INVESTMENT COMPANY INSTITUTE

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December 22, 2014

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

Re: *Plan to Implement a Tick Size Pilot Program (File No. 4-657)*

Dear Mr. Fields:

The Investment Company Institute[1] is writing to respond to the issues raised by the proposed national market system plan to implement a tick size pilot program.[2] ICI members and their shareholders have a significant interest in ensuring that the regulatory structure that governs the financial markets allows for the most orderly, efficient and competitive markets possible. Consistent with this goal, we strongly support the examination of issues, such as those raised by the tick size pilot program, which may impact the operation of the financial markets and investor confidence in those markets.

I. Tick Size Pilot Program

The proposal filed by the national securities exchanges and the Financial Industry Regulatory Authority (FINRA) would establish a national market system plan to implement a one year pilot program that will widen minimum quoting and trading increments for certain stocks with smaller capitalization.

As discussed further below, we believe the pilot program, as proposed, goes beyond what was originally envisioned by Congress and introduces complexity and costs that may outweigh many of the benefits of the pilot. In addition, we do not believe that the pilot will achieve the goals originally

[1] The Investment Company Institute (ICI) is the world's leading association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $17.4 trillion and serve more than 90 million U.S. shareholders.

[2] Securities Exchange Act Release No. 73511 (November 3, 2014).

intended by Congress and may result in unintended consequences for investors when trading, including institutional investors such as funds when trading in large size. Therefore, if the Commission determines to move forward with the pilot, we recommend that it consider changes to reduce the complexity, and associated costs and burdens, on market participants. Our specific comments follow.

A. Purpose and Goals of Pilot Program

ICI has strongly supported addressing issues related to the difficulties for small companies coming to market in the United States and the various proposals to stimulate capital formation. To this end, we have previously recommended that a pilot program be established to examine wider spreads in certain stocks as part of the broader examination of the difficulties in trading small-cap stocks. While, overall, funds have benefited from developments in market structure, since penny spreads were implemented, difficulties remain for funds when trading large blocks of securities, particularly in small-cap and less liquid stocks. We therefore believe it is necessary to examine ways to increase market liquidity and the depth of markets in securities that may not have benefited from the move to penny spreads. As institutional investors, these issues are critical for efficient markets.

While we have supported establishing a pilot program to examine minimum quoting variations, we believe the pilot program, as proposed, goes beyond what was originally envisioned by Congress under the JOBS Act and will not achieve the goals initially discussed for widening the minimum trading increment. Specifically, we do not believe widening tick sizes will stimulate greater research coverage for certain stocks, increase the amount of IPOs, or ensure that market makers provide robust liquidity for the securities most in need. Factors outside of decimalization, including numerous regulatory and macroeconomic factors, may influence smaller companies' decision to go public or a broker's decision to provide research as much as, if not more than, the minimum increment in which companies' stock trade.

If the Commission does move forward with a pilot program, the focus should be on what could be a benefit of an examination of wider tick sizes – determining whether adjusting tick sizes can result in greater displayed liquidity and larger transaction size. Any pilot program should be more narrowly tailored and developed in a manner that would ensure that the Commission receives the data necessary to assess the impact of widening tick sizes on the liquidity and trading of stocks of small capitalization companies. At the very least, we support conducting a narrowly tailored pilot before the Commission moves forward with any rulemaking in this area.[3]

[3] While the consensus among ICI members is that the Commission should move forward with a more narrowly tailored pilot, certain ICI members believe that the SEC should not move forward with a pilot in any form given, as discussed below, the potential costs and complexity associated with implementing the pilot and the potential unintended consequences of widening tick sizes.

B. Scope of the Pilot Program

Securities to be included in the pilot program will consist of stocks that satisfy certain criteria including those based on a stock's market capitalization, its closing price, and its consolidated average daily volume.[4] The pilot program also will include four test groups of securities: (1) a control group in which all current rules will remain constant, *i.e.*, securities may be quoted and traded at any price increment that is currently permitted; (2) a group of securities that will be quoted in $0.05 minimum increments but may continue to trade at any price increment that is currently permitted; (3) a group of securities that will quote and trade only at $0.05 minimum increments; and (4) a group of securities that will quote and trade only at $0.05, with an additional trade-at requirement.

