Security Traders Association
Dictum Meum Pactum Since 1934



September 23, 2014

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

Re: Plan to Implement a Tick Size Pilot Program

Dear Ms. Murphy:

The Security Traders Association ("STA")[1] submits this comment letter on the national market system plan ("Plan") proposal filed by the national securities exchanges and the Financial Industry Regulatory Authority ("FINRA") to implement a targeted 12-month pilot program that will widen minimum quoting and trading increments ("tick sizes") for certain stocks with smaller capitalization. This proposal was filed on August 26, 2014 in response to the June 24, 2014 Securities and Exchange Commission ("SEC" or "Commission") order directing the exchanges and the Financial Industry Regulatory Authority to submit a tick size pilot plan (Release No. 34-72460). Data gathered from the Plan will enable the Commission to study the impact of wider quoting and trading increments on the trading of certain small capitalization stocks. Once published in the Federal Register, the Plan will be open for public comment for 21 days.

As an organization of individual professionals and practitioners in the markets, the STA focuses comments on issues related to market structure. STA does not represent any specific business model, but rather encompasses a broad range of industry participants. It is from this broad based membership that STA seeks to build bottom-up consensus regarding issues that relate directly to the U.S. securities markets.

STA has and continues to ground our comments around several guiding tenets:

- Regulation should be grounded around the analysis of relevant empirical data.
- Key to market innovation and progress is the promotion of competition.

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[1] STA is a trade organization founded in 1934 for individual professionals in the securities industry. STA is comprised of 26 Affiliate organizations with 4,200 individual professionals- most of who are engaged in the buying, selling and trading of securities. The STA is committed to promoting goodwill and fostering high standards of integrity in accord with the Association's founding principle, **Dictum Meum Pactum** – *"My Word is My Bond"*.

[2] STA Comment Letter; "Tick size study mandated by the Jumpstart our Business Startup Act of 2012"
STA Comment Letter to SEC Advisory Committee on Small and Emerging Companies, April 30, 2013
STA Letter to SEC Chairman Mary Schapiro; November 20, 2012
STA Testimony before Capital Markets & Government Sponsored Enterprise Subcommittee, Committee on Financial Services U.S. House of Representatives; June 20, 2012



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**Background**

The subject of minimum pricing variations ("MPVs") and its impact on overall liquidity and capital formation is a topic on which the STA has commented on in the past[1]. We believe that strong secondary trading markets are essential to private capital formation because investors are less likely to participate in initial public offerings without a reasonable expectation that an active secondary trading market will develop for the securities thereafter. In addition, we believe that MPVs greater than one penny may strengthen secondary trading in smaller companies like those defined in the Plan, and could contribute positively to their ability to raise capital.

In our letter to the Commission dated July 16, 2012 we stated:

> *STA recommends the Commission initiate a pilot program utilizing a statistically significant number of emerging growth companies and an appropriate period of time to study the impact on the secondary markets of quoting MPVs in increments of greater than one penny.*

**Executive Summary**

The STA offers several preliminary comments on the proposed design of the Plan. We hope that by doing so, a heightened awareness on the Plan's relevant issues will foster consensus-building.
This letter addresses the following relevant issues:

- Goals of the plan should be clearly defined and prioritized.
- The purpose for specific data and insight into the Commission's response from specific results should be provided in the Plan's filing.
- Data which does not contribute towards measuring improvements or degradations of the goals, or conflicts with the primary goal of the Plan, should not be mandated.
- The Plan should balance simplicity and costs in its design with creating the conditions which allow the variables to be tested efficiently.
- Modifications to Test Group Three ("Trade-At") should be implemented.

**The Primary Goal –Natural and enhanced liquidity.**

It is reasonable for the Plan to gather data for more than one purpose or goal. However, goals should be clearly defined and prioritized. STA believes there should be one primary goal. Doing so will ensure variables which may achieve data for secondary goals, but conflict with the primary goal are not implemented into the Plan's final design.

STA continues to believe the primary goal of the Plan should be collecting data which measures overall liquidity, both natural and enhanced, available to investors in small capitalization stocks.

Simply defined, natural liquidity is liquidity provided by investors and traded on publically lit and privately unlit markets. Enhanced liquidity is liquidity that exceeds what is publicly and privately available in the marketplace. Enhanced liquidity could be the result of a sub-category of trading centers that provide capital commitment and conduct secondary offerings or institutional block trades.

