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

December 22, 2014

**Via Electronic Mail: rule-comments@sec.gov**

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

**Re: Proposed NMS Tick Size Pilot Program; File No. 4-657**

Dear Mr. Fields:

Managed Funds Association[1] ("**MFA**") submits this letter in response to the Securities and Exchange Commission's ("**SEC**" or the "**Commission**") solicitation for comments on its "Notice of Filing of Proposed National Market System Plan to Implement a Tick Size Pilot Program On a One-Year Pilot Basis" (the "**Proposing Release**").[2] On June 24, 2014, the Commission directed the national securities exchanges and the Financial Industry and Regulatory Authority ("**FINRA**") (together, the "**Plan Participants**") to develop and file a National Market System plan to implement a pilot program that would widen the quoting and trading increment for certain small capitalization stocks (the "**SEC Order**").[3] On August 25, 2014, the Plan Participants, in response to the SEC Order submitted to the SEC a plan to implement a tick size pilot (the "**Tick Size Plan**").[4] The Proposing Release requests for comments on the Tick Size Plan.

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[1] 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 many other regions where MFA members are market participants.

[2] 79 Fed. Reg. 66423 (Nov. 7, 2014) (hereinafter, the "Proposing Release"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2014-11-07/pdf/2014-26463.pdf.

[3] Securities Exchange Act Release No. 34-72460, June 24, 2014, *available at*: http://www.sec.gov/rules/other/2014/34-72460.pdf.

[4] *See* letter from Brendon J. Weiss, Vice President, NYSE Group, to Secretary, SEC, dated August 25, 2014, regarding Plan to Implement a Tick Size Pilot Program, *available at:* http://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-transmittal-letter.pdf; *and* Plan to Implement a Tick Size Pilot Program, Submitted to the SEC

MFA appreciates that the Commission has extended the comment period on the Proposing Release from 21-days, as indicated in an earlier Commission press release,[5] to 45-days, providing investors with greater time to analyze it.[6] The SEC Order and the Tick Size Plan are both more extensive and complex in scope than investors originally anticipated. In our letter, we raise concerns that aspects of the Tick Size Plan will harm investors. We respectfully urge the Commission in proposing and implementing market structure initiatives in 2015 to consider MFA's equity market structure recommendations, which we believe will be broadly beneficial for market integrity and market participants. We highlight these recommendations in Section III of our letter and attach a copy of our equity market structure recommendations.[7]

## I. Overview/Executive Summary

MFA supports the Commission's selective and narrow use of pilot programs. As pilot programs are not without costs, the Commission should be mindful of potential risks to investors and market integrity, as well as implementation costs, most of which investors bear in the form of additional fees/costs. In our view, the SEC should design pilot programs to deliberately and carefully test specific changes to market structure.[8] A disciplined, data-driven approach ensures that rulemaking is driven, less by competitive interests among market participants, and more by measurable benefits to liquidity, efficiency, competition and capital formation. To safeguard the integrity of experimental data, however, the Commission must design pilots wisely. Implementing many changes simultaneously will increase market complexity and complicate the Commission's ability to evaluate and draw affirmative conclusions from a pilot.

MFA has deep reservations with the Tick Size Plan as proposed. As investors, we believe that decimalization[9] was an enormous success as it dramatically reduced transaction costs for investors—especially for retail investors who typically trade at or better than the national best

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Pursuant to Rule 608 of Regulation NMS under the Securities Exchange Act of 1934, *available at*: http://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-final.pdf.

[5] SEC Announces Pilot Plan to Assess Stock Market Tick Size Impact for Smaller Companies, August 26, 2014, *available at:* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542761050#.VBzmfFJMvIU.

[6] *See* letter from Stuart J. Kaswell, Executive Vice President & General Counsel, MFA, to Brent J. Fields, Secretary, SEC, dated September 20, 2014 (requesting for a 60-day comment period on a Proposed Tick Size Pilot due to the complexities raised by it), *available at*: https://www.managedfunds.org/wp-content/uploads/2014/09/MFA-Tick-Test-Pilot-ext-9-19-14.pdf.

[7] MFA submitted equity market structure recommendations to Chair Mary Jo White. *See* letter from Stuart J. Kaswell, Executive Vice President and General Counsel, MFA, to Mary Jo White, Chair, SEC, dated September 30, 2014, *available at:* https://www.managedfunds.org/wp-content/uploads/2014/10/MFA-cover-ltr-eq-mkt-struct-recommendations-final-9-30-14.pdf. MFA's Equity Market Structure Recommendations can be found at: https://www.managedfunds.org/wp-content/uploads/2014/09/MFA-Equity-Mkt-Structure-Recommendations-final-9-30-14.pdf.

