SIFMA Insights

Spotlight: Market Structure Thoughts

April 2022

Key Takeaways

Regulatory conversations around equity and listed options market structure continue. The Russia/Ukraine war brought back higher volatility – the VIX was 25.75 in February and 27.02 in March (+20.6% and +26.5% to December 2021 average respectively), with April to date more in line with December 2021 at 21.70. As such, we thought it would be interesting to reiterate some of our key points on market structure:

- Resiliency: COVID. GameStop. Russia/Ukraine. Markets continue to prove their resiliency. In fact, the SEC report analyzing the GameStop event underscored this.
- Retail: Retail investor participation levels estimated at 20-30% for equities and 30-40% for listed options. $0 commissions seen as the key factor for both the growth in and maintaining retail investor participation.
- Regulation: Caveat emptor. Markets – and retail investors – will have to assume the risk that new or rushed regulations may fail to meet expectations or have unintended consequences.

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Market Resiliency

Two years ago, COVID caused the world to shut down, bringing extreme economic and market turmoil. Mass shut downs also forced almost all financial services employees to work from home. While the industry had tested a few remote work sites, it had not tested a scenario with the magnitude of everyone working remotely at the same time.

Markets faced extreme volatility – the VIX peaked at 82.69 in March, +563% from the start of the year – and experienced multiple 1,000 point intraday price swings. Physical trading floors closed. Yet, equity and options markets remained open and functioning. While it was not without some hiccups, the financial system and market infrastructure remained very resilient. And markets eventually settled from the COVID-related turmoil. The December 2020 average VIX was 22.37, -72.9% from the March peak.

Then 2021 began, and volatility resurfaced. In the last week of January 2021, members of the group WallStreetBets joined together to squeeze short sellers in a handful of stocks, such as video game and consumer electronics retailer GameStop. Retail investors joined in on the trade, driving up the price of GameStop over 1,000% to its 2020 average price, ever after being called the GameStop event. This in turn moved the VIX sharply higher. The average VIX for the GameStop week was 29.34, +31.2% to the December 2020 average. January 2021 VIX averaged 24.91, +11.3% to the December 2020 average, and peaked at 37.21, +66.3% to December 2020. The GameStop week average volatility was in line with the full year 2020 average, a year that included months of elevated VIX levels during the height of the global pandemic.

Despite this, markets again proved their resiliency. The SEC report analyzing the GameStop event underscored this fact.

Retail Investor Participation

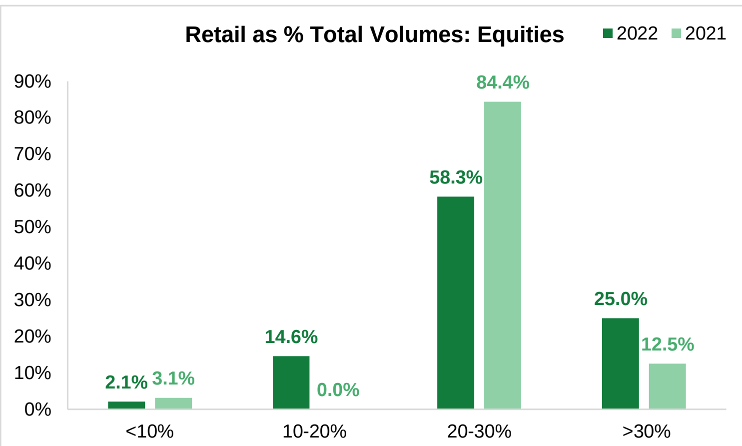
In spite of what some expected, the retail revolution of January 2021 did not slow down. In fact, much of the growth in equities and listed options volumes in 2020/2021 has been attributed to increased participation by retail investors. Earlier this year, we surveyed our equity and listed options trading committees and exchange representatives – the very people executing retail (and institutional) trades – to gauge volumes and retail participation levels.

