SEC Proposes Equity Market Study: Beginning of the End for the Maker-Taker Model?

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In the first major trading and markets initiative under SEC Chairman Jay Clayton, on March 14, 2018, the SEC proposed to establish a transaction fee pilot program to study the effects of maker-taker fee structures. A pilot study was initially recommended by the SEC's Equity Market Structure Advisory Committee in 2016, and the Treasury Department also expressed support for such an initiative in last year's **report** on capital markets regulation (see our previous **blog post**). The outcome of this study could lead to further regulation or even elimination of these fee arrangements.

The maker-taker model is a predominant fee model in the U.S. equities market where a trading center pays its broker-dealer participants a per share rebate to provide (i.e., "make") liquidity in securities and assesses the other side of the trade a fee to remove (i.e., "take") liquidity. Under this structure, trading centers typically realize revenue from the difference between the fee paid by the "taker" of liquidity and the rebate paid to the provider or "maker" of liquidity. The SEC currently regulates exchange access fees. Rule 610(c) under Regulation NMS imposes a $0.0030 per share cap to prevent high access fees from undermining Regulation NMS's price protection and linkage requirements. Some market participants have expressed concerns that this fee cap has artificially pegged exchange fees at this rate, with most of the fee funding taker rebates, while market forces and technological advances have otherwise sharply driven down transaction fees.

The proposed pilot is intended to investigate the implications of the maker-taker model on order routing behavior, execution quality and market quality, as well as whether such fee structures create conflicts of interest for broker-dealers, who have a duty to pursue the best execution of their customers' orders.

The pilot would apply to all equities exchanges, but not to options exchanges or ATSs or other non-exchange trading centers. A chart highlighting the other key terms of the proposed pilot is provided below. Under the pilot, exchanges would have to publicly post various statistics and other information on their public websites. As proposed, the pilot would establish three "Test Groups" and a "Control Group." Each Test Group will consist of 1,000 stocks, and will be subject to specific fee constraints, as described below.

The pilot, if launched, will last for two years, with an automatic sunset at the end of the first year unless the SEC issues a notice extending it for another year and will also have a six-month pre-pilot and a six month post-pilot period. The pre-pilot period is intended to gather data to help establish a baseline against which to assess the effects of the proposed pilot, and the post-pilot program is intended to help assess any post-pilot effects following the conclusion of the proposed pilot. The SEC is requesting comments on all aspects relating to the scope and structure of the pilot program, and has provided a 60-day comment period. The pilot structure could be modified or scrapped altogether based on the comments received.

This pilot would provide the SEC with data which could inform future regulatory actions, including potentially limiting maker-taker fee structures. While the elimination of maker-taker models could potentially benefit investors by ameliorating a possible conflict that may affect brokers' order routing decisions, it would likely upend the competitive landscape for exchanges and the significant incentive they offer to liquidity providers.

Outline of the Proposed Transaction Fee Pilot		
Securities in Scope	NMS stocks with share price ≥ $2 per share that do not close below $1 per share during the proposed pilot, and that have an unlimited duration or a duration beyond the end of the post-pilot period	
Pilot Design	**Test Group 1 (1,000 NMS stocks)**	**$0.0015 fee cap** for removing and providing displayed liquidity (no cap on rebates)
	Test Group 2 (1,000 NMS stocks)	**$0.0005 fee cap** for removing and providing displayed liquidity (no cap on rebates)
	Test Group 3 (1,000 NMS stocks)	**Rebates and Linked Pricing Prohibited** for removing and providing displayed and undisplayed liquidity (Rule 610(c)'s $0.0030 cap continues to apply to fees for removing displayed liquidity)
	Control Group (Remaining Eligible NMS Stocks)	Rule 610(c)'s cap continues to apply to fees for removing displayed liquidity (no cap on rebates)