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

[9] SEC's Implementation of Decimalization, *available at*: http://www.sec.gov/hot/decimal.htm.

bid or offer.[10] Studies on decimalization show that the average quoted bid-ask spreads for all companies declined from pre- to post-decimalization in both NYSE- and NASDAQ-listed stocks.[11] We believe decimalization achieved the goals set out by the Commission—namely, "enhancing investor comprehension, facilitating globalization of our markets, and . . . reducing transaction costs."[12] Moreover, the benefits of reduced tick sizes are not unique to the U.S. equity markets; other markets around the world have experienced similar benefits, which are well documented. Research studies from foreign markets have found consistent evidence that reducing tick sizes reduces transaction costs and improves market efficiency.[13]

In fact, we believe the Commission should consider testing half-penny trading increments for the most liquid securities. Recent analyses report that the reduction in tick size for securities in the TOPIX 100 on the Tokyo Stock Exchange have significantly improved quality of the Tokyo Stock Exchange, decreasing transaction costs by 70% and improving price discovery.[14] MFA believes that an appropriately designed pilot could test whether half-penny trading increments in the most liquid securities would improve market quality, without imposing an undue burden on market participants. Study findings lead us to believe that half-penny trading increments for the most liquid securities would benefit investors by greatly reducing transaction costs in the most commonly-traded securities.

MFA is concerned that the Tick Size Plan will harm investors by creating unnecessary market complexity and systems risk. By requiring exchanges and market participants to engage in wholesale redesigns of their trading systems and algorithms, the Tick Size Plan greatly increases the risk of technical malfunctions and market disruptions. Artificially widening spreads and increasing trading costs will make it more expensive for investors to buy and sell pilot securities, and may damage liquid small and mid-cap securities markets. We are also concerned that including a Trade-At[15] variable into a tick size pilot program could meaningfully

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[10] *See, e.g.,* SEC Staff Report to Congress on Decimalization, July 2012, *available at:* http://www.sec.gov/news/studies/2012/decimalization-072012.pdf. *See also,* Recommendations of the Investor Advisory Committee on Decimalization and Tick Sizes, *available at*: http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-decimilization-recommendation.pdf.

[11] *See, e.g.,* SEC Staff Report to Congress on Decimalization, *supra* n. 5; and Bessembinder, Hendrik, 2003, Trade execution costs and market quality after decimalization, *Journal of Financial and Quantitative Analysis* 38(4), 747-777.

[12] 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).

[13] *See, e.g.,* Dionigi Gerace, Ciorstan Smark & Timothy Freestone, Impact of Reduced Tick Sizes on the Hong Kong Stock Exchange, 2012, *available at:* http://ro.uow.edu.au/cgi/viewcontent.cgi?article=1185&context=buspapers; *and* Kee H. Chung and Jung S. Shin, Tick Size and Trading Costs on the Korea Stock Exchange, January 2005, *available at:* http://www.researchgate.net/publication/228723439_Tick_size_and_trading_costs_on_the_Korea_Stock_Exchange.

[14] Tick Size Boosts Japanese Market Efficiency, Capital Markets Cooperative Research Centre, October 28, 2014, *available at:* http://www.mondovisione.com/media-and-resources/news/tick-size-boosts-japanese-market-efficiency-cmcrc/.

[15] *See* SEC Order at p. 22:

impact the pilot data by drastically changing market participant behavior, and frustrate the Commission's ability to assess the impact of increased tick sizes on liquidity for small-cap stocks.

After careful consideration of the Proposing Release, as discussed further below, MFA makes the following recommendations:

- In the best interests of investors, the Commission should not proceed with the Tick Size Plan to widen tick sizes, but should pursue alternative proposals to enhance liquidity and trading in small-cap securities. Nevertheless, if the Commission determines to proceed with a pilot to test tick sizes as a means to increasing liquidity, we believe the Commission should design a pilot program that is more surgical in scope and unencumbered by novel and extraneous changes to market structure.
- MFA recommends that the Commission limit Tick Size Plan pilot securities to those of small capitalization companies, defined as companies with total annual gross revenue of $750 million or less.
- MFA recommends that the Commission amend the Tick Size Plan to only test illiquid small-cap securities—specifically, securities that currently trade at a spread of five cents or more.
- MFA recommends that the Commission amend the Tick Size Plan to exclude Test Group Three, *i.e.*, the test group with the Trade-At provision, as this deletion would reduce the complexity, systems risk and costs associated with the pilot.
- MFA respectfully urges the Commission to propose the Tick Size Plan as rulemaking subject to the protections of the Administrative Procedures Act and for the Commission to conduct a rigorous cost-benefit analysis.

