IssuWorks

Transmitted via electronic mail to: rule-comments@sec.gov

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

December 3, 2014

Re: Plan to Implement a Tick Size Pilot Program

Dear Mr. Fields:

I applaud the U.S. Securities and Exchange Commission for its initiative and direction. The focus on the health and well-being of markets generally, and of small capitalization companies and capital formation specifically – essential infrastructure for the U.S. economy and job growth – is long overdue. Chair White's speech on June 5, 2014, at the Sandler O'Neill *Global Exchange and Brokerage Conference* in New York outlined "…five broad sets of issues: market instability, high frequency trading, fragmentation, broker conflicts, and the quality of markets for smaller companies."[1] These are the right five issues to focus on and I commend the Staff and the Commissioners. The first four speak squarely to issues impacting investor confidence. The last speaks, in my view, to the American Dream.

IssuWorks is a company-aligned investment bank. We focus on helping companies and their investment banks improve equity capital raising, institutional distribution and aftermarket support. Our applied data science is used to improve outcomes by identifying more of the right investors for corporate issuers. IssuWorks does not accept commissions from institutional or retail investors. We thus avoid the conflict of needing to favor the highest-commission paying investors who are often not long-term investors for corporations. We also do not trade securities. Thus, we derive no direct benefit from arguing for or against higher tick sizes.

It is an honor to be asked to testify in Congress or to speak at the SEC. To have the opportunity to contribute to the improvement of our markets and to help support economic growth for my fellow citizens is both satisfying and humbling. My colleagues and I are grateful.

Many who read these comment letters will not recall that Chair White once served on the Board of Directors of The NASDAQ Stock Market. Almost all who read these comment letters will not know that, when I was the keynote speaker at Northwestern University School of Law's *Securities Regulation Institute* in Coronado, California, several years ago, Chair White was in the audience. She approached me with her husband (a former head of the Division of Corporation Finance at the SEC) afterwards to discuss the presentation which focused on the collapse in the small IPO market and the precipitous decline in the population of listed public companies in the United States. Our discussion happened well before Chair White's nomination and subsequent

[1] See: http://www.sec.gov/News/Speech/Detail/Speech/1370542004312#.VHjcEtgtCpo

Senate confirmation. It was clear to me at that time that she had a sincere interest and innate understanding of markets and the importance of capital formation. In my opinion, we are all lucky to have her at the helm of the SEC today.

On June 24, 2014, the SEC issued its *Order Directing the Exchanges and the Financial Industry Regulatory Authority To Submit a Tick Size Pilot Plan.*[2] On August 26, 2014, the SEC announced the publication of the proposed plan, submitted by eleven stock exchanges and FINRA – all Self-Regulatory Organizations. [3]

By way of background, the idea to increase tick sizes was first proposed by me at a dinner some years ago for Congressman David Schweikert (R-AZ). At the time he was a member of the U.S. House Financial Services Committee and Vice Chair of the Capital Markets and Government-Sponsored Enterprises Subcommittee. As a former head of Prudential Securities' global equity transactions group and corporate finance department, co-head of strategy for investment banking, equity research, institutional sales and trading and later vice chairman and head of listed companies at NASDAQ, I saw a clear linkage between the loss of aftermarket economic incentives and the decline in aftermarket support and capital formation for small-, micro- and nano-capitalizaiton companies.[4] The move to electronic markets in 1998, on the heels of the Order Handling Rules in 1997, very clearly has decimated the greatest job creation engine the world has ever known: The U.S. small IPO market. These conditions were further exacerbated by Decimalization in 2001 and the higher costs to small companies of the Sarbanes-Oxley Act of 2002.

