SEC: Recent microstructure markets regulatory actions. July 2010.

Since September 2009 the US SEC has been involved in adjusting the microstructure of the US markets. Several hinges have needed refurbishment. The US markets, in any product: equities, bonds, derivatives, have been the first markets in the world that have been subjected to a fierce competition among trading venues. As a result of that the regulated markets like NYSE and NASDAQ have shrunk in the home markets. Fragmentation, technology and constant innovations are raising new regulatory challenge to maintain the high level of protection of investors and the correct price formation that market participants demand. The SEC experience could help in the regulatory challenges that Spanish markets and European markets are facing. The main topics that are included in this short summary are: flash orders; short Selling restrictions and some consequences of the flash crash of 6 May 2010.
In September 2009 the SEC proposed a rule amendment that would ban the so-called "flash orders". This market order allowed the person who had introduced it in the computer system of the market to see the rest of the orders before the public were able to trade against the "flash order". Some markets had permitted those orders following the approach of the oldest open outcry market where the spoken order was only heard by the people closest to the person that voiced his intention. The Chair of the SEC considered that "*flash orders may create a two-tier market by allowing only selected participants to access information about the best available prices for listed securities*".

During 2009 the SEC also analysed the pros and cons of limiting or banning the short selling practices. In July 2007 the SEC removed all the short selling price test restrictions (the up tick rule). However, due to the severe markets conditions, the SEC, in 19 September 2008, established a ban on shelling short in 799 financial companies until 2 October 2008 and finally expanded it until 8 October 2008. With these experiences the SEC launched a consultation paper on 9 April 2009 which proposed two approaches to restrictions on Short Selling: one related to a permanent market wide basis and another which focused on temporary restrictions for a particular security if there is a significant fall in its market price. After the analysis of the answers the SEC adopted, in 24 February 2010, a new rule to place certain restrictions on short selling when a stock is experiencing significant downward price. If the price of a particular stock declines by 10% or more in one day from the prior day's closing the uptick rule will apply to short sale order in that stock for the remainder of the day and the day after. The uptick rule only allows investors sell short if the last price goes up a tick from the previous transaction.

The structure of the equity markets is also one of the SEC main worries. In 13 January 2010 the SEC issued a public consultation asking the market participants about, the new micro structure in the equity market and its impact in among investors. The main questions were: 1) What are the best metrics for assessing market quality? 2) Is the current highly automated high speed market structures fundamentally for investor? 3) High frequency trades: are these strategies beneficial or harmful for other investors? 4) Do co-location services (which enable exchange customers to potentially route orders faster by placing their computer servers in close proximity to an exchange's computer system) give proprietary trading firms an unfair advantage? 5) Dark liquidity: if the level of dark transactions is significant and whether those trades were brought to the market the price formation would cause narrow spreads. After the consultation period the SEC organised a public conference about those issues. It is expected that the SEC will publish its findings and resolutions at the end of 2010.

The SEC analysed the impact of the new micro structure of the equity market which was shaken by the "flash crash" on 6 May 2010, when some index and stocks prices plunged significant amounts in less than 5 minutes (the prices some stocks reached only one penny), and recovered their previous levels in a similar period. The SEC and CFTC released their initial findings on 18 May but they have not found yet a proper answer of the causes. However there have been two proposals so far: 1) the establishment of a trading halt system (circuit breaker) across the US equity market so that if a security drops more than 10% in the last five minutes all the markets where that security trades shall stop their transactions on that particular security for 5 minutes; and 2) setting up a annulment system of transactions when the prices of those trades diverge from a public "reference price" like a percentage of the circuit breaker trigger prices.

If you are interested in more details you can click on:

Press Release SEC Proposes Flash Order Ban; 2009-201; Sept_ 17, 2009.mht:
http://www.sec.gov/news/press/2009/2009-201.htm

Press Release SEC Approves Short Selling Restrictions; 2010-26; Feb_ 24, 2010.mht
http://www.sec.gov/news/press/2010/2010-26.htm

Press Release SEC Issues Concept Release Seeking Comment on Structure of Equity Markets; 2010-8; Jan_ 13, 2010.mht
http://www.sec.gov/news/press/2010/2010-8.htm

Press Release SEC-CFTC Release Preliminary Findings in Review of May 6 Market Events; 2010-81; May 18, 2010.mht
http://www.sec.gov/news/press/2010/2010-81.htm

Press Release SEC Proposes Consolidated Audit Trail System to Better Track Market Trades; 2010-86; May 26, 2010.mht
http://www.sec.gov/news/press/2010/2010-86.htm

Press Release SEC Approves New Stock-by-Stock Circuit Breaker Rules; 2010-98; June 10, 2010.mht
http://www.sec.gov/news/press/2010/2010-98.htm