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December 19, 2014

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Proposed Tick Size Pilot Plan (File No. 4-657)

Dear Mr. Fields:

KCG Holdings, Inc. ("KCG") appreciates the opportunity to comment on the proposed Plan to Implement a Tick Size Pilot Program (the "Proposed Plan") filed by FINRA and eleven registered national securities exchanges[1] with the U.S. Securities and Exchange Commission (the "Commission").

KCG believes it is imperative that the Tick Size Pilot be narrowly focused and targeted to increase liquidity in small capitalization stocks while structured to prevent any increase in trading costs for retail and institutional investors and to avoid undue complexity. For these reasons, KCG generally supports the SROs' approach regarding Test Group One and Test Group Two of the Proposed Plan; however, we have significant concerns regarding the "trade-at" requirement contained in Test Group Three and believe it should be eliminated.

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[1] On June 24, 2014, the Commission issued an order directing BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Nasdaq Stock Market LLC, NASDAQ OMX BX, NASDAQ OMX PHLX, National Stock Exchange, Inc., New York Stock Exchange LLC, NYSE Arca, Inc., and NYSE MKT LLC, (collectively, "the exchanges") and the Financial Industry Regulatory Authority ("FINRA" and together with the exchanges the "SROs") to jointly develop and file with the Commission a national market system plan to implement a pilot program that would widen the quoting and trading increments for certain small capitalization stocks. *See* Order Directing the Exchanges and Financial Industry Regulatory Authority to Submit a Tick Size Pilot Plan, Release No. 34-72460 (June 20, 2014). In response, on August 25, 2014, the SROs filed their proposed Plan to Implement a Tick Size Pilot Program, which the Commission subsequently published to solicit comments and feedback. *See* Release No. 34-73511, 79 Fed. Reg. 66423 (Nov. 7, 2014).

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I. Background

KCG is a global financial services firm that offers investors a range of services designed to address their trading needs across asset classes, product types and time zones. As an independent, electronic market maker, KCG combines advanced technology with exceptional client service to deliver greater liquidity, lower transaction costs, improve pricing, and provide execution choices. KCG is a registered market maker on numerous U.S. cash equity and options exchanges, including a DMM and Supplemental Liquidity Provider on the New York Stock Exchange ("NYSE"), and a Lead Market Maker on NYSE Arca. As a market maker, KCG commits its capital to facilitate trades by buyers and sellers on exchanges, ATSs, and directly to our clients.

KCG offers clients multiple opportunities to interact with our market making operations. In addition, KCG's institutional clients have access to algorithms and experienced trading desks to access liquidity, maintain anonymity and minimize market impact. KCG also operates two Commission-registered ATSs.

II. Executive Summary

Below is an executive summary of KCG's key points related to the Tick Size Pilot:

- KCG supports a continual review of market structure, including tick sizes, but disagrees with those who claim the ability of small and emerging companies to raise capital will be enhanced by widening the minimum tick size of such companies' stock.

- KCG supports the Tick Size Pilot to the extent that it is data driven and constructed as a well-designed experiment. The results could have a profound impact on U.S. equity market structure – more than any regulation since Regulation NMS – and thus it is imperative that the Pilot be tightly controlled and subject to rigorous analysis.

- The Tick Size Pilot will lead to wider spreads for securities in all three Test Groups that will increase transaction costs for retail and institutional

investors as they are typically liquidity takers who cross the spread to access immediate liquidity.

- The Tick Size Pilot should be implemented and analyzed by the Commission instead of the SROs. The exchanges should not be put in a position of having to design and administer a Tick Size Pilot Plan and collect, review and interpret data that may have a direct impact upon their business models as well as the business models of broker-dealers who compete with the exchanges for order flow.

- Requiring market maker profitability data is entirely unnecessary for determining the impact of wider tick sizes on the trading and liquidity for certain small cap stocks and should be eliminated altogether.

- An optimal structure for the Tick Size Pilot would include one test group (instead of three) that contains only a minimum quoting increment of $0.05 (this would make the results more meaningful and reduce the risk of creating confusion while minimizing the implementation burden).

- A cost/benefit analysis should be conducted to ensure that any costs imposed by the Tick Size Pilot are outweighed by any benefits of wider tick sizes to listing companies and other constituencies.

