MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

May 1, 2013

Via Electronic Mail
Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: SEC Decimalization Roundtable

Dear Ms. Murphy:

Managed Funds Association[1] ("MFA") submits this letter in response to the Securities and Exchange Commission's ("SEC" or "Commission") Decimalization Roundtable notice and request for comments.[2] MFA appreciates the Commission's review, evaluation, and continued efforts to improve aspects of the U.S. equity markets. We appreciate the Commission's examination of the current tick size regime and whether the SEC or the markets should make further changes to promote more fully fair and efficient trading and the protection of investors.

MFA represents the views of hedge fund managers, including registered investment advisers and private investment pools, whose investors include pensions, endowments, foundations and insurance companies. As investors, generally, we believe that decimalization has been an enormous success as it has dramatically reduced transaction costs for investors—especially for retail investors who typically trade at the national best bid or offer. We believe decimalization has achieved the goals set-out by the Commission—namely, "enhancing investor comprehension, facilitating globalization of our markets, and . . . reducing transaction costs."[3]

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[1] The Managed Funds Association ("MFA") represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

[2] SEC Release No. 34-68510; File No. 4-657 (Dec. 21, 2012).

[3] SEC Order and Notice: Order Directing the Exchanges and NASD to Submit a Phase-In Plan to Implement Decimal Pricing in Equity Securities and Options, Release No. 34-42914 (June 8, 2000).

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I. Pilot Program on Tick Sizes

At the Commission's Decimalization Roundtable, roundtable participants discussed their views on how tick sizes affect small and mid-cap companies. They discussed ways to collect useful data that would enable the Commission to evaluate tick size issues, including the idea of a pilot program that would assign varying tick sizes to a control group of stocks of different types of companies ("Pilot Program"). We believe pilot programs can be very effective in testing and measuring the efficacy of regulatory proposals in a manner that limits the potential costs and negative consequences.[4] We believe establishing a Pilot Program would be instrumental in providing the Commission with useful data to evaluate tick sizes. MFA supports standardized minimum tick sizes that are set methodically and based on empirical data to help securities trade more efficiently.

We would be concerned, however, if the purpose of a Pilot Program was to increase minimum tick size for the securities of smaller capitalization companies solely to provide market intermediaries with greater profits on the theory that they would then increase their promotion of such securities.[5] Investors should not be forced to cross-subsidize sell-side market research through artificially wide tick sizes.

Despite the potential benefits of a Pilot Program, we recognize that pilot programs are not without costs and can be very time-consuming and expensive to implement. As an initial step, we believe the Commission staff could analyze trading information from its Market Information Data Analytics System ("MIDAS") to better understand trading dynamics and the full depth of book for liquid and illiquid stocks.[6] If the Commission determines to propose a Pilot Program, we believe the Commission should proceed at this time only with a targeted pilot for less liquid stocks for the duration of one year. This would give the Commission the opportunity to gather data and proceed in a focused and cautious manner, before adjusting fundamental rules for trading stocks.

II. Criteria for a Pilot Program

In order for a Pilot Program to be meaningful, the objective needs to be clearly defined and measurable. In MFA's view, the objective of the Pilot Program should be to test an approach for improving the liquidity of less liquid stocks. The Commission should focus on measuring trading volume, top of book quote size, and depth of the quoted book. We believe a Pilot Program could be helpful in testing an approach to improve liquidity of smaller stocks. We do not believe, however, a Pilot Program would prove useful as a means for assessing the impact of tick size on the sell-side research following of these stocks or on the number of initial public

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[4] *See, e.g.,* Economic Analysis of the Short Sale Price Restrictions Under the Regulation SHO Pilot, SEC Office of Economic Analysis, February 6, 2007.

[5] *See* SEC Report to Congress on Decimalization, July 2012, at 21 referencing Weild, David and Edward Kim, 2010, Market structure is causing the IPO Crisis – and More, Grant Thornton Capital Markets Series.

offerings. The link between these broader objectives is too tenuous and too dependent on inefficient cross-subsidies to make a pilot program on tick size effective as a test of means for achieving these goals. As a result, we do not believe that it is realistic to construct a Pilot Program to measure such attenuated effects.

With respect to criteria for a Pilot Program, we suggest using a cross-section of the Russell 2000 securities as the test and control group, which will allow the Commission to compare and measure the impact of tick size on securities from a range of liquidity levels and price. The Commission should use price and market capitalization as controls for a Pilot Program. The Commission should measure pre- and post-Pilot Program, as well as cross-sectionally during the Pilot Program: (1) trading volume of securities; (2) average trade size; (3) wait time for order fills; (4) the percent of orders filled in dark pools or whether there is price improvement in dark pools; (5) width of NBBO (as a proxy for retail cost); (6) the cancellation rate in the securities; and (7) the difference between estimated transaction costs and the amount actually paid (slippage) for institutional orders. The Commission should also consider measuring market quality, such as the cost of trading for institutional and retail customers and the depth of book; as well as other measures, including how frequently a security trades and how much quoted security is at the national best bid and offer and beyond.

We further believe that a Pilot should be designed to test the hypothesis that tick size should be inversely proportional to each of stock price and stock trading volume (*i.e.*, the higher the price, the larger the tick size; and the greater the stock volume, the smaller the tick size). The ratio of stock price to tick size is a benchmark used to set tick sizes in both the United States and in many other markets around the world.[7] It is a useful benchmark because if the minimum tick size is too large relative to the price of a stock, trading the stock becomes costly.

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[7] In the U.S., stocks priced above $1 trade in increments of $.01, and stocks priced below $1 trade in increments of $.0001. *See* Rule 612 of Regulation NMS, 17 CFR § 242.612. Similarly, U.S. listed options tick sizes get progressively larger as the price of the option contract increases.

MFA appreciates the opportunity to submit comments to the Commission on a tick size Pilot Program. MFA supports a Pilot Program focused on enhancing market liquidity and efficiency, and believes that such a data-driven approach minimizes unintended consequences and harm to markets and investors. We would be concerned, however, if the purpose of a Pilot Program was to provide market intermediaries with greater profits on the theory that they would then increase their promotion of such securities. We would be pleased to meet with the Commission or its staff to further discuss a Pilot Program. If the staff has questions or comments, please do not hesitate to contact the undersigned or Jennifer Han, Associate General Counsel, at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President and Managing Director,
General Counsel

CC: The Hon. Mary Jo White, Chairman
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner
The Hon. Daniel M. Gallagher, Commissioner
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