The dinner was attended by many accomplished Wall Street professionals including: Don Calvin, a former EVP of the NYSE and current chair of the International Stock Exchanges Executives Emeriti (a New York Educational Non-Profit); Al Berkeley, a former President of NASDAQ who, while at the investment bank Alex Brown, worked on the Microsoft IPO; Scott Ganeles, the then and still CEO of IPREO (formerly owned by KKR and now owned by Blackstone and Goldman Sachs Asset Management); Depak Raj, the former head of equity research at Merrill Lynch and then a partner at the investment bank ThinkEquity; and Brett Johnson, the Founder and CEO of OneMedPlace. Their immediate reaction was, "It can't be that easy, can it?" Quickly, they came to the conclusion that yes, it can be that easy. "We can fix capital formation by increasing tick sizes because it won't require an abrogation of Reg. NMS."

In rapid succession:

1. We worked with others to get an amendment inserted into the near final version of the JOBS Act. This amendment became Section 106(b) entitled "Tick Size."[5]
2. In September 2012, we wrote *The trouble with small tick sizes,*[6] which was published by Grant Thornton.

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[2] See: http://www.sec.gov/rules/other/2014/34-72460.pdf

[3] See: http://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-final.pdf

[4] We define small capitalization companies as sub-$2 billion in equity market value, micro-cap companies as sub-$500 million in equity market value, and nano-cap companies as sub-$100 million in equity market value.

[5] See Section 106(b) Tick Size at the *Jumpstart Our Business Startups Act* at http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf.

[6] *The trouble with small tick sizes,* September 2012, by Weild, Kim & Newport – see http://www.sec.gov/info/smallbus/acsec/acsec-backgroundmaterials-090712-weild-article.pdf

3. In July 2013, we wrote *Making Stock Markets Work to Support Economic Growth*,[7] which was published by the Organisation for Economic Co-Operation and Development (OECD).

I would be remiss if I did not recognize the leadership of Congressmen Sean Duffy (R-WI) and John Carney (D-DE) who jointly sponsored H.R. 3448, *The Small Cap Liquidity Reform Act.* It was passed by the U.S. House of Representatives by a vote of 412-4, and it calls for a 5 year test of pilot and tick increments of both 5 cents and 10 cents versus the 1-year life and 5 cent increment called for in the SEC's pilot. The House Financial Services Committee voted 55-0 in support of this bill. Both parties grasp what is at stake, and I was gratified by the level of bipartisan interest when I testified in support of H.R. 3488 on October 23, 2013.[8]

The United States has made mistakes in its design of stock markets. These need to be corrected if they are to support adequate capital formation, innovation, job and economic growth. These mistakes include: one-size-fits-all stock markets (what works for large cap, naturally liquid stocks does not work for small cap, naturally illiquid stocks); extreme complexity (with over fifty trading venues and over 2,000 order types, there is a lot that can go wrong, and one wonders how vulnerable our markets are to outside hacking threats); support for information mining strategies (e.g., ETFs, index funds, basket trading, etc) at the expense of information additive strategies (e.g. single stock selection).

The *Plan to Implement a Tick Size Pilot Program*[9] (the "Plan"): Concerns and Recommendations:

1. **Brevity (1 year) of the pilot and the ability of the "Control Group" to serve as a true "Control."**
    a. **Concern:** In a perfect experiment the group of market participants involved in the "Control" group should be identical to those in each of the three "Test Groups." We are also concerned that the short (1 year) length of the pilot will create selection biases by market participants opting out of the pilot. The combination of "opt-outs" and variation in number and types of market participants across all four groups of stocks could render the pilot meaningless.
    b. **Recommendation:** The length of the pilot should be extended to 5 years, and the SEC should stipulate that those market participants that participate in the control group must also participate in each of the three test groups. By extending the pilot to 5 years the SEC would neutralize the concerns about the costs incurred by market participants to create and implement systems for such short (1 year)

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[7] *Making Stock Markets Work to Support Economic Growth,* July 2013, by Weild, Kim & Newport – see http://www.oecd.org/corporate/makingstockmarketsworktosupporteconomicgrowth.htm

[8] See written statement by David Weild to the U.S. House of Representatives Financial Serivces Committee, Capital Markets and Government Sponsored Enterprises Subcommittee, *Hearing on Legislation to Further Reduce Impediments to Capital Formation* on October 23, 2013 at http://financialservices.house.gov/uploadedfiles/hhrg-113-ba16-wstate-dweild-20131023.pdf

[9] See *PLAN TO IMPLEMENT A TICK SIZE PILOT PROGRAM* at http://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-final.pdf

duration. Standardizing the participants across all four groups (Control Group plus three Test Groups) will lead to a data set which is much more reliable.

