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February 21, 2014

Ms. Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington DC 20549-1090

Re: **Securities and Exchange Commission Dodd-Frank Investor Advisory Committee; File Number 265-28**

Dear Ms. Murphy,

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to comment on a recent recommendation made by the Securities and Exchange Commission's (the "SEC" or "Commission") Investor Advisory Committee, Market Structure Subcommittee with respect to decimalization and tick sizes.[2,3] We agree with the Market Structure Subcommittee's recommendation that the Commission should *not* reverse its decimal pricing policy, including *not* engaging in "tests" or "pilot" programs to widen the tick size for smaller companies (the "Subcommittee's Recommendation").

The Jumpstart Our Business Startups Act[4] (the "JOBS Act") and related SEC rulemaking have created new opportunities for smaller companies to raise capital in the public and private markets. For example, by easing certain requirements in the securities registration process for smaller companies, the JOBS Act seeks to encourage smaller companies to pursue an IPO. Fidelity supports many of the provisions in the JOBS Act designed to improve access to the capital markets for smaller companies.

The JOBS Act also asked the Commission to explore the impact of decimalization on smaller companies and permits, but does not require, the Commission to change the tick size for these securities.[5] We believe that wider tick sizes will increase trading costs for retail investors without improving smaller company access to the public capital markets or the liquidity of their securities.

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[1]Fidelity Investments is one of the world's largest providers of financial services. The firm is a leading provider of investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 20 million individuals and institutions, as well as through 5,000 financial intermediary firms.
[2]Notice of Meeting of Securities and Exchange Commission Dodd-Frank Investor Advisory Committee, Exchange Act Release No. 71289, 79 FR 3260 (January 17, 2014).
[3]Recommendation of the Market Structure Subcommittee, Decimalization and Tick Sizes (January 14, 2014) *available at*: http://www.sec.gov/spotlight/investor-advisory-committee-2012/decimal-pricing-draft-recommendation-iac.pdf
[4]Pub. L. No. 112-106, 126 Stat. 306.
[5]JOBS Act§106(b), 15 U.S.C.§78(k)-1(c)(6)(2012).

Fidelity expressed this view at the SEC's 2013 Decimalization Roundtable ("Roundtable").[6] Since the Roundtable, Fidelity has observed the continued discussion on tick sizes. Among other items, legislative proposals have been introduced that would establish a five-year pilot program administered by the SEC to permit Emerging Growth Companies to increase the tick size at which their securities would be quoted to increments of five or ten cents[7] and SEC Commissioners have discussed the possibility of a pilot program.[8]

We have also observed frequent calls from market participants for a pilot program to widen tick sizes for securities of smaller companies. We attribute this increased interest to market participant's frustrations with recent technology glitches and perceived inefficiencies in the equities markets. In our discussions with other market participants, many concede that a pilot program to widen tick sizes is not likely to increase capital formation for smaller companies. Instead, many are in favor of a tick size pilot program simply as a way to experiment with change in equity market structure. We support a comprehensive SEC review of the current equity market structure, but we do not believe that retail investors and smaller companies should bear the burden of market participant's desire for change.

The Subcommittee's Recommendation has added to a potential tick size pilot program. We agree with the Subcommittee's Recommendation for three primary reasons: 1) other factors, outside of decimalization, have prevented smaller companies from going public and have impacted the liquidity of their securities; 2) imposing wider tick sizes on smaller companies will increase trading costs for retail investors without a corresponding benefit; and 3) we do not believe that widening tick sizes for smaller companies will lead to a greater research focus on those companies. Each of these comments is discussed in further detail below.

<u>Widening the tick size will not help smaller companies because factors outside of decimalization influence smaller companies' decisions to go public and impact liquidity in their securities</u>

In our experience, macroeconomic and regulatory factors influence a company's decision to go public, not tick size. The CEOs and CFOs of private companies consider many factors when determining whether or not to engage in an IPO. Generally, these considerations include disclosure and other regulatory requirements, the need for primary capital, acquisition strategy, employee retention, sector sentiment, market sentiment and valuations -- but not tick size. Moreover, the past decade has witnessed a number of additional factors that have had an impact on a smaller company's decision to go public, such as the Sarbanes Oxley Act of 2002, the proliferation of private securities litigation, the credit crisis of 2008-2009, the availability of

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[6]*See* Decimalization Roundtable, Exchange Act Release No. 68510, 77 FR 76572 (December 28, 2012). Brian B. Conroy, President, Fidelity Capital Markets participated in *Panel 1: Evaluating Concerns Relating to Tick Size for Small and Middle Capitalization Companies*. SEC Decimalization Roundtable, February 5, 2013.

