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January 23, 2014

Joseph Dear, Chairman
Investor Advisory Committee
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

VIA INTERNET SUBMISSION

Re: Notice of meeting of Securities and Exchange Commission Dodd-Frank Investor Advisory Committee (“IAC”)

Dear Chairman Dear:

I am grateful for the opportunity to comment on the recommendation of the Market Structure Subcommittee (the “MSS”) of the IAC with respect to decimalization and tick sizes (the “**Recommendation**”).¹ The purpose of this letter is to urge the MSS to adopt Alternative Recommendation #1, as set forth in the dissenting opinion of MSS member Stephen Holmes,² which calls for a pilot program for small-capitalization public companies to trade at wider tick-sizes and limited trading increments within the tick.

I am the Nomura Professor and Director of the Program on International Financial Systems at Harvard Law School, teaching courses on capital markets regulation, international finance, and securities regulation. I also serve as the Director of the Committee on Capital Markets Regulation. I hold a B.A. from Princeton University (Woodrow Wilson School, 1965), an M.A. in Political Science from Stanford University (1967), and a J.D. from the University of Chicago Law School (1972). In 1974, prior to joining the faculty of Harvard Law School, I served as law clerk to the Honorable Justice Byron White. My books include *International Finance: Transactions, Policy and Regulation* (19th ed., 2012); *International Finance: Law and Regulation* (3rd ed., 2012); and *The Global Financial Crisis* (2009). I am also Co-Chairman of the Council on Global Financial Regulation, an independent director of Lazard, Ltd., a member of the Bretton Woods Committee, a past president of the International Academy of Consumer and

¹ Sec. & Exch. Comm’n, *Recommendation of the Market Structure Subcommittee Decimalization and Tick Sizes 1* (Jan. 2014), <http://www.sec.gov/spotlight/investor-advisory-committee-2012/decimal-pricing-draft-recommendation-iac.pdf>.

² Stephen Holmes, Sec. & Exch. Comm’n, *A Dissenting Opinion and Alternative Recommendation #1 regarding the Market Structure Subcommittee’s Recommendation #1 Decimalization and Tick Size 1* (Jan. 2014), <http://www.sec.gov/spotlight/investor-advisory-committee-2012/dissenting-opinion-decimalization-iac.pdf>.

Commercial Law, and a past governor of the American Stock Exchange.

I would commend to the MSS the report of the Equity Capital Formation Task Force, of which I was a member, presented to the U.S. Department of the Treasury on November 11, 2013 (the “**ECF Report**”).³ The ECF Report sets forth in detail the difficulties facing small companies in the current market and regulatory climate, particularly with regards to capital formation and post-IPO liquidity. I respectfully disagree, however, with the MSS’s Recommendation #1, which takes the position that a tick-size pilot program should not be pursued.⁴ The MSS sets forth substantial evidence in its Recommendation in support of the proposition that the decimalization of stock prices in 2000 has not materially affected either capital formation or after-market liquidity for small-capitalization companies.⁵ In contrast, the ECF Report and, indeed, the dissenting opinion of one of the MSS’s own members,⁶ make the opposite claim, highlighting evidence indicating that an increase in tick-sizes would encourage small-capitalization companies to enter the public equity markets.⁷ The ECF Report argues that lack of trading liquidity in many publicly traded small-capitalization companies contributes to the historically low levels of capital formation in this segment. Under existing market structure rules, the ECF Report argues, the lack of trading liquidity has discouraged meaningful institutional investor ownership. Moreover, the ECF Report notes that retail investors—the primary shareholders of small-capitalization companies—would in fact benefit from renewed institutional investor participation. In my judgment, the empirical evidence as to the effects of tick-size on capital formation and after-market liquidity remains an open question and is thus worthy of further study.

I would therefore advocate pursuing a pilot program to test the claims of each side empirically. Such an experiment would most naturally take the form of a pilot program conducted by the Securities and Exchange Commission. A pilot program offers a fair process to test a market structure that I believe will have a positive impact on the U.S. economy, individual investors, institutional investors, and small companies. A properly designed pilot program must feature control and test groups of small-capitalization companies that are selected in a scientifically rigorous fashion. This is a subtle but vital point. Allowing, for example, companies

³ Equity Capital Formation Task Force, *From the On-Ramp to the Freeway: Refueling Job Creation and Growth by Reconnecting Investors with Small-Cap Companies* 1 (Nov. 11, 2013), <http://www.equitycapitalformationtaskforce.com/files/ECF%20From%20the%20On-Ramp%20to%20the%20Freeway%20vF.pdf>.

⁴ Sec. & Exch. Comm’n, *Recommendation of the Market Structure Subcommittee Decimalization and Tick Sizes* 1, 6-8 (Jan. 2014), <http://www.sec.gov/spotlight/investor-advisory-committee-2012/decimal-pricing-draft-recommendation-iac.pdf>.

⁵ *Id.* at 1-10.

⁶ Stephen Holmes, Sec. & Exch. Comm’n, *A Dissenting Opinion and Alternative Recommendation #1 regarding the Market Structure Subcommittee’s Recommendation #1 Decimalization and Tick Size* 1 (Jan. 2014), <http://www.sec.gov/spotlight/investor-advisory-committee-2012/dissenting-opinion-decimalization-iac.pdf>.

⁷ See Equity Capital Formation Task Force, *From the On-Ramp to the Freeway: Refueling Job Creation and Growth by Reconnecting Investors with Small-Cap Companies* 1, 16-22 (Nov. 11, 2013), <http://www.equitycapitalformationtaskforce.com/files/ECF%20From%20the%20On-Ramp%20to%20the%20Freeway%20vF.pdf>; see also Stephen Holmes, Sec. & Exch. Comm’n, *A Dissenting Opinion and Alternative Recommendation #1 regarding the Market Structure Subcommittee’s Recommendation #1 Decimalization and Tick Size* 1, 3-9 (Jan. 2014), <http://www.sec.gov/spotlight/investor-advisory-committee-2012/dissenting-opinion-decimalization-iac.pdf>.

to opt into or out of the test group would undermine the scientific value of the pilot program by introducing self-selection and other endogeneity problems. Further, any pilot program should be permitted to run for a sufficiently long period of time to provide a true empirical test of tick-size on capital formation and after-market liquidity and should test for a number of variables.

Thank you very much for offering an opportunity to comment on this important topic. Should you have any questions or concerns, please do not hesitate to contact me at [REDACTED]

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Hal S. Scott', with a long horizontal flourish extending to the right.

Hal S. Scott