The Commission requests comment on several aspects of the scope of the pilot program. As discussed more fully below, we share concerns of other commenters that the broad scope of the pilot may create costs and burdens that outweigh some of the potential benefits of the pilot. We therefore recommend that the Commission make certain changes to the parameters of the pilot to alleviate some of these concerns.

1. Trade-At Provision

The Commission generally requests comment on the advisability of testing a trade-at requirement as part of the pilot program and whether such a requirement is necessary to analyze the impact of widened tick sizes on the trading and liquidity of small-cap securities.

ICI supports examining issues related to the migration of trading volume away from "lit" venues to "dark" venues. When Regulation NMS was proposed, ICI supported the establishment of a uniform trade-through rule for all market centers. Our comment letter stated that, by affirming the principle of price priority, a trade-through rule should encourage the display of limit orders, which in turn would improve the price discovery process and contribute to increased market depth and liquidity. The letter also stated that a trade-through rule would increase investor confidence in the securities markets by helping to eliminate an impression of unfairness when an investor's order executes at a price worse than the displayed quote. ICI believes the same arguments set forth in support of the trade-through rule could apply to a trade-at requirement, as far as protecting displayed liquidity and preventing passive price matching.

While we support examining the impact of a trade-at requirement on liquidity in the markets, we believe such a requirement is not an appropriate regulatory tool for the proposed pilot program.

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[4] Specifically, securities must have: (1) a market capitalization of $5 billion or less on the last day of the "measurement period"; (2) a closing price of at least $2.00 on the last day of the measurement period; (3) a closing price on every trading day during the measurement period that is not less than $1.50; (4) a "Consolidated Average Daily Volume" during the measurement period of one million shares or less; and (5) a "Measurement Period Volume-Weighted Average Price" of at least $2.00.

Instead, we believe examining the impact of a trade-at requirement in the markets is more appropriate as a separate pilot program, where the Commission can more fully examine the impact of a trade-at requirement on a wider range of securities (not just on small-cap securities), on a wider test group (not just on a limited group of 400 illiquid securities), and in conjunction with a number of other aspects of the current market structure that may impact the amount of liquidity in the lit markets such as liquidity rebates, access fees and broker-dealer internalization.

We also share concerns of other commenters that including a trade-at requirement in the proposed pilot program would be difficult and costly to implement, may overly complicate the pilot program, adds to the operational risk the proposed pilot creates in the markets, and may reduce execution certainty. Significantly, we have heard from other market participants that, particularly as it relates to the trade-at requirement, market makers may choose not to participate in the pilot and therefore not make markets in the securities in the trade-at test group. Such a result could be detrimental to investors and overall liquidity in the markets, and runs counter to the market structure experiment that the SEC hopes to achieve in the proposed pilot.

Given the complexity and uncertainty surrounding the trade-at component of the pilot, ICI recommends that the Commission not include the trade-at requirement in the proposed pilot program. We recommend, however, that the Commission examine the merits of establishing a pilot, as discussed above, which would more broadly examine the impact of a trade-at requirement on the securities markets.

2. Securities to be Included in Pilot

The proposal includes a market capitalization threshold of $5 billion for securities to be included in the pilot. ICI is concerned such a threshold is too broad and will capture stocks beyond those intended to be covered by the pilot. The JOBS Act, and related proposals in Congress around the pilot, focused on smaller-cap companies. ICI believes that setting the threshold at $5 billion would include companies not traditionally in the small capitalization universe. We therefore support lowering the market capitalization for stocks to be included in the pilot.

We also believe that stocks in the pilot should be limited to those of operating companies. ETFs are currently not included in the pilot and we would not support any expansion of the securities to be included in the pilot to include ETFs. In particular, given the unique characteristics of how ETFs are structured and trade, and concerns over the uncertainty of the impact of the pilot on market making activities, we believe ETFs should not be included in the pilot program.

Finally, we do not believe that companies whose securities are included in the pilot should be allowed to opt-out of participating in the pilot. We believe this would impair the ability of the Commission and others to analyze the pilot and would create confusion among market participants when trading.

