December 22, 2014

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F St., NE
Washington, DC 20549-1090

Re: **Proposed national market system Plan to Implement a Tick Size Pilot Program; File No. 4-657**

Dear Mr. Fields:

Charles Schwab & Company, Inc. ("Schwab")[1] appreciates the opportunity to comment on the recently-proposed national market system ("NMS") Plan to Implement a Tick Size Pilot Program ("Plan"). As stated in the release, "The purpose of the Plan, and the Tick Size Pilot Program it contains, is to assist the Securities and Exchange Commission ("Commission"), market participants, and the public in studying and assessing the impact of increment conventions on the liquidity and trading of stocks of small capitalization companies."[2] Schwab has several concerns about the proposal and its impact on individual retail investors, which we outline below.

Executive Summary

Schwab's concerns with the proposal fall into three broad categories: the likely outcome of the Plan as currently constructed, which we believe will have a negative impact on retail investors; procedural concerns with how the Plan came about as well as doubts about the legal authority for including a trade-at provision; and particular concerns about the structure of the Plan.

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[1] Charles Schwab & Co., Inc., (member SIPC) is the broker-dealer affiliate of The Charles Schwab Corporation (NYSE: SCHW), a leading provider of financial services, with more than 325 offices and 9.3 million active brokerage accounts, 1.4 million corporate retirement plan participants, 979,000 banking accounts, and $2.48 trillion in client assets as of November 30, 2014. Through its operating subsidiaries, the company provides a full range of securities brokerage, banking, money management and financial advisory services to individual investors and independent investment advisors. Charles Schwab & Co., Inc. and affiliates offer a complete range of investment services and products including an extensive selection of mutual funds; financial planning and investment advice; retirement plan and equity compensation plan services; referrals to independent fee-based investment advisors; and custodial, operational and trading support for independent, fee-based investment advisors through Schwab Advisor Services.
[2] Securities and Exchange Commission Release No. 73511, File No. 4-657, page 2. Release can be accessed here: http://www.sec.gov/rules/sro/nms/2014/34-73511.pdf

Outcome of the plan -- negative impact on retail investors: Schwab believes that mandating wider spreads will result in a wealth transfer from retail investors to exchanges and market makers.[3] Recognizing the inequity, the pilot's authors propose a retail exemption in Test Groups Two and Three, providing ½ cent price improvement options for retail orders. Yet in this proposed scenario, retail orders will still pay the spread of 4 ½ cents – a 350% increase in spread cost over today's minimum increment of 1 cent. Or, if given a midpoint execution, which is also a permitted exception, a 150% increase in spread cost. Either way, the result will be that retail investors will pay increased spread cost, which will flow directly to professional traders.

Schwab has additional concerns about the impact the Plan's trade-at provision in Test Group Three will have on execution quality and cost for retail investors.

Procedural concerns – Plan governance/conflict of interest/lack of authority: Given the wider NMS plan governance problems that Schwab has longstanding concerns with, the proposed Plan, as designed, provides a significant advantage to the exchanges that were given the opportunity to propose it without any input from their competitor broker-dealers or other market participants. Specifically, the trade-at provision would reduce the natural competition existing among venues to execute trades. For a variety of reasons, Schwab is highly skeptical that a tick size pilot program can be put forward that will not do more harm than good, but if a proposal is put forward, it should be proposed by the SEC, and subjected to the protections of the Administrative Procedures Act, not by the exchanges through an NMS plan.

In addition, we do not believe there is currently legal authority to include any form of a trade-at provision in the proposal. In Section 11(A) of the Securities Exchange Act of 1934, Congress found that competition between exchanges and markets other than exchanges promoted the public interest and the maintenance of fair and orderly markets. The trade-at provision included in Test Group Three ignores this Congressional finding by directing orders to be executed on exchanges with minimal exceptions. In fact, Section 11(A) authorizes the Commission to prohibit trading on markets other than exchange markets only after it has made a finding on the record, subject to notice and an opportunity for a hearing, that off-exchange trading affects the fairness and orderliness of securities markets in a manner contrary to the public interest and the protection of investors. We are not aware of any efforts on the part of the Commission and the self-regulatory organizations ("SROs") to make such a finding. Instead, it appears as if the Tick Size Pilot proposal puts the cart before the horse by using the Plan's Test Group Three and the trade-at provision to force order executions in real securities bought and sold by real investors to the exchanges in order to gather data on its consequences. We believe this flawed process violates Section 11(A).