- The trade-at requirement raises numerous significant concerns:

    - The trade-at requirement is anti-competitive. While exchanges play an important role in the process of capital formation and risk transfer, so do other market participants. Wholesale market makers, like KCG and our competitors, provide a valuable service to retail broker-dealers and institutions by handling complex order types (e.g., stop orders, all or none, larger size orders in illiquid securities) that directly compete with exchange offerings. As a result, some firms do not want to route

their orders to an exchange, however, the trade-at requirement essentially forces them to do so.

- The trade-at requirement detracts from the intended focus of the Tick Size Pilot. In order to be successful, the Pilot should be strictly limited to experimenting with a single variable—wider tick sizes—for small-cap issuers. By introducing other market structure experiments (variables) such as a trade-at requirement within the Pilot the Commission will not be able to determine which caused its success or failure.

- The Tick Size Pilot is too important to serve as a battleground for the long-standing industry debate about the merits of a trade-at rule, which certain market participants (primarily exchanges) have been advocating in favor of for years.

- The Tick Size Pilot creates such significant conflicts of interest for the exchanges that any results showing market quality improvements will be immediately called into question.

- The trade-at requirement will harm investors by increasing trading costs for retail and institutional investors, as they will be forced to pay access fees when trading on exchanges while at the same time increasing the likelihood of information leakage.

- The routing requirements to comply with the trade-at component dramatically increase the complexity of the Tick Size Pilot and increase the operational risks for the entire market place.

III. Discussion

A. KCG Supports the Continual Review of Market Structure

KCG believes the existing U.S. equity market is the best functioning, most robust and fairest market globally. Almost every dimension of market quality indicates that investors are enjoying better markets today than at any prior time. The U.S. equity market has become increasingly efficient over the last several years – bid-ask spreads are as narrow as they have ever been and continue to decrease; executions are extremely fast and reliable; and transaction costs are lower than they have ever been. Our market structure is transparent and promotes robust competition among a diverse set of market participants, which allows for investor choice and fosters constant innovation. We believe the quality and strength of our current market is no accident; it has been achieved through a thoughtful process of fact-based analysis coupled with prudent and cautious rulemaking.

Despite the strength and quality of today's U.S. equity market, particular market structure features may not always be optimal. Thus, aspects of our market structure warrant continued review and regulatory fine-tuning to ensure the framework of our market continues to serve the needs of investors and the public companies that choose to list their shares in the United States.

One issue that has received recent attention is developing ways to enhance access to capital for smaller and emerging companies. According to some market participants, the ability of small and emerging companies to raise capital may be impeded by the current "one size fits all" approach to tick size requirements and one way to enhance access to capital and increase liquidity could be achieved by widening the minimum tick size of such companies' stock from the current one cent ($0.01) to five cents ($0.05). KCG does not agree with this viewpoint.[2]

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[2] According to its proponents, widening tick sizes in small cap stocks will increase market maker profitability in those stocks, which will incent market makers to support and promote those stocks with more research. Increased analyst coverage and research, according to this reasoning, will attract interest from institutional investors and ultimately make it easier and cheaper for smaller companies to access the capital markets and pursue IPOs. We believe this line of reasoning has numerous flaws.

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KCG generally believes that the current minimum increment of $0.01 is appropriate. Despite a $0.01 minimum increment, market participants are not required to quote at these minimum widths and instead spreads are allowed to occur naturally from market forces. In fact, many small-cap stocks already trade with spreads of $0.05 or wider.[3] Importantly, these wider spreads are determined by competition and prudent risk management practices rather than imposed by regulation. We are concerned that mandating the widening of tick sizes for small-cap companies will only raise trading costs for retail and institutional investors without achieving the desired effect of improving access to public capital markets or liquidity to smaller companies. With these concerns in mind, we offer the following views on the Proposed Plan submitted to the Commission by the SROs.

B. General Comments

1. KCG Supports a Tick Size Pilot that is Data Driven and Constructed as a Well-Designed Experiment

KCG supports the Commission's commitment to a data-driven approach and empirically-based decision-making when considering complex market structure issues, as outlined by Chair Mary Jo White in recent statements. Optimal tick size is an incredibly complex subject and many jurisdictions have struggled with this issue, so it is crucial that the Tick Size Pilot be driven by data and any permanent market

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First, capital-raising opportunities for smaller companies have actually increased recently, largely as a result of the reduced disclosure requirements associated with the Jumpstart Our Business Startups Act (the "JOBS Act") and recent Commission rulemaking. Second, as noted by the SEC Advisory Committee, there is no evidence that increased market maker profitability in small cap stocks would result in a greater degree of analyst coverage and research in small-caps. In fact, most of the largest market making firms do not provide any analyst coverage or market research. *See* Recommendation of the Market Structure Subcommittee – Decimalization and Tick Size.

