December 19, 2014

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 205491090

Re: Release No. 34-72460, Plan to Implement a Tick Size Pilot Program

Dear Ms. Murphy,

Themis Trading appreciates the opportunity to comment on the plan submitted by the exchanges and FINRA to implement a tick size pilot program.

For your background, Themis Trading is an institutional agency brokerage, providing investment managers of all sizes with best possible execution on their equity trade orders. We represent long-term investors who form the backbone of our capital markets system by investing in the growth of public companies and the US economy.

We would like to commend the Commission for ordering the exchanges and FINRA to produce this plan. We understand that there were many industry participants who lobbied against the tick size pilot program and even the SEC's Investment Advisory Committee voted against the pilot. By ordering the exchanges to produce a plan, the Commission has demonstrated that they are serious about market structure reform and will not be distracted by self-interested industry participants.

Themis Trading has long supported the tick size pilot program. In addition to filing two comment letters with the Commission strongly supporting the program (Letter 1, 11/20/13; Letter 2, 1/27/14), we have written numerous blog posts on the subject. In our letter to the SEC's Investor Advisory Committee dated January 27, 2014, we commented:

> "We believe that one of the main reasons for the dearth of liquidity in these small cap stocks is the lack of incentive for investors and real market makers to display visible liquidity. Visible quotes are often traded in front of by so called 'internalizing' market makers. These market makers pay online retail brokerage firms for the right to trade against orders from the firms' clients.

These trades take place off exchange in ‘dark markets’ with at best minute sub-penny price improvement. In fact, it is routine to observe half of the trade volume in the small cap space to occur off-exchange and in the dark. Thus, the internalizer-payment-for-order-flow-system that fuels this off-exchange trading disadvantages displayed liquidity providers.

“We strongly believe a mandated wide tick program can help alleviate this problem, particularly if it includes a minimum price improvement feature for any trade that occurs off-exchange. Therefore, we recommend that all trades executed in stocks that are in the wide tick pilot program only be allowed to trade at the bid and offer of such minimum wide tick increment, with an exception allowed for all participants at the mid-point between the two.”

We were pleased to see that the tick size pilot plan contained a test bucket (Test Group Three) that addresses our concerns about off-exchange trading. However, we do have a number of concerns that we would like to express to the Commission about the plan:

1) **Selection of securities in the pilot program**

According to the Plan, securities will be selected as follows:“The Operating Committee will select the Pilot Securities to be placed into three Test Groups by means of a stratified random sampling process. To effect this sampling, each of the Pilot Securities will be categorized as having (1) a low, medium, or high share price based on the Measurement Period VWAP, (2) low, medium, or high market capitalization based on the last day of the Measurement Period, and (3) low, medium, or high trading volume based on the CADY during the Measurement Period, yielding 27 possible categories. Low, medium, and high subcategories will be established by dividing the categories into three parts, each containing a third of the population.”

We believe that the publicly traded companies that are being selected for the pilot program should be notified prior to their inclusion and offered the opportunity to opt out if they have specific concerns. Tim Quast from ModernIR points out in his comment letter some issuer-based concerns:

“Yet issuers are barely mentioned in the proposed pilot. We were able to identify but a handful of instances of the words “company” or “issuer,” and two referenced terms and definitions.”

Public companies have long been a missing constituent in the market structure debate, but should be consulted before this major change takes place in their stocks. We view the goal of this program as one focused on helping increase liquidity in small-cap stocks and helping those companies realize the full benefits of publicly listing their shares. As such, the program should place more emphasis on feedback from the companies themselves.

2) **Size of companies being included in the pilot program**

The Plan has called for companies with a market capitalization of less than $5 billion and consolidated average daily volume of one million shares or less. We believe these measures are too large and should be scaled back to a market capitalization more representative of small cap stocks: $2 billion or less. We think these values are more appropriate in targeting the type of companies that could benefit from the tick size pilot program. Our size suggestions are based on data from a September 2014 SEC study by Charles Collver titled **"**A characterization of market quality for small capitalization US equities." The study states these facts:

- Small capitalization stocks exhibit much less depth than stocks in the $2 to $5 Billion capitalization range. The smallest stocks (< $100 Million capitalization) exhibit displayed depth on the order of 0.2 to 1.1 per cent of the depth for similarly priced stocks in the $2 to $5 Billion.

- During 2013, US-listed, US-domiciled small cap stocks with capitalizations below $1 Billion were much less liquid than stocks with capitalizations between $1 Billion and $5 Billion. Small cap stocks had larger quoted and effective spreads and traded much lower volumes than mid cap stocks. They also showed lower depth at the inside quotes and beyond. Liquidity improved with market capitalization: the smallest stocks with capitalizations below $100 Million exhibited the least liquidity and mid cap stocks with capitalizations between $2 Billion and $5 Billion exhibited the greatest liquidity.

- Median quoted spreads range from 6.22 to 113.52 cents for the smallest stocks and from 1.00 to 5.77 cents for stocks with capitalizations between $2 Billion and $5 Billion.

- On average, the smallest capitalization stocks have much less displayed size at all levels of the order book when compared to larger capitalization stocks.