## II. Comments

### A. Targeting Pilot to Small Capitalization Stocks and Limiting Market Risk

The SEC Order states that "the Commission believes that it is in the public interest for the Commission to further study and assess decimalization's impact on the liquidity and trading of the securities of **small capitalization companies**" (emphasis added), and discusses concerns expressed from a variety of sources with respect to small-cap companies.[16] The Proposing Release states that the purpose of the Tick Size Plan is to study and assess "the impact of increment conventions on the liquidity and trading of stocks of small capitalization

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Under a trade-at requirement, a trading center that was not displaying the NBBO at the time it received an incoming marketable order could: (1) execute the order with significant price improvement (such as the minimum allowable $0.05 increment or the mid-point between the NBBO), (2) execute the order at the NBBO with significant size improvement if the size of the order was of block size, or (3) route intermarket sweep orders to execute against the full displayed size of protected quotations at the NBBO and then execute the balance of the order at the NBBO price.

[16] See SEC Order at p. 13.

companies."[17] We note that the SEC Order and the Proposing Release, however, set the market capitalization size for pilot securities as $5 billion or less, capturing not only small-cap companies but mid-cap companies as well, and add a Trade-At component to the pilot program. As proposed, the scope of the Tick Size Plan is significantly more expansive than the stated intent and justification of the SEC Order, and has the potential to cause significant market disruption.

In MFA's view, the Commission should design any pilot program narrowly to test a discrete hypothesis or address a specific concern. Pilot programs carry real costs, risks to markets and investors, and are expensive to implement.[18] We believe that a primary concern should be for a pilot program to first, do no harm. We appreciate the Commission's desire to balance the interests and needs of different constituents as it "believes that it should assess, through a targeted short-term pilot program, whether wider minimum tick sizes for small capitalization stocks would enhance market quality to the benefit of market participants, issuers and U.S. investors."[19] Given the empirical evidence on the benefits of reduced tick sizes for investors, we believe it is especially important for a pilot program that increases tick size to be targeted in its approach.

The SEC Order does not identify concerns with respect to mid-cap securities, nor does it present any data supporting the need to increase tick sizes for mid-cap securities. We believe the security-size set forth in the Tick Size Plan at $5 billion or less is too large, and that a pilot focused on the impact of increasing tick increments on small-cap securities should be limited to companies that truly have a small capitalization. By expanding the scope of the Tick Size Plan to mid-cap securities, the Commission unnecessarily increases the likelihood for disruption and harm to investors and raises implementation costs. The Tick Size Plan also includes a Trade-At provision, which we believe will greatly increase the risk of market disruptions and systems

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[17] Proposing Release, p. 66423. Some have argued that increasing the minimum tick size for the small-cap securities would provide market intermediaries with greater profits on the theory that they would then increase their promotion of such securities and encourage initial public offerings ("IPOs"). See SEC Report to Congress on Decimalization, July 2012, at p. 21 referencing David Weild & Edward Kim, 2010, Market structure is causing the IPO Crisis – and More, Grant Thornton Capital Markets Series, available at: http://www.grantthornton.com/staticfiles/GTCom/Public%20companies%20and%20capital%20markets/Files/IPO%20crisis%20-%20June%202010%20-%20FINAL.pdf. For the reasons stated in the Recommendation of the Investor Advisory Committee on Decimalization and Tick Sizes, we do not believe a tick size pilot program would be effective in assessing the impact on the sell-side research following of small-cap securities or on the number of initial public offerings. Many factors have influenced the IPO market and it would be difficult to ascertain the impact of a larger tick size on the number of IPOs. *See* SEC Staff Report to Congress on Decimalization, at p. 22. Moreover, recent studies suggest that the number of IPOs in 2013 and 2014 have greatly increased and are at an all-time high over the previous six or seven years. *See, e.g.,* 2014 IPO Report, Wilmer Cutler Pickering Hale and Dorr LLP, *available at:* http://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/Publications/Documents/2014-WilmerHale-IPO-Report.pdf; and EY Global IPO Trends, 2014 Q3, *available at:* http://www.ey.com/Publication/vwLUAssets/EY-global-ipo-trends-2014-Q3/$FILE/EY-Global-IPO-Trends-2014-Q3.pdf.

[18] *See infra* section C (discussing complexity and costs associated with a Trade-At component).