[3] As KCG recently highlighted, more than 60% of the stocks that meet the criteria and qualify for inclusion within the Tick Size Pilot already trade at spreads wider than $0.05. Mandating a 5-cent spread for a stock that already trades at, for example, 50 cents wide, will do little to change the nature of trading or liquidity in such a stock. *See*, KCG Market Analyses, Who Gets the Short End of the 'Tick? (July 2014) and Today's Spreads Make More Sense Than Nickels (August 2014).

structure changes resulting from the pilot be based on facts and hard evidence that such changes are warranted.[4] It is also important that the Tick Size Pilot, which is essentially an experiment, be properly constructed.

The starting point in any well-designed experiment is a clearly-formed hypothesis that is then supported or refuted through the evidence gathered in the experiment. In order for a hypothesis to be testable, there needs to be a single independent variable that is manipulated to determine its impact on other, dependent, variables. The Tick Size Pilot Plan, as currently designed, fails to provide a clear hypothesis. It is unclear exactly what hypothesis about wider tick sizes is being tested through the Pilot. As currently designed, the Tick Size Pilot Plan might be trying to prove that wider tick sizes result in an increase any of the following:

- Market maker profitability
- Research coverage
- Initial Public Offerings (IPOs)
- Job creation
- Displayed liquidity
- Undisplayed liquidity
- Capital commitment
- Costs for retail investors
- Costs for institutional investors

In short, it is necessary to determine which dependent variables should be observed and it is critical that this be identified before the initiation of the Pilot to ensure there is an understanding of exactly what is sought to be proven and how "success" will be determined.

Another hallmark of a well-designed experiment is a single independent variable. As originally proposed by Congress in the Jumpstart Our Business Startups Act (the

[4] Spread rules in many countries have multiple price levels and the U.S. is not the first jurisdiction to consider introducing variable spreads. Spreads in Hong Kong and Japan are extremely complicated and both of these markets use stock price to determine when spreads increase which results in a more consistent basis point spread across price levels. Interestingly, Japan recently reduced its tick sizes to bring trading costs closer to those of other jurisdictions.

"JOBS Act") and the Small Cap Liquidity Reform Act of 2014 (the "Duffy-Carney Bill"), only one variable – the tick size increment - would be tested. Test Groups One and Two of the Tick Size Pilot Plan submitted by the SROs comes closest to a single independent variable as they involve increasing tick size and then testing the associated quoting and trading increments. Test Group Three adds the trade-at restrictions as a second independent variable to Test Group Two which, when coupled with all of the incremental variable variants (visible quote size, block size, non-regular way, etc.), would make proving causality impossible. In this regard, there is no way that Test Group Three as designed could ever be deemed to have proven any hypothesis and should therefore be eliminated altogether from the Tick Size Pilot.

Another characteristic of a well-designed experiment is the establishment of parameters and/or quantifiable metrics before initiation of the experiment. It is important to define at the outset what data results would indicate success (and failure) for each metric to be evaluated. Doing so helps those analyzing the results to avoid any confirmation biases and prevents misinterpretation of the data, which can be more of an issue in a politically charged environment such as the one surrounding the Tick Size Pilot. Although the Commission does appear to be pushing a data driven approach, the pilot lacks a publically disclosed hypothesis and measures of success (and failure) have not been identified. Without these fundamental components for a well-constructed study, the 200+ data collection items are susceptible to post-pilot use to build a story of "success" based on whatever criteria a given reviewer decides at that time, including criteria that may benefit a market participant's commercial interests.