This SEC study shows that once you get past the most active stocks, most small cap stocks trade with wide spreads and with very little liquidity. It is precisely these stocks that the tick size pilot program should be designed to assist.

3) **Exceptions to the trade-at prohibitions**

We believe that for the tick size pilot program to be properly evaluated it must remain as pure as possible. This means having as few as possible exceptions to the new rule.

Of the four pilot test groups, Test Group 3 is the most controversial since it contains a trade-at provision. There were 13 trade-at exceptions from this rule written into the tick size pilot plan by the exchanges and FINRA. This surprised us since we thought the exchanges would be satisfied with the trade-at provision since it would drive some off-exchange volume back to the exchanges. Some of the more curious of the 13 trade-at exceptions were exceptions five through thirteen:

- The order is executed as part of a transaction that was not a "regular way" contract;
- The order is executed as part of a single-priced opening, reopening, or closing transaction by the trading center;
- The order is executed when a protected bid was priced higher than a protected offer in the Pilot Security
- The order is identified as an Intermarket Sweep Order;
- The order is executed by a trading center that simultaneously routed Trade-at Intermarket Sweep Orders to execute against the full displayed size of the protected quotation that was traded at;
- The order is executed as part of a Negotiated Trade;
- The order is executed when the trading center displaying the protected quotation that was traded at had displayed, within one second prior to execution of the transaction that constituted the trade-at, a best bid or best offer, as applicable, for the Pilot Security with a price that was inferior to the price of the trade-at transaction.

- The order is executed by a trading center which, at the time of order receipt, the trading center had guaranteed an execution at no worse than a specified price (a "stopped order") .
- The order is for a fractional share of a Pilot Security, provided that such fractional share order was not the result of breaking an order for one or more whole shares of a Pilot Security into orders for fractional shares or was not otherwise effected to evade the requirements of the trade-at prohibition or any other provisions of the Plan.

In their cover letter to the SEC, the exchanges and FINRA justified exemptions five through thirteen as follows:

> "The fifth through thirteenth exceptions apply the trade-through exceptions found in Rule 611(b) to the trade-at prohibition. **The Participants believe that the rationales underlying the trade through exceptions apply to the trade-at prohibition as well.** Consistent with this belief, the Participants have included the trade-through exceptions as exceptions to the trade-at prohibition, subject to a few minor changes to account for the difference between the trade-at prohibition and the trade-through prohibition."

The exchanges and FINRA are using the rationale behind the exceptions to Reg NMS's Rule 611(b) as precedence for their exemptions to the trade-at prohibition. We believe that the trade-through rule, which was controversial when it was approved in 2005 by the Commission, was designed with a different intent than the proposed trade-at prohibition. **To equate the two rules is disingenuous and will undermine the intent of the pilot program.**

While it was no doubt well-intentioned, Reg NMS is at the heart of many of today's market structure problems. We believe that if the Commission were to grant trade-at prohibition exemptions based on a Reg NMS precedence, our market structure problems will be further exacerbated and the pilot program will be undermined. In our opinion, approving all of the trade-at prohibition exemptions just because Reg NMS had trade-through exemptions is not a valid reason.

The complexity of the Reg NMS trade-through rule and its many exceptions gave rise to special exchange order types such as the Post Only Day ISO and the Hide-Not-Slide orders. These order types are currently the focus of an intense industry debate as well as the subject of whistle-blower complaints. We fear that, if the tick size pilot trade-at prohibition exemptions are approved as proposed, we will just be recreating the same problems that we are trying to fix now.

4) **Duration of the pilot program**

The Plan has proposed a one-year pilot program. We believe that this is too short a time period for industry participants to properly analyze the results of increasing the tick size for small cap stocks.

- Brokerage firms will need some time to reestablish themselves in the small cap arena if they decide the economics have changed due to the tick size pilot.

- Institutional investors, who have abandoned the small cap space due to liquidity concerns, will need time to establish research operations to properly evaluate the fundamentals of these stocks.

We believe that a more appropriate time frame for the tick size pilot is five years. This longer period will give industry participants more time to reestablish themselves in the small cap arena.

Conclusion

Themis Trading believes that issuers need to be a bigger part of the tick size pilot program – they should be consulted earlier and more regularly in the process, since the goal of the program is to help their stocks trade in a more liquid way.

We believe the pilot program should be extended from the proposed one year period to five years so that the market has time to adjust to the new conditions. We also believe that the pilot program should be targeting stocks that currently have liquidity concerns – specifically stocks with a capitalization of $2 billion or less.

We also strongly believe that the excessive trade-at exceptions will undermine the entire program by compounding current Reg NMS-borne problems and even creating new ones. Again, we cannot lose sight of the purpose of the program, which is to facilitate better capital flows among small-cap companies. The needs and desires of intermediaries should be secondary to that goal.

Addressing all of these issues will make the program more effective and will enable it to be evaluated by the market on its merits, and without compromise. It will make the results of the tick size pilot program more meaningful, and everyone will be in a better position to determine if it's worth expanding.

Sincerely,

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Themis Trading, LLC

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