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SRO-Sponsored Payment for Order Flow

Lynn Phillips Kugele, Robert A. Wood

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Abstract

Trade Shredding — the practice of breaking orders into smaller, multiple trades solely for the purpose of generating market data revenue — has been an ongoing object of concern, comment and controversy. In this research, we address three questions regarding the practice of trade or tape shredding. First, what market dynamics — economic and regulatory — combined to provide a climate that was amenable to and even encouraged trade shredding? Second, while there is virtually no argument that trade shredding has occurred can it be isolated; is it observable in the market data? Finally, the battle for market data revenue is considered to have been a major driver of the market data portion of Regulation NMS. But will Reg NMS' new, more complex formula succeed in eliminating this distortive practice?

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