2. The Commission (as Opposed to the SROs) Should Conduct the Tick Size Pilot

KCG believes the Tick Size Pilot should be implemented and analyzed by the Commission instead of the SROs. First, the Proposed Plan filed by the SROs was designed in large part by the exchanges that compete directly for order flow with broker-dealers who will be subject to the requirements of the Tick Size Pilot and any resultant rule(s). The exchanges should not be put in a position of having to collect, review and interpret data that may have a direct impact upon their business models as well as the business models of broker-dealers who compete with them for order

flow and who also are exchange customers. Implementation, review and analysis of the Tick Size Pilot data by the exchanges presents obvious and significant conflicts of interest issues that should be avoided. Stated another way, any results of the Pilot that could conceivably be construed to benefit the exchanges' business models will be immediately and rightfully subjected to conflicts of interest questions.[5] Second, Test Group Three of the Proposed Plan closely resembles many aspects of Regulation NMS, which is a national market system plan designed and administered by the Commission. Similar to Regulation NMS, Test Group Three requires complex order routing scenarios and the use of inter-market sweep orders ("ISOs") as exceptions. Third, having the Commission conduct the Tick Size Pilot will allow for a cost/benefit analysis to be conducted, which is especially important with respect to Test Group Three since we believe that the costs to investors and market participants would far outweigh any benefits of data collection in this group.

3. The Pilot Will Widen Spreads and Increase Trading Costs for Investors Across the Board

By design, the Tick Size Pilot will lead to wider spreads for securities in all three Test Groups. The minimum quoted spread for those securities will now be five hundred percent wider than the current spread. These artificially wider spreads will almost certainly lead to increased transaction costs for investors, both retail and institutional, as they are typically liquidity takers who often cross the spread to obtain access to immediate liquidity. In addition, one cost mitigation strategy that tends to naturally occur with wider spread stocks – transferring trading volume away from exchanges and into dark pools – will be significantly limited and/or unavailable for securities in Test Groups Two and Three. This is also true even for groups, such as retail investors, who are provided an exemption under the rule. The proposed retail definition, using the NYSE RLP as a benchmark, is too complex and ambiguous leading many of the largest retail firms to not sign the required retail attestations. In the event a retail investor at one of these firms submits an order, they would not receive the benefit of the exemption and therefore would be burdened by the additional cost of the Pilot. To this end, the Commission should conduct a cost/benefit analysis for the pilot to ensure that any costs imposed by the

[5] The Proposed Plan submitted by the SROs has already provided an indication of the conflicts of interest faced by the exchanges, particularly as it relates to the trade-at requirement. That is, the exchanges have proposed the most expansive definition of a trade-at requirement imaginable.

pilot are outweighed by the benefits of wider tick sizes to listing companies and other constituencies.

Finally, artificially wider spreads will increase transaction costs both on-exchange and off-exchange as broker-dealer wholesaler firms who fill orders off-exchange and often provide price improvement using public quotations as reference prices. Artificially wider public quotations (and reference prices) will result in inferior priced executions for retail orders compared to executions they would otherwise receive if spreads (and reference prices) were tighter.

C. Comments Regarding Test Group One and Test Group Two

KCG believes that an optimal Tick Size Pilot structure would include one test group that contained only a minimum quoting increment of $0.05 (this would make the results more meaningful and reduce the risk of creating confusion while minimizing the implementation burden). Nevertheless, we generally support the approach taken in the Proposed Plan with respect to Test Groups One and Two, which sets $0.05 minimum quoting increments (Test Group One) and $0.05 minimum quoting and trading increments (Test Group Two) for applicable securities as long as both groups have the same exceptions to ensure that the Pilot is properly constructed with a single independent variable.

1. Test Groups One and Two Comport with Congressional Directives

We believe these aspects of the Proposed Plan comport with the directives Congress gave the Commission under the JOBS Act as well as the pending Duffy-Carney Bill. The JOBS Act generally required the Commission to study the impact of decimalization on IPOs and the liquidity and trading of smaller capitalization company securities and specifically directed the Commission to consider changing the tick size of emerging growth companies, those with less than $1 billion market capitalization, to an increment greater than $0.01. Likewise, in the Duffy-Carney Bill, legislation has been proposed that considers resetting minimum quoting and trading increments for emerging growth companies from $0.01 to $0.05 and/or $0.10. Significantly, the JOBS Act and the Duffy-Carney Bill both considered increasing minimum tick size and neither piece of legislation contained any reference, specific

or implied, to a trade-at requirement. The trade-at requirement is clearly outside of any congressional directive concerning tick size.