It remains STA's view that shareholders in smaller capitalization securities that lack a robust secondary market benefit from the presence of market makers and block traders who can, among other things, provide enhanced liquidity to increase the depth of the market. The commitment of capital to facilitate trading might not be noteworthy for actively traded stocks, but can have a significant positive impact on the quality of trade executions in illiquid securities.

While the conditions which incentivize enhanced liquidity are numerous, certain core conditions are found in the design of market structure which could improve its existence. STA is interested to see if empirical data gathered from this pilot program shows improvements or degradations to those core factors which nurture enhanced liquidity, such as:

- **Quote quality**. Improvements to displayed liquidity should focus on quote size and ensure that what is publically displayed is accessible in a fair and reasonable way.
- **Volatility.** Providers of enhanced liquidity are more inclined to commit capital and more able to conduct block trading if the prices of the security the provider transacts in remains stable.
- **Reduction in costs**. The withdrawal of market makers is partially related to the increased costs of trading illiquid securities.

**The purpose for specific data and insight into the Commission's response from specific results should be provided in the Plan's filing.**

The Plan's initial design imposes numerous mandates for data. The purpose for the specific data points is unclear, and how the data may be used is also unclear. In addition, insight into what is considered meaningful or not relevant for a permanent decision on particular goals is recommended.

**Data which does not contribute toward measuring improvements or degradations of the goal(s) should not be mandated.**

Several of the data points identified in the release, coupled with the public availability of such data will add explicit and implicit costs. Requiring firms to capture data they are not capturing today will add additional costs to the pilot. In addition, making certain data publicly available could disincentivize behavior which the pilot is attempting to encourage. Therefore, the STA believes data which does not contribute towards measuring improvements or degradations of the goal(s) should not be mandated.

For example, as stated previously, STA continues to believe the primary goal of the Plan should be collecting data which measures overall liquidity, both natural and enhanced, available to investors in small capitalization stocks. The profitability data requirement in the release may be useful for measuring certain secondary goals of the Plan, but will disincentivize certain market makers from participating in the Pilot.

**The Plan should balance simplicity and costs in its design with creating the conditions which allow the specific variables to be tested efficiently.**

Consideration should be given to the feasibility of conducting a pilot with existing routing and data capture which is performed by participants today. Exemption requests should be considered in situations where major enhancements and incremental costs are required to comply with the Plan.

For example:

The NBBO for Pilot Security ABC is $20.00 x $20.10. Trading Center 1 is displaying a 100-share protected bid at $20.00. Trading Center 2 is displaying a 100-share protected bid at $20.00. Trading Center 2 also has 300 shares hidden at $20.00. There are no other protected bids. Trading Center 2 receives an incoming order to sell for 400 shares. Under the proposal, Trading Center 2 may execute 100 shares against its full displayed size at the protected bid at $20.00. To execute the 300 shares hidden at $20.00, Trading Center 2 must respect the protected bid on Trading Center 1 at $20.00, even though Trading Center 2 can satisfy the entire 400 shares. The change in execution logic for Trading Center to facilitate compliance under the Plan is highly complex. Therefore, STA recommends that passive bids and offers be provided an exemption which allows them to satisfy incoming orders which fill both their displayed and non-displayed prices.

**Modifications to Test Group Three ("Trade-At") should be considered.**

STA is opposed to trade-at for reasons stated in our April 2011 letter.[2] It remains our view that execution choices for an investor's orders would be limited in a "trade-at" regime. Furthermore, the explicit and implicit costs to implement and execute in a "trade-at" regime would be significant. However, we are not opposed to conducting a pilot which gathers empirical data of the effects a "trade-at" regime has on the overall liquidity available to investors in small companies, provided the additional resulting complexity, and the associated cost benefit analysis is reasonable.

We believe that Test Group Three, the "trade-at" group, as currently designed with depth of book price protection is too complex and we recommend it be simplified.

**Conclusion:**

The STA views the proposed plan as too complex in its current design, but supports a pilot plan to study the effects decimalization with no minimum price variation has on the liquidity of smaller capitalization stocks.

John Daley, Stifel Nicolaus
Chairman of the Board

James A. Toes
President & CEO

[2] Letter to Elizabeth Murphy Re: File No. 265-26; Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues Recommendations Regarding Regulatory Responses to Market Events of May 6, 2010.