[19] SEC Order at p. 14.

issues by significantly increasing the complexity of the pilot program (discussed further in section II.C below). By eliminating Test Group Three, the Tick Size Plan can be more targeted and affect fewer securities. This would mitigate the risk of investor harm, while still ensuring the Tick Size Plan yields statistically robust data. Moreover, the Commission should consider that including a much broader universe of securities as well as a Trade-At provision will add multiple variables to the Tick Size Plan, including a change in market structure that may drastically change market participant behavior. This broader scope will likely frustrate the Commission's ability to assess the impact of increased tick sizes on liquidity for small-cap stocks.

Accordingly, we recommend that the Commission limit Tick Size Plan pilot securities to small capitalization companies, defined as companies with total annual gross revenue of $750 million or less—as contemplated in recent measures with respect to small-caps by Congress, and prescribed in other contexts, such as the Jumpstart Our Business Startups ("JOBS") Act.[20]

### B. The Tick Size Test Will Harm Investors

MFA is concerned that increasing tick sizes will damage market quality and raise transaction costs. A pilot program should not harm liquid markets in order to test a working hypothesis with respect to illiquid securities. The Tick Size Plan proposes to include 1,200 small and mid-cap securities in test groups, which means that more than 20% of all U.S. listed companies will be impacted by the Tick Size Plan.[21] While a majority of securities that qualify for the Tick Size Plan may already trade wider than five cents, many of the securities have spreads smaller than five cents.[22]

We understand that the Tick Size Plan may increase spreads for the most liquid securities eligible for the pilot by 500%.[23] This change will greatly increase costs for, and harm, investors. Artificially increasing the tick size for securities with spreads less than five cents will raise transaction costs for investors, making it more expensive and less appealing for investors to invest in these securities. In addition, the Tick Size Plan may harm liquid markets by deteriorating market quality and making it less cost-effective for investors to invest in these

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[20] *See, e.g.*, U.S. House, 113th Congress. "H.R. 3448. Small Cap Liquidity Reform Act of 2014" *available at:* *https://beta.congress.gov/bill/113th-congress/house-bill/3448*. H.R. 3448 provides that issuers eligible for the liquidity pilot program are emerging growth companies with total annual gross revenues of less than $750,000,000. *See, e.g.*, JOBS Act, Pub. L. No. 112-106 (defining an "emerging growth company" as an issuer with total annual gross revenues of less than $1,000,000,000), *available at:* http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf.

[21] *See, e.g.* Market Structure, The Great Liquidity Divide, Credit Suisse, August 7, 2014 (noting that as of August 2014 there were about 5100 companies listed in the U.S.).

[22] *See, e.g.*, A characterization of market quality for small capitalization US equities, Charles Collver, September 2014, *available at:* http://www.sec.gov/marketstructure/research/small_cap_liquidity.pdf; *and* Today's Spreads Make More Sense Than Nickels, KCG, August 2014, available at: https://www.kcg.com/uploads/documents/Todays_Spreads_Make_More_Sense_Than_Nickels.pdf.

[23] KCG, Today's Spreads Make More Sense Than Nickels, August 2014, *available at:* https://www.kcg.com/uploads/documents/Todays_Spreads_Make_More_Sense_Than_Nickels.pdf.

markets. For example, a key development from Japan's TSE tick size reduction has been greater interest amongst investors in trading mid cap names.[24] This raises the concern that widening tick size could decrease interest amongst investors in pilot securities and harm these markets.

We echo Chair Mary Jo White's views that the SEC "must evaluate all issues through the prism of the best interest of investors and the facilitation of capital formation for public companies."[25] We are concerned that the Tick Size Plan will harm investors and liquid markets. In our view, the Commission should not proceed with the Tick Size Plan, but should pursue alternative proposals to enhance liquidity and trading in small-cap securities. In the alternative, the Commission should amend the Tick Size Plan so that it imposes the least amount of harm possible to institutional and retail investors. To this end, if the Commission proceeds with a tick size pilot program, it should narrowly design the pilot to only test illiquid small-cap securities—securities with total gross market capitalization of $750 million or less that trade at a spread of five cents or more.

### C. Complexity and Costs Associated with a Trade-At Component

The Tick Size Plan proposes four different trading schemes, including three test groups and one control group.[26] The pilot securities of the third test group in the Tick Size Plan ("Test Group Three") will be subject to a five cent quoting and trading increments and a Trade-At prohibition, subject to fourteen exceptions.[27] We are concerned that Test Group Three exponentially increases the complexity and cost of the Tick Size Plan.