2. Test Groups One and Two Are Not Unduly Complex

Unlike Test Group Three, the parameters of Test Group One and Test Group Two are not overly complex. Securities in Test Group One will be quoted in $0.05 minimum increments but may continue to trade at any price increment this is currently permitted.[6] Securities in Test Group Two will be quoted and traded in $0.05 minimum increments.[7] Because neither of these test groups contain a trade-at requirement they will not require market participants to engage in the same complex routing considerations related to Test Group Three. Moreover, Test Groups One and Two are designed as single variable tests that, due to controlling for a single variable, are capable of being scientifically proven via clear metrics to have succeeded or failed in the stated purpose – determining if widening tick size impacts trading and liquidity for certain small-cap stocks. This contrasts sharply with Test Group Three, with its multi-variate approach, which will make it impossible to determine whether the group succeeded or failed in proving any hypothesis (assuming one is defined).

D. Comments Regarding Test Group Three

The results of the Tick Size Pilot could have a profound impact on U.S. equity market structure, more than any regulation since Regulation NMS, thus it is imperative that the Pilot be tightly controlled and subject to rigorous analysis. Most importantly, KCG believes the Pilot's experimentation with wider tick sizes must not compromise or come at the expense of retail and institutional investors, which is why we have the following significant concerns with the approach of Test Group Three.

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[6] Test Group 1 contains exceptions to the quoting requirement for orders priced to execute at the midpoint and orders entered in a RLP, such that they may continue to be accepted and ranked in increments less than $0.05.

[7] Test Group 2 contains the same quoting exceptions as Test Group 1 and also contains certain trading exceptions: midpoint trading between the NBBO or the Protected BBO; retail investor orders with price improvement of at least $0.05 better than the PBBO; and negotiated trades (e.g., benchmark trades such as VWAP).

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1. The Trade-At Requirement is Anti-Competitive

As an initial matter a trade-at rule is anti-competitive. For nearly two decades—starting with the SEC's 21A report in 1996 against Nasdaq market makers for anti-competitive collusion—the Commission has taken very specific policy actions to create a market structure that vigorously promotes competition and innovation, including adoption of the order handling rules, Regulation ATS and Regulation NMS. These actions have inured to the benefit of long term investors, particularly retail investors, in the form of lower transaction costs and access to immediate liquidity. While exchanges play an important role in the process of capital formation and risk transfer, so do other market participants. Wholesale market makers, like KCG and our competitors, provide a valuable service to retail broker-dealers and institutions by handling complex order types (e.g., stop orders, all or none, larger size orders in illiquid securities) that directly compete with exchange offerings. Stated another way, exchanges are not equipped (and in many cases even allowed) to provide the services that other market participants provide, and as a result not all firms want their orders routed to an exchange for execution. The trade-at requirement of Test Group Three would essentially force firms to do just that.

In addition, forcing trading away from market makers and towards exchanges will increase investors' exposure to certain "bad trade" risks. Exchanges' ability to deal with erroneous trading situations are limited. KCG and other wholesale market makers provide a valuable service to our clients by managing these complex scenarios in a fair and efficient manner. Due to exchange rules, exchanges simply cannot break trades that are not outside of limit up/down bands. KCG does this on a regular basis. Removing intermediaries, such as wholesale market makers, not only puts retail investor at a disadvantage by being forced to trade on exchange at higher prices, it also removes their ability to get price adjustments when mistakes are made.

2. The Tick Size Pilot Creates a Conflict of Interest for the Exchanges

Several market participants (primarily exchanges) have pushed regulators for some version of a trade-at rule for years. We believe the Tick Size Pilot is too important to serve as a battleground for the long-standing industry debate regarding the merits of a trade-at requirement. Inclusion of a trade-at component will only serve to detract

from the intended focus of the Tick Size Pilot, which is to study the impact of a single variable (wider quoting and trading increments) on small capitalization securities.

As currently structured, the Tick Size Pilot creates conflicts of interest for the exchanges that are so significant that any results showing market quality improvements resulting from the Test Group Three pilot will be immediately called into question. In particular, exchanges are no longer not-for-profit mutualized organizations, but are for-profit-entities that are heavily incentivized to find the data to show that trading on exchanges is better than trading on competing venues. This incentive not only stems from the potential to increase revenue generated from direct trading fees (e.g., access fees)[8] but also from market data revenue and listing fees. This is just one of the reasons its imperative that we define the pilot hypothesis, determine how to prove it and seek out the data necessary to define success all within the confines of the Commission – not through an NMS plan.