[7]*See,* i.e. H.R. 3448: Small Cap Liquidity Reform Act of 2014, which passed the United States House of Representatives on February 11, 2014.

[8]*See,* i.e. *Focusing on Fundamentals: The Path to Address Equity Market Structure*, speech by SEC Chair Mary Jo White, Securities Traders Association 80th Annual Market Structure Conference, Washington, D.C. October 2, 2013 *available at*: http://www.sec.gov/News/Speech/Detail/Speech/1370539857459 and *Advancing and Defending the SEC's Core Mission*, speech by SEC Commissioner Michael S. Piwowar, U.S. Chamber of Commerce, Washington, D.C., Jan. 27, 2014 *available at*: http://www.sec.gov/News/Speech/Detail/Speech/1370540671978

private equity capital, bank recapitalizations and the TARP program, low valuations and declining overall market liquidity. Given this variety of factors, we do not believe that tick size is relevant to a company's decision to conduct an IPO.

Similarly, we believe that float and position concentration, not decimalization, cause lower liquidity in the securities of smaller companies. Institutional investors are significant participants in the U.S. equity markets. An important factor in the decision of an institutional investor to invest in a company is the availability of enough outstanding shares of a given company's stock, or "float", to permit the institutional investor to make trades in and out of the market without significantly affecting the price of the security. If an institutional investor cannot trade a small company's stock without moving its price substantially, it will often decide not to invest in the security.

A smaller company typically has fewer shareholders than a larger company has.[9] Company insiders often hold the majority of a smaller company's outstanding shares, which means that there is less stock left for the public to own. The ability to match buyers and sellers is more difficult when only a few sophisticated investors own the stock, and a Commission decision to widen the tick size of securities of smaller companies will not increase the float at these companies. Moreover, in our experience, holders of securities in smaller companies normally hold their stock with a high level of conviction, which means that a decision to sell the stock is based more on the fundamentals of the company, and less on any premium to last sale. As a result, we do not believe that wider tick sizes will improve liquidity in these securities.

<u>A change in tick size for smaller companies will increase trading costs for retail investors without a corresponding benefit</u>

Several participants at the Roundtable, and recent comment letters to the Commission, observed that because securities analysts depend on revenue from trading commissions, they have an incentive to cover only high volume stocks. Conversely, because many securities of small and middle capitalization companies do not have such trading volume, they have less analyst coverage, which has led to a decline in investor awareness and interest in these securities. If the SEC were to increase the minimum tick size for the securities of smaller companies, then, so the argument goes, market intermediaries would realize greater profits from trading costs, which would in turn lead them to promote the securities of smaller companies, thereby spurring investor demand.

We question the assertion that greater promotion of smaller company securities by market makers will spur retail investor interest. Our retail investor data indicates that retail investors typically shun securities, in all capitalization categories, with wider spreads, and smaller capitalization securities already have wider spreads relative to the securities of companies with

[9] For example, the median number of institutional holders of a Russell 2000® stock is 155 holders and the median number of institutional holders of an S&P 500® stock is 833 holders. Source: Bloomberg data (February 2014).

middle or larger capitalizations.[10] Given this data, we believe that any increased promotional activities will be more than offset by the negative impact of wider spreads.

Moreover, those retail investors that continue to buy securities of smaller companies will also be harmed. Instead of placing orders in penny increments, retail investors will be required to place orders in higher increments, such as nickel and dime increments. Over time, we believe that these increased trading costs will detract from retail investors' savings goals. Moreover, in our experience, retail customers have grown accustomed to placing orders in a penny increment and find it intuitive to do so.

<u>Eliminating decimalization will not improve the economics of research on smaller companies</u>

Many who argue for wider tick sizes for smaller companies assert that an increase in tick size will provide increased profits to market makers that will spur research coverage for and interest in, smaller companies. We believe these claims are unfounded and that ample research on securities of smaller companies currently exists.