Test Group Three requires significant changes from current Regulation National Market System ("**Reg NMS**") rules and will require trading centers and market participants to implement extensive systems development and/or reprogramming. Implementing a quoting increment change requires making a narrow unit change (*e.g.*, one cent to five cents), whereas implementing a Trade-At provision will require an entire redesign of a trading system's trading logic or algorithm. We anticipate that implementing a Trade-At provision will be on par in complexity with implementing the trade-through provisions (the "Order Protection Rule")[28] of Reg NMS due to the modifications that will need to be made with respect to order types and trading logic. Since publication of Reg NMS in June 2005, the Commission issued two extensions for the implementation of the Order Protection Rule and the Intermarket Access Rule[29] and an extensive set of FAQs on the two rules, before the completion of Reg NMS in

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[24] TSE Tick Sizes: Phase 2 Outcomes, Makoto Nagahori, COO Chi-X Japan, October 20, 2014, *available at:* http://fixglobal.com/home/tse-tick-sizes-phase-2-outcomes/.

[25] Mary Jo White, Chair, SEC, Enhancing Our Equity Market Structure, June 5, 2014, *available at:* http://www.sec.gov/News/Speech/Detail/Speech/1370542004312#.VHNgrFJMuM8.

26 Proposing Release at p. 66424.

27 *Id*. at p. 66427.

[28] Rule 611 of Reg NMS (requiring trading centers to obtain the best price for investors when such price is represented by automated quotations that are immediately accessible).

[29] Rule 610 of Reg NMS (establishing a uniform market access rule that would promote non-discriminatory access to quotations displayed by self-regulatory organization trading centers through a private linkage approach).

October 2007.[30] Similarly, implementing the Tick Size Plan as proposed will likely take twelve months or more and require extensive testing by market participants.

At a time when many are calling for a more simplified market structure, the Tick Test Plan will greatly increase complexity by creating four different trading schemes that will need to be implemented by trading centers and institutional investors. Market participants will also need to develop customized order routing and execution algorithms for each trading scheme. We are concerned that the fundamental systems changes and the numerous trading schemes the Tick Size Plan requires will introduce substantial unnecessary systems risk to markets and investors.

In addition to the complexity, we are concerned about the costs associated with implementing the Tick Size Plan. The financial cost for such significant systems development, coding, reprogramming and testing are likely to be meaningful. Plan Participants and market participants are likely to redirect resources and staffing from different departments in order to implement the Tick Size Plan. We question whether this change would increase risk in other respects. We are also concerned that investors may shy away from trading certain Tick Size Plan pilot securities because of the complexity, systems risk, higher transaction costs and other costs associated with implementing a trade-at provision. This would harm investors currently invested in these pilot securities, adversely impact liquidity, and run counter to the stated goals of the Tick Size Plan's proponents.

We believe Test Group Three greatly increases the complexity, systems risk and costs for the Tick Size Plan to the extent that it outweighs the benefits of implementing a temporary pilot program. Accordingly, we recommend that if the Commission determines to proceed with a tick size pilot, it should amend the Tick Size Plan to exclude Test Group Three.

### D. The Tick Size Plan Should be a Rule Proposal

The Tick Size Plan raises a number of substantial issues, such as changes to equity market structure, transaction costs for investors, market efficiency, pricing fairness, potential harm to issuers, systems risk and market complexity. As such, we believe the Commission should have published the Tick Size Plan as a proposed rulemaking under the Administrative Procedures Act, subject to public notice and comment, and in particular, a cost-benefit analysis.[31] We think it is critical that the Commission conducts a cost-benefit analysis with respect to the Tick Size Plan. We are concerned that the costs of the Tick Size Plan greatly outweigh any perceived benefits and that proceeding with a Tick Size Plan would be harmful to investors.

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[30] *See* Extension Release, 71 *Fed. Reg.* 30038 (May 24, 2006), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2006-05-24/pdf/06-4797.pdf; Extension Release II, 72 *Fed. Reg.* 4202 (Jan. 30, 2007), *available at*: http://www.gpo.gov/fdsys/pkg/FR-2007-01-30/pdf/E7-1384.pdf; *and* Responses to Frequently Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS, Division of Trading and Markets, April 4, 2008 Update (previously updated on June 8, 2007), *available at:* http://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm#P636_130626.

[31] *See, e.g.,* SEC description of Reg SHO Pilot Program, *available at*: http://www.sec.gov/spotlight/shopilot.htm.