3. The Trade-At Requirement Will Increase Trading Costs for Retail and Institutional Investors

Put simply, the trade-at requirement will increase trading costs for retail and institutional investors above and beyond the cost increases they will experience from wider spreads. For example, under a trade-at rule many users of low-cost alternative trading venues will be forced to pay exchange "access fees" that they currently are not subject to and that will add to their overall transaction costs. The trade-at requirement will also impact costs by minimizing price improvement opportunities for retail investors – under trade-at their orders are more likely trade at the NBBO as wholesale market makers otherwise willing to offer smaller price improvement than the exemption allows may not offer the requisite level of price improvement under

[8] Interestingly, the Intercontinental Exchange ("ICE") that operates the New York Stock Exchange ("NYSE") recently announced a proposal that it would lower access fees from the current .30 per 100 shares to .05 per 100 shares in return for a trade-at requirement. KCG has long argued that lowering access fees will likely lead to increased trading on exchanges. If the ICE's goal is to increase trading on its platforms the exchange should take the simple and uncontroversial step of lowering fees and then evaluate the results. Coupling a trade-at requirement with lowering fees demonstrates the exchange's sole objective is to achieve its intended result (i.e., higher market share) through regulatory fiat rather than traditional competitive forces such as price, service, and operational reliability.

Test Group Three or pay as much for retail orders. Some retail firms may also not sign the retail attestation (as many have refrained from today).

4. The Trade-At Requirement Increases Operational Complexity

The routing requirements required to comply with the trade-at component of Test Group Three dramatically increase the complexity of the Tick Size Pilot. This presents several concerns. First, the design of the trade-at component appears to have been modeled off of the trade-through rule of Regulation NMS, which is interesting given that the trade-through rule is frequently cited as one of the more significant sources of complexity within our current market structure and calls for a reduction in scope of the trade-through rule have been increasing. Our market is already extremely intricate and increasing the complexity for a one-year trade-at experiment does not seem to be worth the associated costs nor will it serve the interests of investors, market participants, or regulators. Second, more complex rule proposals often necessitate delays in implementation as regulators seek to address the many issues and concerns raised by commenters. Inclusion of the trade-at component contained in Test Group Three will likely lead to significant implementation delays for the entire Tick Size Pilot, which would delay the relatively straightforward aspects of the Pilot represented by Test Group One and Test Group Two. And this added complexity only relates to the items that are already well-known. To be sure, there will be unintended consequences of a trade-at rule that have yet to be contemplated that may be difficult to undo, which will further increase market complexity and reduce the effectiveness of the Pilot.

5. The Trade-At Requirement Creates Information Leakage for Institutional Investors

Test Group Three's trade-at component will result in a transfer of institutional trading away from dark pools and onto exchanges. Compelling institutional order flow onto displayed venues may cause pre-trade price impact and information leakage. Unlike market makers, who are typically two-sided in their trading, institutions are more often one-sided when taking liquidity that subjects them to significant signaling risk before they even get to trade. In displayed venues, participants will likely adjust and move away from traders who signal their intentions. Institutions are also more exposed to signaling risk given their typical

trade size is multiples of the NBBO and this signaling risk increases as trade size increases. Even with using algorithms to break down their trades, large and aggressive traces in displayed markets will expose institutions to increased signaling risk.

In an attempt to mitigate increased transaction costs, institutions may attempt to alter their trading to capture the spread themselves. The problem for institutions with substantially increasing their bid or offer in order to gain priority to capture the spread is that it will also tend to signal their trading intentions. In addition, the longer queues resulting from a trade-at requirement will subject institutions to increased execution risk, as their orders will be exposed to adverse selection on displayed venues for longer.

6. Certain Aspects of the Trade-At Requirement as Designed by the SROs Go Beyond the Scope of the Commission's Order

Displayed Size Restriction. Under the trade-at requirement contained in the SROs' Proposed Plan, it will "permit a trading center that was quoting at a protected quotation to execute orders at that level, but only up to the amount of its displayed size."[9] This displayed size restriction is beyond the scope of the Commission's Order and appears to be contradicted by other language contained in the SRO Proposal.