2. **The nature of $2 to $5 stocks may be fundamentally different than stocks above $5:**
   a. **Concern:** Stocks that trade below $5 per share are often subject to house rules at brokerage firms that: Prohibit the ownership of sub $5 stocks on margin, prohibit the short-selling of sub $5 stocks and prohibit the solicitation of investors to purchase sub $5 shares. As a result, the character of the market for sub $5 stocks is likely, even for listed companies, to be different from that of the market for stocks with prices greater than $5. The plan already contemplates 27 possible categories of stocks[10] based on low, medium and high groupings of 1) share prices, 2) market capitalization and 3) trading volume.
   b. **Recommendation:** The Plan must control for stocks that are <$5 per share vs. stocks that are >$5 a share.

3. **Testing only 5 cent tick sizes (and not also 10 cent tick sizes):**
   a. **Concern:** The appropriate metric to gauge the level of incentive needed to induce market making activity is *tick size as a percentage of share price* – not absolute tick size. Of course, practical limitations are such that it is easier to test one or more specific tick sizes. The question is, "What are the appropriate tick sizes to test and why?" To the best of our knowledge, we have seen no discussion from the SEC as to why 5 cents is the right tick size and the only tick size that should be tested. Based on econometric models that we ran for the OECD,[11] we believe that 5 cents may be inadequate since 5 cents represents less than 1% of share price for stocks greater than $5 per share and, as aforementioned (see 2.a. above), stocks that trade below $5 per share in the United States are subject to a different set of conditions (restrictions) at most brokerage firms and are not likely to provide a viable test for higher than 1% incentives. We analyzed a variety of variables from 26 different stock markets to determine small IPO output. We found that the percentage of micro-cap (sub $500 million) stocks with tick sizes greater than 1% of share value, was the single greatest determinant of small IPO output. We believe this is because tick sizes higher than 1% create adequate incentives to support smaller capitalization stocks, and the market competes on the provision of value – not price – in market making. This in turn creates a more robust ecosystem with aftermarket support and sets the stage to bring more companies public. ***We believe that because the Plan tests only 5 cent tick sizes, and that 5 cents represents less than 1% of share prices >$5, that the pilot program risks failure.***
   b. **Recommendation:** The Plan should test 10 cent (or larger) tick sizes in addition to 5 cents in order to ensure that there is a sufficient population of stocks tested where tick sizes exceed 1% of share price.

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[10] Page 13 of *PLAN TO IMPLEMENT A TICK SIZE PILOT PROGRAM* at http://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-final.pdf

[11] See *Making Stock Markets Works to Support Economic Growth,* July 2013 by Weild, Kim & Newport for the OECD at http://www.oecd.org/corporate/makingstockmarketsworktosupporteconomicgrowth.htm

4. **Special retail price improvement should be prohibited:**
    a. **Concern:** Markets that compete on price are generally unable to compete on the provision of value (e.g., research, sales and capital commitment). Consequently, our fear is that exempting retail orders from Groups 2 and 3 of the pilot and allowing so-called price improvement on retail orders will cause the market to devolve into one that competes mostly on price. We believe that the "tick size" must have integrity to it. We also believe that once the tick size does have integrity and retail orders are posted at 5 cent or 10 cent increments, that higher displayed liquidity will attract even more investor interest. Rarely do markets offer better retail pricing than wholesale pricing. Retail price improvement makes little economic sense, adds complexity, and increases the risk of gaming.
    b. **Recommentation:** Prohibit price improvement on retail orders. A tick size that has integrity to it and offers a first-come-first-served "fill" will improve investor confidence, add to liquidity and decrease pilot complexity.