Thus, we respectfully urge the Commission to propose the Tick Size Plan as rulemaking and for the Commission to conduct a rigorous cost-benefit analysis.[32]

## III. Equity Market Structure Reforms

MFA supports the SEC's plans for a holistic review of equity markets and to assess whether regulatory enhancements are needed to address new or changing vulnerabilities. As discussed, we think the Tick Test Plan as currently proposed would be harmful to investors and markets; significantly increase market complexity and risk; and threaten market integrity. We believe the Commission should focus on other ways to enhance market structure. We submit a number of market structure recommendations, which we believe are cost-effective and would provide the greatest benefits to investors and markets. Highlighted below and discussed in further detail in our attachment are MFA's equity market structure recommendations:

**Improving Market Resilience and Risk Management**

- **Pre-trade controls** – The SEC or FINRA should provide more specific guidance on pre-trade risk controls to increase transparency to investors, encourage greater uniformity of controls among broker-dealers and reduce concerns with respect to discrepancies in latency.

- **Standardized kill switches** – The SEC should direct the exchanges to develop a standardized mandatory kill switch protocol, methodology and rules. This step would simplify implementation and use by exchange members and create a level playing field with respect to latency discrepancies.

**Increasing Disclosure and Transparency**

- **Trading venue transparency** - FINRA should expand its alternative trading system ("**ATS**") transparency initiative to include publishing the number of trades and weekly volume information on a stock-by-stock basis for equity securities traded over-the-counter.

- The SEC should also enhance disclosure requirements by requiring an ATS to make its Form ATS publicly available on its website along with general information on how it operates and how its orders interact. The SEC should also include on its website a list of all ATSs and links to their Form ATS to improve information flow to investors and to allow them to more easily compare ATS venues.

- **Timely market data** - The SEC should request Plan Participants of the Securities Information Processors ("**SIPs**") to improve the reliability, resilience, connectivity and latency of the data processors—integral components of the equity market structure to address recent outages and other issues.

[32] MFA believes that the Commission's review of a National Market System plan is subject to the standards of Section 3(f) of the Securities Exchange Act of 1934.

- **Order routing disclosure** – The SEC should require broker-dealers to provide more detailed disclosure of order routing and execution practices. Exchanges should also provide clearer disclosure on order routing, order type interaction and execution volume from orders.

- **Exchange Order Types** – The SEC should continue to ensure that order types promote just and equitable principles of trade, protect investors and the public interest, and ensure that order type information is readily accessible to market participants, including clear descriptions on function, use, and benefits.

## IV. Conclusion

As investors, MFA remains concerned with the implications of increasing tick sizes. MFA believes that the Commission, in the best interests of investors, should not proceed with implementing the Tick Size Plan to widen ticks sizes, but should instead consider other ways to enhance market structure, such as MFA's equity market structure recommendations. If the Commission determines to proceed with a tick size pilot, however, we recommend that the Commission propose for rulemaking a pilot program that is designed first and foremost with investors in mind and that limits harm to investors. Such pilot should be narrowly designed and targeted to test a wider tick increment in securities of companies with total annual gross revenue of $750 million or less and that trade at a spread of five cents or wider. Finally, MFA recommends that the Tick Test Plan or any tick size pilot the Commission proceeds with exclude Test Group Three or a Trade-At component.

We appreciate the opportunity to provide the Commission with our comments on the Tick Size Plan. If you have questions or comments, please do not hesitate to contact Jennifer Han, Associate General Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

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

CC: The Hon. Mary Jo White, Chair
The Hon. Luis A. Aguilar, Commissioner
The Hon. Daniel M. Gallagher, Commissioner
The Hon. Kara M. Stein, Commissioner
The Hon. Michael S. Piwowar, Commissioner
Stephen Luparello, Director, Division of Trading & Markets
Gregg Berman, Associate Director, Office of Analytics and Research, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets

Daniel Gray, Senior Special Counsel, Division of Trading and Markets
Mark J. Flannery, Director and Chief Economist, Division of Economic and Risk Analysis

**Managed Funds Association**
**Equity Market Structure Policy Recommendations**
**September 30, 2014**

The U.S. equity markets have evolved dramatically the last thirty years with both regulatory changes and technological innovations that have largely benefited retail and institutional investors. Nevertheless, regulators should periodically assess market practices and regulations to ensure that U.S. equity markets continue to remain efficient, liquid, fair, transparent, and stable for all market participants. MFA represents the global alternative investment industry and its investors; and in such capacity, welcomes a number of proposed regulatory initiatives to improve market resilience and risk management, and increase disclosure and transparency. To the extent regulators need to experiment with existing market structure, they should proceed with caution and focus on the impact any changes could have on investors.