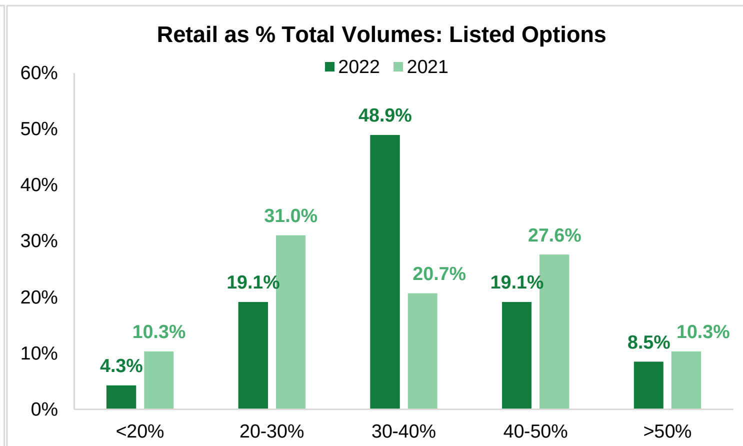
- **Equity Markets**
    - ADV expected to remain around 10 billion shares (74.0% of responses), with very few people (10.0% of responses) expecting a return to historical levels (~7 billion shares)
    - 2021 retail participation estimated at 20-30% of the total market (58.3% of respondents), versus around 10% historically, with 43.8% of respondents expecting this to decrease somewhat
- **Listed Options Markets**
    - ADV expected to remain in the mid-high 30s million contracts (52.1% of responses), with very few people (4.2% of responses) expecting a return to historical levels (~19 million contracts)

  - 2021 retail participation estimated at 30-40% of the total market (48.9% of respondents), with 36.7% of respondents expecting this to decrease somewhat

When comparing this year's survey to last, we highlight the following changes:

- **Equity** – Retail participation top estimate remains the same at 20-30%, but the conviction rate for this level was lower this year, 58.3% vs. 84.4%
- **Listed Options** – Retail participation top estimate increased to 30-40% up from 20-30%, and the conviction rate for the top response increased, 48.9% vs. 31.0%





Source: SIFMA Insights market structure survey

What drove the growth in retail participation? Moving up to the top, $0 commissions is now seen as the key factor for the growth in retail investor participation, up from #3 last year. Technology/platform access remained the second most important factor (#2 this year and last year). In other words, retail investors like the ease of access and affordability of trading.

Growth Factors	2022 Survey	2021 Survey
$0 commissions	#1	#3
Technology/platform access	#2	#2
Continued WFH	#3	
Interest in markets/investing	#4	
Fractional share trading	#5	#6
Lockdowns/staying at home		#1
Money saved		#4
No sports/gambling		#5
March 2020 lows opportunities		#7
Interest in stay-at-home stocks		#8

As to maintaining retail investor participation, $0 commissions was also the top factor, up from #3 last year. Providing a positive investing experience remained the second most important factor (#2 this year and last year).

Maintaining Factors	2022 Survey	2021 Survey
$0 commissions	#1	#3
Positive Investing Experience	#2	#2
Upward Market Momentum	#3	#1
Investor Education	#4	#4
Customer Service	#5	#5
Retail Product Offerings	#6	#6

Regulatory Changes

Regulatory conversations around market structure continue. While listed options have not been without scrutiny, the focus of most conversations has been on U.S. equity market structure (EMS). We acknowledge that markets have evolved since Regulation National Market System (Reg NMS) began in 2006, meaning a review may be warranted. However, as indicated by SEC Commissioner Hester Peirce, opening one aspect of EMS – which has a lot of tentacles – could cause unintended consequences in other areas. Such unintended consequences must be considered and analyzed.

Commissioner Peirce reiterated that the equity markets work very well, and the retail investor has never had it better – and SIFMA agrees – in terms of costs ($0 commissions) and access. We point to our survey results above. $0 commissions ranked as the top factor for why retail investor participation has grown as well as for how to maintain retail investor engagement. If changes to EMS were to increase costs to trade, it could negatively impact retail investor participation. Commissioner Peirce indicated this would not be a good result, as “everyone should have cheap, efficient access to markets.” The industry has worked for years to democratize investing, and it would be disappointing to reverse the positive trends we have seen in retail investor participation.

One other point we would like to add is that while the SEC is currently focused on EMS, the growth in retail participation has certainly increased regulatory scrutiny in listed options as well. What would be concerning to us is if regulators lumped these markets together when setting policy. Yes, equities and listed options are related – single-stock options represent around 95% of total listed options volumes. However, the market structure differs across these asset classes. For example, listed options are quote driven markets versus order driven in equities. Regulatory changes should not be considered as a one-size-fits-all solution for both asset classes.

We’ll leave you with this…caveat emptor. Markets – and retail investors – will have to assume the risk that new or rushed regulations may fail to meet expectations or have unintended consequences.

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