5. **The exemption for "Odd-lots" from the "Trade-at" rule:**
    a. **Concern:** In an age where electronic "wood chippers" and high-frequency traders constantly create large numbers of odd-lot orders, we worry that Rule 611 exemptions could be used to circumnavigate the intent of the Plan. In a study by O'Hara, Yao and Ye entitled, *What's Not There, The Odd-Lot Bias in TAQ Data*,[12] they found that the median number of missing trades from the consolidated tape was 19% and that some stocks were missing as many as 66% of all trades.
    b. **Recommendation:** We believe that the SEC should both require odd-lot trades to adhere to any test of "Trade-at" and that all odd-lot trades should be reported and included in the consolidated tape. This would, in our view, lead to higher order depth at the inside market while creating greater overall transparency.

As we showed in our work for the OECD comparing tick size distributions in twenty-six markets, the United States has a set of practices and conventions that cause U.S. listed corporations to skew their stock prices to higher denominations. As a result, of the twenty-six nations studied, the United States had the lowest tick sizes as a percent of share prices of any of the nations studied. It is our conclusion that the decrease in economic incentives which began with the Order Handling Rules (1997) and Reg. ATS (1998) triggered a collapse in the U.S. small cap ecosystem and with it, capital formation and job growth. We also suspect that, had the SEC not altered market structure, the United States would be producing 900 corporate IPOs per year on a GDP weighted basis instead of the 140 or so that it has averaged since 2000 when the Dot Com Bubble burst and that the implicit opportunity cost is at least 10 million jobs to the U.S. economy.

The United States is the world's largest economy. As such, we should also boast the world's most vibrant small IPO market. While the United States did appropriately enjoy this distinction through the 1990's, by 2013 we had fallen to 12th place of the 26 nations surveyed. Worse, on a

[12] See *What's Not There, The Odd-Lot Bias in TAQ Data* by O'Hara, Yao and Ye, July 22, 2011 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1892972

GDP-weighted basis, we had fallen to 24th out of 26 countries, ahead of only Mexico and Brazil – a fact that we testified to in Congress.[13]

Making stock markets work is ultimately a fine balancing act. The overly simplistic approach of one-size-fits-all penny tick sizes, while appropriate to innately liquid (large cap) stocks, has been a disaster for innately illiquid (small cap) stocks. A couple of years ago, I met with executives at the London Stock Exchange and visited with several European investment banks, market makers and institutional investors. This summer, I keynoted the Federation of European Securities Exchanges IPO Summit in Zurich. I have found that Europeans no longer consider the U.S. stock markets to be the envy of stock markets throughout the world. I found further that Europeans had once envied our robust IPO markets and our ability to give birth to entire new industries. With the best intentions we've squandered that fundamental building block of the American Dream. Hopefully, with the Commisson's leadership we'll drive toward the types of changes that will lay the foundation for a U.S. resurgence to where the next time I visit Europe, they will once again be envious of our stock markets – and justly so.

Sincerely,

Dave Weild
Chairman & CEO
IssuWorks, Inc.
Former Vice Chairman of The Nasdaq Stock Market

CC: The Hon. Mary Jo White, Chair
The Hon. Luis A. Aguilar, Commissioner
The Hon. Daniel M. Gallagher, Commissioner
The Hon. Kara M. Stein, Commissioner
The Hon. Michael S. Piwowar, Commissioner
Lona Nallengara, Chief of Staff
Stephen Luparello, Director, Division of Trading & Markets
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David Shillman, Associate Director, Division of Trading and Markets
Daniel Gray, Senior Special Counsel, Division of Trading and Markets
Keith Higgins, Director, Division of Corporation Finance
Sebastian Gomez, Chief, Small Business Policy, Division of Corporation Finance

[13] October 23, 2013, House Financial Services Committee, Capital Markets and Governement Sponsored Enterpreises Subcommittee, Hearing on Legislation to Further Reduce Impediments to Capital Formation - See http://financialservices.house.gov/uploadedfiles/hhrg-113-ba16-wstate-dweild-20131023.pdf