Structural concerns, including poorly defined goals, metrics, and project scope: A fundamental concern we have regarding the proposed Plan is its stated goal. Previously articulated as a "jobs" proposal, the Plan before us makes no mention of jobs. Other than the goal of increased liquidity at the National Best Bid and Offer ("NBBO"), its articulated purpose is quite vague.

[3] The vast majority of today's market making is performed by high frequency trading firms.

We believe the Commission needs to clearly specify what constructive public policy goals are being sought by undertaking a pilot, how those goals will be measured, and at what level of measurement they will be deemed a success. Specific goals need to be included so that the Plan's results can be measured against as-yet-not-articulated benchmarks for determining its success. Furthermore, without clearly defined measures of how the Plan will be considered a success, it will be difficult to undertake a cost-benefit analysis. For a proposal this significant and complex, a thorough cost-benefit analysis is absolutely necessary. As it stands now, there is no articulation of, or even any mention of, any plans to produce a cost-benefit analysis in the proposal.

Finally, this tick size pilot Plan, at least as originally articulated, was meant to encourage increased trading in small capitalization, less liquid stocks. Yet the pilot includes companies with up to a $5 billion market capitalization and stocks that trade up to 1 million shares per day. If the Commission goes forward with a tick size pilot, Schwab believes that it needs to redefine the scope of what stocks will be included in a way that focuses on small, illiquid company securities.

Outcome of the Plan -- Negative Impact on Retail Investors

1. **Increased tick sizes**

Like the SEC's own Investor Advisory Committee ("Committee"), Schwab believes that mandating wider tick sizes, in and of itself, will negatively impact retail investors. On January 31, 2014, the Committee voted 13-3 to urge the agency not to conduct a pilot program to widen the minimum tick at which small stock prices are quoted on exchanges.[4] In a document posted on the Commission's web site,[5] the Committee lays out its reasons for its opposition, which focus on the negative impact increased tick sizes have on retail investors. The justification for these reasons largely can be found by accessing existing research that the Commission either already has access to or produced itself.[6]

The Committee explains that decimalization has helped spreads narrow to historically low levels, producing significant savings for investors. In addition, the Committee argues that decreasing tick sizes leads to more competition, in particular for retail order flow – also benefiting investors.

The Committee also examined some of the reasons used to justify wider tick sizes and found that market making activity increased after moving to decimalization (which narrowed tick

[4] The Committee has a diverse membership, including former SEC Commissioners, market participants and consumer advocates.

[5] *Recommendation of the Investor Advisory Committee, Decimalization and Tick Sizes*: http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-decimilization-recommendation.pdf

[6] See e.g., SEC, *Market 2000: An Examination Of Current Equity Market Developments* (1994), available at http://www.sec.gov/divisions/marketreg/market2000.pdf; SEC's Implementation of Decimalization, available at: http://www.sec.gov/hot/decimal.htm; SEC, *Report to Congress on Decimalization* (July 2012), available at: http://www.sec.gov/news/studies/2012/decimalization-072012.pdf; SEC Decimalization Roundtable (February 5, 2013), available at: http://www.sec.gov/spotlight/decimalization.shtml

sizes). Furthermore, the Committee found no evidence to support the notion that even if market makers were to increase profits under a wider tick size regime, that this would lead to greater research coverage of small cap stocks. As the Committee points out, "Most of the largest market makers do not provide market research."[7]

We agree with the Committee's conclusions that widening tick sizes would benefit some sophisticated market participants, such as certain exchanges and market makers, at the expense of retail investors. Additional recent research also found that other sophisticated investors will benefit and proliferate, concluding: "…recent proposals to increase tick size will not improve liquidity. Instead, they will encourage high frequency trading…"[8]

All of this research led the SEC's Investor Advisory Committee to the following conclusion, with which Schwab heartily agrees:

> "In essence, a government-mandated increase in tick size would subsidize profits for the most sophisticated financial participants at the expense of retail investors. The Committee believes that alternative means should be found to promote capital formation and small stock liquidity that do not come at the expense of retail investors. Indeed, engaging in pilot programs, when we know what occurs from prior experience (and it is not good for investors) seems unjustifiable."[9]

2. Trade-At

The trade-at provision found in the Plan's Test Group Three threatens to compound the harm to retail investor trade execution quality and cost. By restricting the ability of off-exchange venues to compete for executions, the trading costs of our clients, retail investors, will rise. We believe concerns about restricting competition contributed to the reason that a trade-at provision was not included in the tick-size legislation that passed the U.S. House of Representatives earlier this year.[10]

Schwab's experience with multi-venue competition supports our view. Using 2014 year-to-date data for our customers' small orders (100 – 1,999 shares) shows how much better they fared when they were executed in off-exchange venues versus the execution quality they received on the New York Stock Exchange (NYSE). The overall off-exchange average effective/quoted ratio was 52.92% versus 86.73% on exchange. When a buy order is executed at a price equal to the offer price or a sell order is executed at a price equal to the bid price the effective/quoted ratio is 100%. Lower ratios indicate executions better than the NBBO and greater cost savings to clients. Furthermore, for this cohort, 92.7% of the off-exchange

[7] *Recommendation of the Investor Advisory Committee, Decimalization and Tick Sizes,* page 8.
[8] Yao, Chen and Mao Ye, *Tick Size Constraints, Market Structure and Liquidity*; January 31, 2014: http://www2.warwick.ac.uk/fac/soc/wbs/subjects/finance/fof2014/programme/chen_yao.pdf
[9] *Recommendation of the Investor Advisory Committee, Decimalization and Tick Sizes,* page 6.
[10] The Small Cap Liquidity Reform Act of 2014 (HR 3448) passed the House on February 11, 2014. Text of the House-passed bill can be found here: http://www.gpo.gov/fdsys/pkg/BILLS-113hr3448eh/pdf/BILLS-113hr3448eh.pdf

executions were price improved, versus only 22.3% on an exchange.[11] Off-exchange competition with the exchanges created this execution disparity. Abandoning this competition through trade-at is not in the public interest.

We are also concerned that some market participants may opt not to go forward with the expense of coding their systems to comply with the overly complicated trade-at provision contained in the pilot. If this is the case, the proposal will be self-defeating, and any data compiled for the Test Group will be flawed. The ability to draw any constructive conclusions from Test Group Three will be constrained by the limited participation of market participants. While the proposal may have the real effect of forcing a certain level of price improvement for executions in this Test Group, it will not force greater liquidity in less liquid securities on lit venues.

3. A better approach

Schwab recognizes that order flow has migrated to off-exchange venues in recent years. However, attempting to force flow to markets that charge substantial fees to access liquidity compounds the problems of wider tick sizes by forcing investors to pay these fees. Today, exchanges charge access fees of approximately $.003 per share or 30 cents per 100 (30 mils) shares. These access fees are charged to orders that "take" liquidity by crossing the spread and trading with a posted bid or offer. The "maker" provides liquidity by posting bids and offers and receives a liquidity provider rebate of between 25 - 28 cents per 100 shares. This maker/taker system has drawn substantial criticism over the last few years due to its distortive effect on our markets. Schwab believes that the maker/taker system, along with the size of the access fees, has driven order flow to less expensive off-exchange venues. Regulation NMS capped the size of the fees that exchanges could charge at 30 mils and markets naturally have migrated to the maximum amount in order to be able to offer higher rebates. If high fees and rebates are so fundamental to attracting order flow, exchanges risk losing order flow should they unilaterally reduce their access fees, and thus their rebates, as order flow could migrate to those exchanges maintaining higher fees and rebates.

Exchanges themselves recognize that the current level of access fees, high rebates and the maker/taker system may be problematic. According to recent news reports,[12] at least one of the major exchanges has indicated a willingness to reduce those fees if the trade-at requirement becomes universal. In addition, the same exchange has announced intentions to eliminate access fees for retail orders executed through their retail liquidity program.[13] What is readily apparent from these recent proposals is that exchanges recognize access fees may be a deterrent to attracting order flow to their markets and that reducing fees may attract order flow.

