



Highlights of [GAO-04-968T](#), a report to Committee on Banking, Housing, and Urban Affairs

Why GAO Did This Study

In 2001, U.S. stock and options markets, which had previously quoted prices in fractions, began quoting in decimals. Since then, various positive and negative effects have been attributed to the transition to decimal pricing. As part of this transition, the major stock markets chose one penny (\$.01) as the minimum price variation for quoting prices for orders to buy or sell. However, some electronic trading systems allowed their customers to quote in increments of less than a penny (such as \$.001). The use of subpenny prices for securities trades has proved controversial and the Securities and Exchange Commission (SEC) has proposed a ban against subpenny quoting for stocks priced above one dollar across all U.S. markets.

As part of ongoing work that examines a range of issues relating to decimal pricing, GAO reviewed (1) how widely subpenny prices are used and by whom, (2) the advantages and disadvantages of subpenny pricing cited by market participants, and (3) market participants' reactions to SEC's proposed ban.

www.gao.gov/cgi-bin/getrpt?GAO-04-968T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Davi D'Agostino at (202) 512-8678 or dagostinod@gao.gov.

SECURITIES MARKETS

Preliminary Observations on Subpenny Pricing

What GAO Found

Data on the extent to which market participants are quoting in subpenny increments across all U.S. equity markets are not routinely reported or readily available. However, studies of limited scope conducted by regulators and one market found that subpenny prices were not widely used. For example, a study done by the Nasdaq Stock Market in 2001 of Nasdaq stocks found that subpenny increments were used in less than 15 percent of the orders that specified a price (limit orders). Currently, the major markets do not allow subpenny quoting but a few electronic trading systems that match customer orders do.

On electronic trading systems, professional traders (such as those employed by hedge funds) use subpenny quotes to gain a competitive price advantage over other orders. However, many market participants GAO interviewed cited numerous disadvantages to the use of subpenny quoting. They argued that subpenny quotes primarily benefit the professional traders who subscribe to market data systems displaying subpenny prices and who use fast systems to transmit their orders to take advantage of such prices. As a result, most investors do not benefit from subpenny quotes because they do not use these systems and because many broker-dealers do not accept orders from their customers in subpenny increments. In addition, participants said that subpenny quotes allow some traders to step ahead of others' orders for an economically insignificant amount. They said this discourages other traders from submitting limit orders and reduces overall transparency and liquidity in the markets.

Based on the work GAO has conducted to date, including a limited review of comments on SEC's proposal to ban subpenny quoting, most market participants support SEC's proposed action. However, some organizations opposed to the ban said that it could reduce the ability of traders to offer better prices and stifle technological innovation and reduce market participants' incentive to invest in better systems. Although some electronic trading systems supported the ban, others indicated that the decision to use subpenny quotes should be left to market participants who, as technology advances, may increasingly find subpenny quotes more useful than they do today.

In addition to reviewing subpenny pricing, GAO continues to review the broader impacts of decimal pricing on markets, securities firms, and investors. As part of this work, we plan to conduct original analysis using a comprehensive database of trades and quotes from U.S. markets to identify trends in quoted spreads, clustering of quotes and trades across certain prices, and other potential changes since decimal pricing was introduced.