

Once Upon a Broker Time?

Order Preferencing and Market Quality ¹

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Abstract

We develop a dynamic, infinite horizon, microstructure model to study how priority rules determine market quality and investor welfare. We compare order preferencing, modeled as price-broker-time priority (PBT), to price-time priority (PT). Priority rules impact investors' choice between limit and market orders. When the tick is tight, trading rates are higher with PBT whereas investor welfare is higher with PT. The opposite holds for a wide tick. PBT endogenously results when brokers individually choose between PT or PBT. Our model has testable implications regarding systematic patterns in order flow, market depth, trade composition, and market fragmentation.