[11] Data for Charles Schwab is calculated pursuant to SEC Rule 605 and derived from Vista One, a third-party vendor that is not affiliated with Charles Schwab. The Effective/Quoted Table data is derived from market orders for at least 100 shares and up to 1,999 shares for S&P covered securities. Statistics displayed represent market orders with share sizes between 100 and 1,999 shares, excluding pre-opening orders, orders received during locked, crossed, or fast markets, and destination outages.

[12] Hope, Bradley and Scott Patterson, "NYSE Plan Would Revamp Trading," *The Wall Street Journal*, December 18, 2014

[13] Hope, Bradley, "NYSE Group Plans to Slash Costs for Retail Investors," *The Wall Street Journal*, December 16, 2014

If the Commission wishes to test the dynamics of order flow migration,[14] Schwab believes that a better, more market-oriented, test would be to reduce exchange access fees and the corresponding liquidity rebates that drive much of today's trading. We recommend that the Commission replace Test Group Three and its trade-at requirement with a pilot that reduces access fees to a maximum of 10 mils. A 10 mil access fee provides exchanges sufficient revenue to continue providing rebates, although at a lower level, while retaining revenue levels consistent with current amounts. We believe this pilot would provide far greater insight into order flow migration dynamics than the proposed trade-at pilot, which will ham-handedly force order flow to markets without regard to the economics that has driven flow away.

4. Limits of Plan's "retail exemption"

There is broad consensus that elements of the proposed Plan's Test Group Two and Three will increase transaction costs for retail investors. Recognizing this fact, the Commission and the SROs inserted a retail (as well as a mid-point) exemption within the two pilot test groups that limit trading between the best bid and offer. Retail Investor Orders, defined by the SROs in the proposal,[15] may be provided with price improvement that is at least $0.005 (1/2 cent or 5 mils) better than the best protected bid or offer. With the minimum increment being 5 cents, however, investors seeking immediate execution must pay the increased spread. Should an investor's execution receive the minimum price improvement in a minimum increment NBBO, an investor will incur spread costs of $.035 (3 1/2 cents) per share *greater* than would have occurred in today's minimum increment environment of $.01 (1 cent), should the client not receive any price improvement.

The disparities are even greater if the investor receives even minimal price improvement in today's markets, which Schwab's clients do on the vast majority of their trades. By way of example, a retail investor seeking to purchase 100 shares of XYZ Corporation within the pilot with a current NBBO of a $10.00 bid and a $10.05 offer could receive price improvement of at least 1/2 cent, resulting in a net price of $10.045 and a total outlay of $1004.50. In today's 1 cent minimum increment the same transaction would occur with a NBBO of a $10.00 bid and a $10.01 offer. If the investor received price improvement of just 1 mil (less than the average), the execution would result in a price of $10.009 and a total outlay of $1000.90. The cost of paying the spread even with the proposed retail price improvement exemption is $.045 or 4.5 cents per share. When compared with the current $.009 or .9 cents per share, the proposed increased minimum tick increment results in an increased spread cost of $.036 per share – a 400% increase to the retail investor.

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[14] "The Pilot should test whether a trade-at requirement would stem the potential migration of trading volume away from these lit venues." Securities and Exchange Commission (Release No. 34-72460), Order Directing the Exchanges and the Financial Industry Regulatory Authority To Submit a Tick Size Pilot Plan, page 24

[15] "…defined in the Plan as an agency order or a riskless principal order originating from a natural person, provided that, prior to submission, no change is made to the terms of the order with respect to price or side of market and the order does not originate from a trading algorithm or any other computerized methodology." (SEC Release No. 73511, File No. 4-657, page 8) This definition, in and of itself will create difficulty for broker-dealers handling retail orders. It will be impossible to know if downstream introducing brokers used algorithmic or computerized methodologies.

