

“Trading Stocks in America: Key Policy Issues”

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Whom Should We Care About?

- Little comparative focus on bond markets
- Welfare of issuers and investors is key
- Market design is not about the platforms (NYSE, NASDAQ, ...) and their profits
- The platforms are the most vocal due to their business models
- Surprisingly politicized
- Issues evolving, but market design has been an issue for decades
- Ex ante orientation important
- Skeptical of extent focusing on glitches

More Broad Themes

- Don't evaluate issues in isolation
 - Equilibrium responses are crucial
- Retrospective analysis of NMS—what can we learn?
 - Competition within and across platforms
 - Fragmentation vs. centralization
- Tick size—pilot study could be helpful
 - Skeptical this is at the root of inadequate access to capital

Specific Themes

- Maker-Taker Pricing
- High-Frequency Trading (HFT)
- Are Rapid Cancellations Problematic?

Maker-Taker Pricing

- Absence of a consistent pricing standard
- Traders adjust strategy to try to execute on the opposite side to receive rebates
- Tick size is not consistently followed since net prices are inside the trading grid
- Rebates are not available to all market participants and often received by the broker rather than the customer
 - creates conflicts of interest in routing
- Effective rebates, fees have grown considerably since NMS, enlarging conflicts of interest

High-Frequency Trading

- Enhances liquidity and speed of execution
- Investment in speed, collocation is compensated for with a return on investment (selection problem?)
- Of course, investments in speed could be wasteful; How to determine?
- Minimum resting time?—Problematic because stuck orders can be exploited
- Small noise in timing would be preferred

Cancellations

- Why are orders often cancelled quickly?
 - Attempt to limit exposure when the order does not fill (e.g., because of changing conditions)
 - Avoid exposure to adverse selection
 - Old “fill or kill” orders
- SEC web site data suggests placements occur almost as quickly as cancellations
 - In equilibrium it is reasonable to expect a close connection between speed of cancellations and executions