No. 96493, 88 FR 3786 (January 20, 2023) ("Reg NMS Reform Release").
3. See Securities Exchange Act Release No. 96494, 87 FR 80266 (December 29, 2022).
4. See Securities Exchange Act Release No. 96495, 88 FR 128 (January 3, 2023).
5. See Securities Exchange Act Release No. 94696, 88 FR 5440 (January 27, 2023).
6. IEX, "The Clock is Ticking on Equity Market Reform" (February 7, 2023), avail. athttps://www.iexexchange.io/blog/the-clock-is-ticking-on-equity-market-reform; IEX, "Breaking Down the SEC Plan on Exchange Fees" (February 21, 2023), avail.at https://www.iexexchange.io/blog/breaking-down-the-sec-plan-on-exchange-fees; IEX, "The SEC Plan to Light Up Better Prices: Lots Still to Do" (March 13,2023), avail. at https://www.iexexchange.io/blog/the-sec-plan-to-light-up-better-prices-lots-still-to-do.
7. See generally comment file for the Reg NMS Reform Release athttps://www.sec.gov/comments/s7-30-22/s73022.htm.
8. See, e.g., Letter from Nasdaq, Inc. dated March 30, 2023; Letter from Blackrock, Inc. dated March 31, 2023 ("Blackrock Letter"); Letter from Themis Trading LLC dated March 31, 2023.
9. In addition to letters from exchanges, see, e.g., Letter from Ontario Teachers' Pension Plan Board, the Alberta Investment Management Corporation, the California State Teachers' Retirement System, the California Public Employees' Retirement System, the Canada Pension Plan Investment Board, the Teacher Retirement System of Texas. et al., dated March 31, 2023 ("Group Pension Fund Letter"); Blackrock Letter.
10. See Letter from Investors Exchange LLC dated March 20, 2023 ("IEX Letter"), at 6-15.
11. See, e.g., Letter from Brandes Investment Partners, L.P., et al. dated March 23,2023 ("Group Asset Manager Letter"); Letter from The Vanguard Group, Inc. dated March 31, 2023 ("Vanguard Letter"); Letter from Charles Schwab and Co, Inc. dated March 31, 2023 ("Schwab Letter"); Letter from Citigroup Global Markets, Inc. dated March 31, 2023 ("Citi Letter"); Letter from JPMorgan Chase & Co. dated March 31, 2023 ("JPMorgan Letter"); Letter from Healthy Markets Association dated March 31, 2023 ("HMA Letter");
12. IEX Letter, at 15-21.

13. Group Asset Manager Letter and Group Pension Fund letter, supra; Letter from The Capital Group Companies, Inc. dated March 31, 2023; Vanguard Letter; Letter fromm Invesco Ltd. dated March 31, 2023; HMA Letter; Letter from Council of Institutional Investors dated March 30, 2023; Letter from Better Markets, Inc. dated March 31, 2023.

14. Letter from American Securities Association dated March 31, 2023; JPMorgan Letter; Letter from BMO Capital Markets Corp. dated March 31, 2023.

15. See, e.g., Schwab Letter; Citi Letter; Letter from Morgan Stanley dated March 31,2023; Letter from Fidelity Investments dated March 31, 2023; Letter from Robinhood Markets dated March 31, 2023; Letters from MEMX, Nasdaq, and NYSE.

16. IEX Letter, at 21-28.