One could argue that the above example is too simplistic - that there is no guarantee that an investor would find liquidity at today's 1 cent minimum increment. While that may be true, it is also possible that liquidity could be found at 2, 3, or 4 cents and still reduce the harm that investors will suffer over that caused by the proposed pilot. There is also no guarantee that investors will find liquidity at a 5 cent minimum increment, thus forcing a 10 cent spread and exacerbating the problems and increased costs outlined above.

Procedural Concerns

1. Plan governance/conflict of interest

Schwab has longstanding significant concerns with the NMS plan governance structure. In the days when exchanges were not-for-profit organizations driven by member input and responsive to member concerns, it made sense for NMS plan governance to be the responsibility of exchanges. Broker-dealer members of the exchanges sat on the boards of directors and could influence the positions taken by the exchanges. Those days, however, are gone. Exchanges have become for-profit competitors with broker-dealers and other capital market participants. NMS plan governance committees are rife with conflicts of interest and, therefore, this governance structure no longer makes sense.

In the specific case of the tick-size pilot Plan, which will govern how trades are executed and routed for a significant portion of our equities markets, and where the exchanges directly compete against non-exchange venues for trade execution volume, it is unacceptable for the exchanges to design the Plan without any input from other parts of the industry. Given that the exchanges were allowed free rein to design the Plan, it is not surprising that the proposal is self-serving in important respects.

First, the clearest example of the conflicts of interest evident in the design of this Plan is the inclusion of a trade-at provision in Test Group Three. The exchanges that authored the Plan will benefit and their competitors will suffer from a provision that forces trades that otherwise would have taken place on alternative venues to be executed on the exchanges. Alternative venues will be unable to compete for trade execution flow.

Second, the overall scope of the project, which is supposed to be focused on small-capitalization, lightly-traded stocks, is significantly more broad than it should be. Various estimates conclude that more than two-thirds of NMS securities would be eligible for the pilot, even capturing some S&P 500 securities. The broader the scope of a project built on favorable terms to its authors, the more the authors will benefit.

2. Lack of justification or legal authority for trade-at

Much of the debate about trade-at centers on the desire by the exchanges to increase the percentage of order executions occurring on their markets. Execution volume off exchange has been growing for many years. In its order directing the exchanges to submit a tick size pilot plan, the Commission reflected that the "percentage of volume executed in dark venues has increased in recent years. In 2009, trading volume executed in dark venues was approximately 25 percent. Today, it is approximately 35 percent."[16]

Without offering any evidence that price discovery has been harmed by this shift in execution venues (other than using the positive-sounding "lit" to describe exchanges and pejorative "dark" to describe off-exchange venues), the Commission seems to believe that executions should be forced back to exchanges through the trade-at requirement. Oddly, the Commission does not seek to test its premise that price discovery may have been harmed through the shifting of volume to off-exchange venues. Rather, the Commission proposes adopting a provision that permits trading at the NBBO only if a firm is quoting at that price, and only for the size displayed, on an exchange or FINRA's Alternative Display Facility ("ADF"), inherently forcing trading to exchanges. We believe it is very likely that the trade-at requirement will "stem the migration of trading volume" that the Commission intends to test. This is not a test but a shifting of execution venues by regulatory fiat.

The Commission has been confronted with rules that forced order executions to exchanges in the past in a manner that mirrors the trade-at requirement. Former NYSE Rule 390, which generally prohibited NYSE members from effecting transactions in NYSE-listed securities away from a national securities exchange, was rescinded by the Commission on May 5, 2000.[17] In rescinding the rule, the Commission held that eliminating Rule 390 was consistent with the obligations of Section 11A to assure fair competition between exchange markets and markets other than exchange markets. While wrestling with similar issues confronting the Commission today regarding the quality of price discovery, the Commission concluded that, "whatever beneficial effect Rule 390 may have in enhancing the interaction of investor orders can no longer justify its anticompetitive nature."[18] Indeed, the Commission's "approval of the rescission of Rule 390 is intended solely to free the forces of competition and allow investor interests to control the success or failure of individual market centers."[19] Given the inclusion of trade-at in this pilot, it may well be that the Commission now believes that competition should no longer determine the success or failure of individual market centers.