Allowing a trading center that is quoting at the protected quotation to price-match and execute orders at that level but only up to the amount of its displayed size is beyond the scope of the Commission's directive to the SROs. In its Order, when discussing the reason for its belief that a trade-at requirement should be included in the Pilot, the Commission stated, "a trade-at requirement is intended to prevent price matching by a trading center not displaying the NBBO." Put another way, a trading center publicly displaying/quoting at a protected level is permitted to match those prices and internalize orders at that level without any restriction on size. The Commission Order did not contain any language referencing a displayed size restriction or otherwise direct the SROs to only allowing price matching up to displayed size. As a result, the displayed size restriction contained in the Proposed Plan is beyond the scope of the Commission's Order.

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[9] *See* Proposed Plan submitted by SROs.

The displayed size restriction is also seemingly contradicted in the examples provided by the SROs in the Proposed Plan. Example 2 in the Proposed Plan allows Trading Center 2 to internalize an incoming order once it respects the displayed protected bid of Trading Center 1 by routing a trade-at ISO to Trading Center 1 to execute against its full displayed size. After doing so, Trading Center 2 may execute against the incoming order regardless of the fact that it is not displaying size. Example 3 also contains a similar scenario that seems to contradict the displayed size restriction.

On-Exchange Crossing Restriction. The Proposed Plan filed by SROs also appears to restrict the ability to internalize orders off exchange. In discussing the exceptions to the trade-at requirement, the proposal states a trading center will be permitted to execute an order for a Pilot Security at a price equal to a protected bid or protected offer under the following circumstances:

> (1) The order is executed by a trading center that is displaying a quotation ... at a price equal to the traded-at protected quotation but only up to the trading center's full displayed size. Where the quotation is displayed through a national securities exchange, the execution at the size of the order must occur against the displayed size on that national securities exchange.[10]

This language appears to require that any execution by a trading center against an incoming order must be executed on the exchange where the trading center is displaying size and against that quotation. If so, a trading center displaying a protected quotation that receives an incoming order it wishes to execute against would have to send an order to the exchange and attempt to match against its own resting protected bid or offer.

Like the displayed size restriction, this on-exchange crossing restriction is beyond the scope the Commission's Order and anti-competitive on its face. The Commission's Order notes that the intent of a trade-at requirement is to "prevent price matching by

[10] *Id.*

a trading center not displaying the NBBO."[11] A trading center that is displaying the NBBO should be permitted to engage in executions that match protected quotes. Such executions should obviously be permitted to be executed internally and indeed the language does not suggest that permitted price matching should occur only on exchange. Price matching by definition occurs away from the traded-at quotation. In addition, requiring internalization to occur on-exchange would radically change the handling of incoming orders by firms -- which would typically simply match the order -- and require extremely fast technology and subject the client order to in-flight execution risk.

7. The Trade-At Requirement Will Result in Many Strange Trading Scenarios

The trade-at requirement will result in numerous extraordinary trading scenarios. This will require firms to make assumptions about the trade-at requirement and will force regulators to provide on-the-fly interpretations, which will not be an optimal environment for conducting a valid experiment on tick sizes. At a minimum, the Proposed Plan should include a set of detailed FAQs that addresses all outstanding questions regarding the operation of the trade-at requirement and market participants should be given an opportunity to comment on the FAQs.

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[11] The fact that the Proposed Plan takes such an expansive approach to the trade-at requirement further demonstrates the exchange's commercial conflicts of interest, which appear to have increased over the years. For example, the NYSE has previously acknowledged that implementing a full trade-at rule would be a drastic measure and even suggested that the Commission consider less onerous approaches such as allowing internalization when a market participant is publicly quoting at the inside market:

> As a means for encouraging displayed liquidity, adoption of a full trade-at rule would be a very strong step. Accordingly, we believe the Commission should consider whether there are lesser means to achieve the same objectives. As an alternative, the Commission could consider adopting specific requirements on broker-dealers who internalize orders. For example, the Commission could consider a new requirement prohibiting broker-dealers from internalizing orders unless they have a pre-existing quote in the market at the same price and size and/or they price improve by a minimum price increment.

See, NYSE Euronext Comment Letter File Number S7-02-10 (April 23, 2010).

C. Comments Regarding Proposed Data Requested

The proposed Plan requires each market maker to provide to its Designated Examining Authority (DEA) a data set of market maker profitability that the DEA will aggregate, report to the Commission, and make publicly available on the its website. In the proposing release, the Commission asks for comment on whether market maker profitability data is necessary for an analysis of the Tick Size Pilot.