## INTRODUCTION

Over the past two decades, U.S. market regulations have supported the evolution of equity markets by reducing anticompetitive barriers and promoting fair access to markets and market information. The regulatory framework has fostered innovations in technology that have revolutionized investing in our equity markets and promoted greater competition among marketplaces, all to the benefit of both retail and institutional investors. Indeed, the cost of investing for retail and institutional investors has decreased significantly over the past decades as technologies have improved efficiency and layers of market intermediation have been removed. Advancements in technology have empowered investors with more sophisticated and efficient methods to access markets and execute their investment strategies. As with all technological innovations, however, change brings challenges to market participants, and at times, their business models as well. Nevertheless, the Securities and Exchange Commission ("SEC" or the "Commission") must stay focused on its goal to "adopt regulatory approaches that ensure intermediaries harness the forces of technology and competition to better serve the needs of investors".[1]

MFA supports regulators' plans for a holistic review of equity markets and assess whether regulatory enhancements are needed to address new or changing vulnerabilities. MFA agrees with SEC Chair Mary Jo White's recent statements that it is essential to ensure that "our markets continue to operate openly, fairly, and efficiently to *benefit investors* and *promote capital formation* [emphasis added]" as the "secondary markets exist for investors and public

[1] Mary Jo White, Chair, SEC, Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors, June 20, 2014, *available at:* http://www.sec.gov/News/Speech/Detail/Speech/1370542122012#.VBiOIVJMuM9.

companies, and their interests must be paramount."[2] Accordingly, "all equity market structure issues must be evaluated through the prism of the best interests of investors and the facilitation of capital formation for public companies."[3] In reviewing market structure, it is critical for regulators to take a systematic, data-driven and unbiased approach to continue to foster competition, while limiting harm to investors and issuers.

As the Commission considers equity market structure issues, MFA believes that a number of recent regulatory initiatives have contributed to decreasing operational risk and improving market quality. Nevertheless, MFA believes that more can be done to advance these initiatives and address risk, market quality and investor confidence:

## IMPROVING MARKET RESILIENCE AND RISK MANAGEMENT

MFA has supported certain standardized market measures and believes they have been extremely effective in limiting market disruptions and reducing investor confusion in times of extreme market volatility. Such measures include the use of market-wide circuit breakers, price collars (*i.e.*, the Limit Up-Limit Down mechanism), and uniform exchange rules on clearly erroneous executions. In addition, MFA has supported the Market Access rule[4] and believes it has been effective in reducing risks faced by broker-dealers, their customers including institutional and retail investors, and the markets more generally. However, we believe additional steps can be taken to bolster risk management practices.

### Pre-Trade Controls

- The Commission or the Financial Industry and Regulatory Authority ("FINRA") should provide more specific guidance on pre-trade risk controls to increase transparency to investors, encourage greater uniformity of controls among broker-dealers, and reduce concerns with respect to discrepancies in latency.

### Standardized Kill Switches

- The Commission should direct the Exchanges to work together to develop a standardized mandatory kill switch protocol, methodology, and rules. Standardizing a kill switch protocol will simplify implementation and use by exchange members, as well as create a level playing field with respect to discrepancies in latency.

## INCREASING DISCLOSURE AND TRANSPARENCY

Regulators and market intermediaries have taken a number of steps to increase disclosure and transparency. MFA supports these efforts but believes more work can be done to improve transparency, which is essential to investor confidence and a robust marketplace.

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[2] Mary Jo White, Chair, SEC, Enhancing Our Equity Market Structure, June 5, 2014, *available at:* http://www.sec.gov/News/Speech/Detail/Speech/1370542004312#.VAypdlJMtaQ.

[3] *Id.*

[4] Rule 15c3-5.



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**Trading Venue Transparency**

- MFA supports the steps FINRA and certain alternative trading systems ("ATSs") have taken in enhancing market transparency by making publicly available information on total shares traded each week per stock in each ATS, and information on how each ATS operates, respectively.
- FINRA should expand its ATS transparency initiative to include weekly volume and trade information on a stock-by-stock basis for equity securities traded over-the-counter by each FINRA member.
- The Commission should require an ATS to make publicly available on its website its Form ATS, and information on how it operates and how orders interact on the ATS. The SEC should also make available on its website a list of ATSs and links to each ATS's Form ATS. This would facilitate disclosure to investors and enhance their ability to compare venues.