In addition to our disappointment that the Commission has failed to make the empirical case for the inclusion of trade-at in the Plan, we don't think the proper legal justification has been made, either. In Section 11(A) of the Securities Exchange Act of 1934, Congress found that, "it is in the public interest and…maintenance of fair and orderly markets to assure…fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets."[20] The trade-at provision is designed to direct orders to exchange markets and to reduce competition from other than exchange markets, in direct opposition to Congressional findings in the Act. Also in Section 11(A), however, Congress provided a mechanism for the Commission to prohibit off-exchange trading and direct orders to exchanges. In Section 11(A)(c)(3)(A)(i), the Commission is authorized to prohibit off-

[16] Order Directing the Exchanges and the Financial Industry Regulatory Authority To Submit a Tick Size Pilot Plan, page 23
[17] Release No. 34-42758; File No. SR-NYSE-99-48, NYSE Rulemaking: Order Approving Proposed Rule Change to Rescind Exchange Rule 390
[18] Order Approving Proposed Rule Change to Rescind Exchange Rule 390, page 5
[19] Order Approving Proposed Rule Change to Rescind Exchange Rule 390, page 7
[20] 15 U.S. Code 78k-1(a)(1)(C)(ii)

exchange trading, but only if it finds, on the record after notice and opportunity for a hearing, that "as a result of transactions in such securities effected otherwise than on a national securities exchange, the fairness and orderliness of the markets for such securities has been affected in a manner contrary to the public interest or the protection of investors."[21]

As far as we can tell, there is no "finding" on the record that demonstrates that off-exchange trades are affecting the fairness and orderliness of the markets. The Commission only says that it "…preliminarily believes there is a possibility trading volume could migrate away from 'lit venues'" (emphasis added), and so believes a trade-at requirement should be included in this pilot.[22] The Commission's hedged, conditional statement hardly stands as a finding of unfairness or lack of orderliness which could grant the Commission the authority to force orders to exchanges and away from off-exchange competition. The Test Group Three securities that are to be subject to the trade-at provision are real securities bought and sold by real investors – investors that deserve the benefits of competition that Congress found in the national interest so many years ago.

Structural Concerns

1. Shifting goals

A fundamental concern we have regarding the proposed Plan is its stated goal. When a tick-size pilot was first proposed and then later passed in the U.S. House of Representatives, it was promoted as a "jobs bill."[23] It was thought that through a daisy-chain of events the pilot would incentivize market-makers to hold inventory in less liquid stocks, leading to increased research coverage of these stocks, which would in turn drive interest in these stocks, encouraging more IPOs of emerging growth companies, spurring economic growth, and ultimately creating jobs. While we always reserved doubts about whether all those events would happen based simply on widening the tick size of a certain portion of our equities markets, it was at least a laudable goal. Without that goal, the new goal seems simply to find ways to drive higher profits to exchanges and some of their most favored clients, with those profits coming at the expense of the retail investors Schwab serves.

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[21] 15 U.S. Code 78k-1(c)(3)(A)(i)

[22] "When quoting and trading increments are widened in the absence of a trade-at requirement, the Commission preliminarily believes there is a possibility trading volume could migrate away from 'lit venues' – trading venues that provide public pre-trade transparency by displaying the best priced quotations – to 'dark venues' that do not provide public pre-trade price transparency." (Order Directing the Exchanges and the Financial Industry Regulatory Authority To Submit a Tick Size Pilot Plan, page 23)

[23] Rep. Sean Duffy (R-WI) in a press release associated with the House Financial Services Committee markup of his "Small Cap Liquidity Reform Act" (HR 3448) stated: "The bill that Mr. Carney and I have introduced supports America's newest jobs creators by creating a pilot project to maximize their trading liquidity. Our hope is that our bill will give these emerging growth companies greater access to much needed capital so they can expand their businesses and create much needed American jobs."

2. Lack of clearly defined measurements for success

Another significant concern is that the Plan proposed by the exchanges contains no discussion about the metrics to be used for measuring to what extent the plan ultimately is considered a success.

