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Stock Markets

House Republicans Look to Overhaul SEC Market Structure Rule

House Republicans are eyeing potential changes to a 2005 SEC regulation that rewrote U.S. market structure pricing and data rules, now that their signature Dodd-Frank Act rollback has moved through the chamber.

First, however, lawmakers will decide how far to go as industry participants are divided between those who want a total overhaul of U.S. market structure and others who say more modest tweaks would suffice.

''There is not industry consensus on some of the places to go and directions to go,'' Rep. Bill Huizenga (R-Mich.), whose Financial Services subcommittee held a June 27 hearing on market structure, told Bloomberg BNA. ''We're trying to explore where we can find some common ground.''

The dividing lines among stakeholders aren't drawn neatly, as comments to the SEC demonstrate. Industry trade groups call for revisiting large chunks of the rule. Exchange representatives want to tailor order and pricing rules depending on how actively a stock trades.

''I don't think we need an entire holistic review, which the industry seems to be looking for,'' Joe Saluzzi, a partner at Themis Trading, told Bloomberg BNA in an interview.

Governance, Rebates One major point of contention between industry and regulators is the governance of the Regulation National Market System, known as Reg NMS, according to one industry source. Currently, market participants don't have a say in how the rule is implemented.

The securities industry also has concerns about the maker-taker model that provides rebates to traders that provide liquidity. Matt Lyons, Capital Group senior vice president, said at the June 27 hearing that the model needs to be changed to better serve the markets, but others want it scrapped entirely because of the incentive for market-makers to exploit the rebates.

''There's really an inside game here that's being played by some of the well-connected brokers and clearinghouses,'' Rep. Stephen Lynch (D-Mass.) told Bloomberg BNA in an interview.

Saluzzi said he wants Congress to push the SEC in the right direction, so it can get ahead of potential problems.

Maker-Taker Under maker-taker, market participants that remove liquidity also pay fees for removing that liquidity. The model is meant to encourage investors to provide liquidity and to keep spreads narrow, especially in lightly traded securities.

Critics of the system, including consumer advocates, academics, and some lawmakers, say that brokers route orders to maximize rebates rather than to achieve good price or execution for clients. Another common refrain is that maker-taker payments can create false liquidity by appealing to people who don't trade high volumes of shares.

Lynch has pushed legislation that would force the SEC to test moving away from the rebate model in stocks with less activity. ''It may actually provide greater liquidity for those stocks that are less frequently traded,'' he said.

''With rebates and maker-taker being out of the equation, I think that the decisions will not be made based on the size of the rebate and that it's more likely to be made on the basis of the best interest of the investor,'' Lynch added.

Lynch introduced legislation in the last Congress to require the SEC to study maker-taker pricing in the industry. That bill was never voted on by the House Financial Services Committee.

The SEC Equity Market Structure Advisory Committee recommended in July 2016 that the SEC run a two-year pilot program to adjust the access fee cap used in the maker-taker model. The SEC didn't act on the recommendation.

House Hearing Huizenga said his hearing was a first step in a lengthy process of making changes.

''This is an elephant,'' Huizenga said. ''How do you eat the elephant? One bite at a time.''

''We're making sure that everybody's getting heard on this and really soliciting engagement and input from folks about what's working and what's not working,'' he added.

Future Plans Huizenga is planning at least one more hearing with market participants, and the analysis is likely to further incorporate fixed-income securities.

''If this is what becomes the main thrust of my work on the committee, I would count that as a huge success,'' he said.

The issue of market fairness is likely to play a large role in any policy changes, either by Congress or among regulators.

''If we lose credibility because the average investor here in this country and investors around the world think that this system is fixed, that would be disastrous for the American economy and for our markets,'' Lynch said.

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