3. Length of Pilot

As proposed, the pilot would have a duration of one year. Given the importance of the Commission gathering sufficient data to analyze the result of the pilot, and the programming necessary by market participants to prepare for the pilot, we would not object to allowing the Commission an additional year for the pilot if they believe it is necessary.

We would object, however, to the pilot being extended longer than such a time period. Given the complexity and potential unintended consequences involved with the pilot, we believe any longer duration may result in disruptions to the operation of the markets not warranted by the purpose of the pilot.

4. Size of Minimum Increment

ICI believes the $0.05 minimum increment to be tested in the proposed pilot is appropriate. We do not believe that the minimum increment should be any wider than $0.05, as some have suggested. We also believe that the Commission should consider moving away from a one-size-fits-all approach when it comes to minimum increments. There are undoubtedly certain small-cap securities that may benefit from spreads narrower than $0.05 and large-cap securities that may benefit from minimum increments wider than $0.01. Allowing for flexibility in minimum increments may be beneficial to market participants and result in more efficient trading.

C. The Pilot May Result in Unintended Consequences

As the Commission considers whether, and to what extent, to move forward with a pilot program, it is imperative to keep in mind the risk of unintended consequences. Given the complexity and scope of the proposed pilot, we believe there is the potential for unintended consequences for the manner in which institutional investors trade.

Significantly, we are concerned that the pilot may lead to changes in trading behavior by market makers or other market participants. As a result of the complexity, cost and operational risk associated with the pilot, we understand that many firms may not participate, or not participate fully, in the pilot. For example, to help minimize operational risk and costly programming changes, many firms may decide that they will not trade in pilot securities or will only allow certain types of trading in pilot securities on their execution platforms.

Liquid markets are critical for institutional investors, particularly in smaller and less frequently traded securities. If firms decide not to participate in certain stocks, this can be detrimental to funds. The lack of participation, or full participation, also would impact the results of the pilot, which runs contrary to the market structure experiment that the Commission is trying to achieve.

Finally, we are concerned that wider tick size may raise costs for investors. Particularly, as we widen spreads, there will be fewer trading opportunities and the cost to trade may increase.

D. Need to Address Other Market Structure Issues

The Commission generally requests comment on whether there are other market structure initiatives that the Commission should consider to address concerns about the market structure for small capitalization stocks in addition to, or instead of, the proposed pilot program.

As the Commission considers whether, and to what extent, to move forward with the pilot, it is important not to overlook the other changes necessary for the markets that are equally, if not more, important as widening the minimum trading increment. Specifically, we believe it is time for regulators and market participants alike to address, and take action on, many of the difficult and complex issues raised by developments in the structure and operation of the securities markets and the impact of those developments on investors. Issues remain regarding: conflicts of interest that exist in the markets, particularly those surrounding liquidity rebates, access fees and the creation of new and complex order types; issues associated with undisplayed liquidity, including those related to broker-dealer internalization; and issues surrounding the impact of technology and high frequency trading on the markets.

Significantly, ICI previously recommended that the Commission institute pilot programs in areas other than tick sizes. We have specifically recommended that the Commission institute a pilot program to generate data in the area of liquidity rebates. We firmly believe that more must be learned about the effects of this practice on investors and the markets. Brokers are incentivized to make routing decisions based on the availability and amount of liquidity rebates offered by an exchange. At the same time, the benefits of liquidity rebates to investors are doubtful -- investors do not receive these rebates directly and arguably also do not receive the benefits of rebates indirectly.

We therefore recommend that the SEC work with the exchanges and other market participants to establish a pilot program where a certain set of securities would be prohibited from being subject to liquidity rebates. In this manner, the SEC can examine the data generated about liquidity rebate practices and determine whether rulemaking is necessary to address concerns in this area.

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If you have any questions on our comment letter, please feel free to contact me directly at (202) 371-5408 or at aburstein@ici.org.

Sincerely,

/s/ Ari Burstein

Ari Burstein
Senior Counsel

cc: The Honorable Mary Jo White, Chair
The Honorable Daniel M. Gallagher, Commissioner
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