Today, retail investors have a significant amount of research available to them on smaller company securities. For example, Fidelity currently offers its retail customers, through its website, an Equity Summary Score on over two thousand issuers with total annual gross revenues of less than $1 billion. The Equity Summary Score, provided by Starmine®, provides a consolidated view of the ratings from a number of independent research providers. Only stocks that have four or more analyst opinions qualify for an Equity Summary Score. The availability of the Equity Summary Score for a large number of smaller companies demonstrates that equity research on smaller companies is available to retail investors today, but the source of this research is not sell-side analyst research.

We also note that since decimalization was implemented in the U.S. securities markets, there has been a paradigm shift in research coverage. For a variety of factors, there are fewer publishing analysts at sell-side firms and a steady growth of in-house research staff at many buy-side firms. As a result, many buy-side firms no longer rely on sell-side firms for research coverage to the same extent they did twenty years ago. We believe that if the Commission increases the tick size of smaller securities to incent increased analyst coverage of these securities, the resulting research will not be helpful to buy-side firms and will not improve on the level of research information already available to retail shareholders.

We also question the assumption that wider tick sizes will actually drive the economics of market maker firms sufficiently to create research on smaller companies. We have yet to hear a proponent of wider tick sizes commit to provide research on smaller companies if tick sizes are widened or suggest the presence of research as a measurement of success in a potential tick size pilot program. We believe that a Commission decision to widen tick sizes will serve to subsidize

[10] For example, in dollar weighted volumes, 84% of our retail investor trading is in stocks with less than a 10bps spread.

less-efficient market makers, who may not ultimately produce more research on smaller companies involved in the pilot, at the expense of retail investors and fund shareholders.

Recommendations concerning the structure of a pilot program

Although we do not agree that the Commission should widen tick sizes of smaller company securities, we acknowledge that the Commission may nevertheless pursue a tick size pilot program to generate data prior to making a final decision on this topic. Accordingly, we offer our views on effective ways to structure a pilot program, should the Commission decide to pursue this approach.

We strongly oppose the pilot program including a "Trade-At" rule under which trading venues and brokerage firms would only be allowed to execute orders away from an exchange if the venue or brokerage firm could provide price improvement in the trade by a specified amount over the market's best price. We believe that non-traditional and non-displayed liquidity pools are an integral part of market structure that provide increased liquidity and anonymity as well as pricing conducive to seeking best execution for our mutual funds and retail customers. We believe that a "Trade-At" rule will harm investors by adversely impacting competition, reducing the quality of trade executions and significantly increasing trading costs.

Moreover, we believe that imposing a "Trade-At" rule in a pilot program will *decrease* liquidity in smaller securities. Our experience shows that smaller capitalization securities are more often traded in venues other than exchanges. Under a "Trade-At" rule, there is a disincentive for non-exchange participants to provide liquidity to the market, because small price improvements (i.e., prices that do not exceed the specified amount) would not be sufficient to allow orders to be executed away. For these reasons, we urge the Commission to not include a "Trade-At" rule in a potential pilot program.

At a minimum we believe that any pilot program should be limited in scope and time with clearly established parameters that define what a "successful" pilot means. The pilot program should include periodic reviews, with the ability to immediately terminate the program if it presents negative effects on the included securities. We believe that the primary goal of the pilot program should be to determine whether liquidity was enhanced in the pilot program's securities as a result of a wider tick size. We believe that improved liquidity should be measured by the pre- and post-pilot depth and duration of the quote in the order book.

Lastly, we oppose any pilot program that would prohibit trading at increments smaller than the pilot program's wider quoting increments and market center trading at the midpoint of the wider spread. Such a prohibition would go against current market practices and prevent broker-dealers from providing price improvement to retail customers. Moreover, any potential pilot program should also permit the ability to quote in wider increments.

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Fidelity thanks the Commission for considering our comments. We would be pleased to provide any further information or respond to any questions that you may have.

Sincerely,

Scott C. Goebel

cc:

The Honorable Mary Jo White, Chairman
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner

Mr. Joseph Dear, Chairman, Investor Advisory Committee

Mr. John Ramsay, Acting Director, Division of Trading and Markets
Mr. James R. Burns, Deputy Director, Division of Trading and Markets
Gregg E. Berman, Associate Director, Office of Analytics and Research, Division of Trading and Markets
Mr. David Shillman, Associate Director, Division of Trading and Markets
Craig Lewis, Director and Chief Economist, Division of Economic and Risk Analysis