Rather than allowing the exchanges to simply undertake an open-ended experiment with the vague goals of "studying and assessing the impact of increment conventions on the liquidity and trading of stocks of small capitalization companies,"[24] we believe the Commission needs to clearly specify what constructive public policy goals are being sought by undertaking a pilot, how those goals will be measured, and at what level of measurement they will be deemed a success, especially if the ability for retail investors to have their orders executed inside the spread were to be degraded in any way.

Schwab would like to be in a position to offer guidance on what metrics would be appropriate for measuring the success of the pilot, but without a clear elucidation of what the Commission is trying to accomplish with the pilot, nor a cost-benefit analysis to measure how different alternatives might impact the markets, we are hard-pressed to put forward specific suggestions in this area.

What we do know is that under decimalization, the U.S. equities markets for retail investors are as deep and liquid as they have ever been, with price improvement and other execution quality statistics at historically high levels. As the SEC contemplates any changes that might impact this state of affairs, its first guiding principle should be "Do No Harm."

3. No mention of cost-benefit analysis

Similar to our concerns about the lack of clearly defined and measurable goals in the proposed Plan is the lack of articulation of a cost-benefit analysis associated with the Plan. Part of the problem is the fact that the proposal is an NMS Plan, rather than a rule put forward by the Commission, which would require a robust economic analysis.

As detailed above, Schwab has serious concerns about the negative impact on retail investors posed by any plan to widen tick sizes. In addition to those concerns, we also believe a robust analysis needs to be done on the costs of implementing such a complex proposal on other market participants as well as on the potential costs of investor confusion and decreased investor confidence in our markets if the Plan leads to increased market volatility, as we think it may.

4. Misaligned project scope

Finally, we believe the Commission needs to re-examine the scope of the proposed Plan. For a pilot that is designed to examine liquidity and trade execution quality of small capitalization stocks, Schwab questions why stocks with market caps of as much as $5 billion and stocks with trading volumes of as much as one million shares per day are included. We fail

[24] SEC Release No. 73511, File No. 4-657, page 2

to see what meaningful conclusions could be drawn by including such large capitalization, highly liquid stocks in the pilot.

While we maintain our concerns about the potential benefits of any pilot to widen tick sizes, one suggestion for narrowing the scope of a pilot in order to minimize harm to investors would be to only include securities that already have average quoted spreads greater than 5 cents. Research[25] suggests that more than 60% of the stocks eligible for the proposed pilot already have this characteristic. Including only these securities in a pilot, where competitive forces naturally settled on wider spreads and where retail investors will have already become accustomed to them, would subject our clients to significantly less potential harm than under the pilot's proposed scope.

Conclusion

Schwab agrees with the SEC Investor Advisory Committee that enough evidence already exists to conclude that widening tick sizes will benefit certain sophisticated market participants at the expense of retail investors, and therefore a tick size pilot should not be pursued. If the SEC, however, ultimately decides to go forward with a pilot, it should do so via a rule proposal, rather than through the NMS plan process.

A formal SEC rulemaking would be preferable in many respects. It would require a thorough cost-benefit analysis and clearly articulated goals and ways of measuring those goals. Additionally, it would take the proposal out of the hands of a clearly self-interested and conflicted portion of market participants and rightfully put it in the hands of an independent federal agency tasked with a mission of maintaining fair, orderly and efficient markets, facilitating capital formation, and, most importantly, protecting investors. Only if and when the Commission demonstrates that a pilot could be undertaken in a cost-effective way that ultimately improves our markets without harming investors, should such a proposal be pursued.

[25] Mackintosh, Phil, *Who Gets the Short End of the 'Tick,* KCG (July 2014), available at: https://www.kcg.com/uploads/documents/KCG_Tick_Size_Analysis_Final.pdf

We appreciate the opportunity to comment on the proposed NMS Plan to implement a tick size pilot program and thank the Commission for its consideration of the views we express above. If you have any questions regarding this letter, please contact Jeff Brown at (202) 638-3750.

Sincerely,

Jeff Brown
Senior Vice President
Legislative and Regulatory Affairs
Charles Schwab & Co., Inc.

cc: The Honorable Mary Jo White
The Honorable Luis A. Aguilar
The Honorable Daniel M. Gallagher
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar

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