1. Market Maker Profitability Data is Unnecessary

KCG believes market maker profitability data is entirely unnecessary for an analysis of the Tick Size Pilot and should be eliminated altogether. Data concerning market maker profits is gratuitous, potentially harmful to market makers, and non-essential to determining the impact of wider tick sizes on the trading and liquidity for certain small cap stocks.

- *Confidential Information.* Profitability metrics are highly confidential and proprietary information for market making firms that they do not publicly disclose except in a public company context, let alone share, with direct competitors. Exchanges compete directly with market makers for order flow and should not collect, review and interpret their competitors' profitability data. Exchanges are not under any similar obligation to share with market makers data concerning their profitability. In addition, market makers are also customers of exchanges and sharing profitability data puts them at a disadvantage when negotiating with exchanges for services, such a co-location.
- *Existing Reporting Obligations.* As broker-dealers, market makers already subject to many order and trade reporting obligations. For example, broker-dealers must engage in OATS reporting, trade reporting, short interest reporting and reporting regarding FINRA Rule 4530. Compliance with these existing broker-dealer reporting requirements is expensive, time consuming and resource intensive. They also impose significant compliance burdens and expose market makers to regulatory fines and possible enforcement actions

for failure to accurately report. Imposing extra data collection and reporting obligations on broker-dealers for a 12 month pilot will impose additional costs and resource constraints, as they will involve significant coding changes. These costs will lower marker makers' ability to provide price improvement to their customers.

- *Beyond Scope of the JOBS Act.* The JOBS Act is very specific – it required the Commission to study the impact of decimalization on IPOs and the liquidity and trading of smaller capitalization company securities (which the Commission has done) and directed the Commission to consider changing the tick size of emerging growth companies (those with less than $1B market cap) to an increment greater than $0.01. The JOBS Act did not require the Commission to impose a new reporting regime for market makers concerning their profitability.
- *No Nexus.* The purpose of market maker profitability data is not at all clear. Like others, we question the claim that increased market maker profits will result in the promotion of small cap securities and ignite trading interest. As noted above, most large market makers do not engage in research or provide analyst coverage so there is no reason to believe that increase profitability will drive research.
- *Complicated Analysis.* Profitability calculation is a complicated analysis and the data requested does not account for other fixed and variable costs associated with engaging in this type of business. Moreover, the most appropriate calculation of profitability may vary widely between firms.

2. Investor Costs Should Be Measured

In our view, the most important data point is the ultimate cost to be borne by investors because of the Tick Size Pilot. However, the Pilot does not contain any metrics to measure the costs to retail and institutional investors. Instead of placing orders in $0.01 increments as they currently do, under the Tick Size Pilot investors will now have to place orders in increments of $0.05 (or even $0.10), which will almost certainly increase their transactions costs as these investors typically take

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liquidity and cross the spread. The natural attempt to mitigate wider spread costs by transferring volume into dark pools is countered by the restrictions contained in Test Groups Two and Three. As a result, not only will investors be subject to increased costs in the form of wider spreads, they will also be exposed to other costs such as the effects of lit signaling and exchange access fees. The Commission should seek to obtain and measure all potential costs the Tick Size Pilot may impose on investors.

3. Additional Concerns About the Requested Data

Without creating a hypothesis and determining the data needed to support it, the Pilot has a laundry list of items required from market makers and trading centers with every possible data element that could ever be imagined. Many of these items may not exist today and will lead to significant programming changes at every level of the industry. For example, just the data to support Appendix B.1.a could require weeks of programming changes at our firm alone – not to mention other market makers and trading centers.

To keep the Tick Size Pilot implementation costs to a minimum we recommend the use of existing reporting systems, such as OATS and/or existing exchange reporting, to gather as much information as needed to support its hypothesis. Only after those methods have been exhausted, and the Commission determines that there is a specific metric needed to prove or disprove its hypothesis, should it add additional items to the list of data collection requirements.

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KCG appreciates this opportunity to comment on the proposed Plan to Implement a Tick Size Pilot Program filed by the SROs with the Commission. Please do not hesitate to contact me at 646-428-1615 if you have questions regarding any of the comments provided in this letter.

Sincerely,

John A. McCarthy
General Counsel

cc: Chair Mary Jo White
Commissioner Luis A. Aguilar
Commissioner Daniel M. Gallagher
Commissioner Michael S. Piwowar
Commissioner Kara M. Stein

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