**Timely Market Data**

- MFA believes it is critical for market data and pricing information from all sources to be timely and accurate.
    - **Co-location** is one means by which market participants obtain timely and accurate market data. MFA supports the Commission's current approach for regulating co-location services and believes co-location services should be available to all market participants on a fair-access basis.
- The SEC should request Plan Participants of the Securities Information Processors ("SIPs") to improve the reliability, resilience, connectivity and latency of the SIPs. Recent outages and other issues highlight the fragility of the SIPs, which are integral components of the of equity market infrastructure.
- In addition, each market providing data to the consolidated data feeds should include a time stamp, synchronized with a synchronized time server, to indicate when a trading venue processed the display of an order or executed a trade. Timestamps on third-market trades should be taken at the time the trading center executes the trade. In this way, market participants would be able to monitor the latency of each feed and assess its sufficiency.

**Order Routing Disclosure**

- The SEC should require broker-dealers to provide more detailed disclosures of order routing and execution practices. Providing more detailed information on price improvement and order execution to investors, in a uniform manner, would allow investors to compare routing and execution across broker-dealers. The SEC should consider amending Rules 605 and 606, not with a one-size-fits-all approach, but to require disclosure reports that provide more granular information and are designed specifically for the use of either the retail or institutional investor in mind. These reports should serve as a minimum level of disclosure by broker-dealers, as investors should have the ability to seek greater information.



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- Exchanges should provide clearer disclosure on order routing, order type interaction, and execution volume from displayed orders, partially displayed/undisplayed orders, and fully undisplayed orders.

**Exchange Order Types**

- The SEC has recently heightened its review of the function of order types and should continue to ensure that order types "promote just and equitable principles of trade" and, in general, "protect investors and the public interest".[5] Exchanges should ensure that order type information is readily accessible to market participants, including clear descriptions on function, use and benefits, as well as data on use and fill rates.[6]

## IMPLEMENTING CAREFUL AND CONTROLLED PILOT PROGRAMS

MFA supports the Commission's policy of making changes to market structure deliberately and only after careful study: "[a]ddressing the issues of our current market structure demands a continuous and comprehensive review that integrates targeted enhancements with an expansive consideration of broader changes."[7] A disciplined, data-driven approach ensures that rulemaking is driven, less by competitive interests among market participants, and more by measurable benefits to liquidity, efficiency, competition and capital formation. To safeguard the integrity of experimental data, however, the Commission must design pilots wisely. Implementing many changes simultaneously will make it hard to evaluate the results and will increase market complexity.

**Tick Size Pilot Program**

- Historically, MFA supported a more limited tick size pilot program. MFA believes, however, that the proposed Tick Size Pilot Program, as submitted by the national securities exchanges and FINRA, will harm investors by artificially widening spreads and increasing trading costs without any tangible benefit to market quality.
- The proposed Tick Size Pilot Program has expanded far beyond the original focus on small cap stocks—now including 1,200 companies with capitalization levels that are generally higher than those recently contemplated by Congress or prescribed in other contexts in the Jumpstart Our Business Startups ("JOBS") Act.[8]

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[5] Section 6(b) of the Securities Exchange Act of 1934, as amended. 15 U.S.C § 78f(b).

[6] *See, e.g.,* NYSE Arca, Executed Order Types Usage, *available at:* *https://www.nyse.com/publicdocs/nyse/markets/nyse-arca/NYSE_Arca_Order_Type_Usage.pdf*; *and* BATS Global Markets Inc., Order type Usage Summary, *available at:* http://www.batstrading.com/market_data/order_types/.

[7] *Id.*

[8] *See, e.g.,* U.S. House, 113th Congress. "H.R. 3448. Small Cap Liquidity Reform Act of 2014" *available at:* *https://beta.congress.gov/bill/113th-congress/house-bill/3448*. H.R. 3448 provides that issuers eligible for the liquidity pilot program are emerging growth companies with total annual gross revenues of less than $750,000,000. *See, e.g.,* JOBS Act, Pub. L. No. 112-106 (defining an "emerging growth company" as an issuer with total annual gross revenues of less than $1,000,000,000) *available at:* http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf.



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- For purposes of testing market quality for small cap stocks, the SEC should limit its Tick Size Pilot Program to truly small cap stocks—*i.e.*, stocks with gross revenue of $750 million or less.
- The Trade-At provision complicates the Tick Size Pilot by adding variables that could meaningfully impact the data of the Tick Size Pilot by drastically changing market participant behavior. The Commission should exclude a Trade-At provision from a Tick Size Pilot, as it will likely frustrate the Commission's intent to assess the impact of increased tick sizes on liquidity for small cap stocks.
- If the Commission is still inclined to experiment with tick sizes, the SEC should consider also a pilot to reduce the tick increment to a half-penny for stocks with the highest trading volumes. MFA believes this change in tick size could improve market quality for investors and reduce trading costs.



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