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Via Electronic Mail (rule-comments@sec.gov)

Mr. Brent Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: Securities and Exchange Commission Release No. 34-72460 File No. 4-657 Notice of Filing of Proposed National Market System Plan to Implement a Tick Size Pilot Program on a One-Year Basis

Dear Mr. Fields:

The Security Traders Association of New York, Inc. ("STANY")[1] respectfully submits this letter in response to the Securities and Exchange Commission's ("SEC" or the "Commission") request for comment on the Plan to Implement a Tick Size Pilot Program ("Proposed Plan") submitted by the Financial Industry Regulatory Authority and U.S. equity securities exchanges (collectively "Plan Participants") pursuant to Rule 608 of Regulation NMS under the Securities Exchange Act of 1934 ("the Exchange Act.")[2]

Almost without exception, since the introduction of the Jumpstart Our Business Startup Act (JOBS Act) in 2012, persons and firms interested in the equity markets have advocated that the Commission conduct a study of the impact of alternative minimum price variations ("MPVs") on

[1] STANY is the voice of the trader in the New York metropolitan area and represents approximately 750 individuals who are engaged in the trading of securities. STANY is the largest affiliate of the Security Traders Association ("STA"), a multinational professional association that is committed to being a leading advocate of policies and programs that foster investor trust, professional ethics and marketplace integrity and that support education of market participants, capital formation and marketplace innovation. As an industry organization of individuals employed in the securities markets, STANY does not represent a single business or business model, but rather provides a forum for trading professionals representing institutions, broker-dealers, ATSs, and trading centers to share their unique perspectives on issues facing the securities markets.

[2] *See* Order Directing the Exchanges and Financial Industry Regulatory Authority to Submit a Tick Size Pilot, Release No. 34-72460 (June 20, 2014) and Plan to Implement a Tick Size Pilot Program, Release No. 34-73511, 79 Fed. Reg. 66423 (Nov. 7, 2014)

the stocks of small capitalized (“small cap”)companies. In a letter to the Commission dated August 7, 2012[3], STANY joined the numerous advocates encouraging the Commission to explore the potential benefits of a multi-tiered approach to tick sizes.

The articulated premise of the JOBS Act Tick Size pilot was to test whether MPVs in excess of a penny for small cap companies would stimulate new IPOs and enhance the quality of secondary market trading in these equities. Some positive results which advocates of the pilot hope to achieve include: an increased number of IPOs, greater research coverage of those offerings in the after-market, enhanced market making, and greater liquidity in the secondary market for companies subject to the pilot. A strong secondary market is essential to private capital formation. We believe that investors are more likely to participate in initial public offerings if there is a reasonable expectation that an active secondary trading market will develop for the newly public securities. Therefore, to the extent that MPVs greater than one penny may strengthen secondary trading in smaller cap companies we would expect to see a positive impact on the abilities of smaller companies to raise capital.

Whether to improve conditions for capital formation and enhance the market for IPOs, or otherwise, the majority of market participants have long believed that the U.S. equity markets would be better served by a more tailored methodology to market structure than that afforded by a “one-size-fits-all” approach. While many believe that the “one-size-fits-all” regime is not ideal, setting tick increments is fundamentally a balancing act with different classes of market participants having different interests and preferences. Certain market participants (including some who have filed comment letters in response to this release) advocate reducing MPVs arguing that smaller tick sizes translate into lower costs for investors; others do not believe that it is appropriate for the Commission to set MPVs at all preferring to let market forces set prices; many see value in testing wider MPVs for less liquid stocks. However, rather than consider various approaches to MPVs all at once, we appreciate that testing wider MPVs for less liquid stocks is an excellent start to the broader question of optimal tick sizes in general.

While we have reservations as to whether widening tick sizes can achieve the desired impact articulated by Congress in the JOBS Act and discussed at great length in Congressional Hearings—increased research and post market support of small cap companies—in principle, we are in favor of a tick size pilot to test alternative trading rules for stocks that are on the lower end of the liquidity spectrum.

We view a pilot as the best way in which to gather information about the impact of wider spreads on small cap stocks and commend the Commission’s commitment to a data-driven methodology and empirically based decision-making. However, we believe that all market structure pilots should be prudently designed with clearly defined measures to determine success—in this case whether wider tick sizes successfully increase liquidity in small cap equities and/or creates an environment in which emerging companies can more easily raise capital through participation in the equity markets.

[3] *See* Letter from Kimberly Unger, Executive Director, STANY to Elizabeth Murphy, Secretary , Commission available at http://www.sec.gov/comments/jobs-title-i/tick-size-study/ticksizestudy-5.pdf

Unfortunately, the Proposed Plan simply fails to achieve the standards of a prudently designed and clearly defined pilot and should be reconceived for three reasons:

> First, the Proposed Plan deviates from the Congressional mandate for a tick size pilot;
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> Second, the Proposed Plan lays an onerous burden on the securities industry that will impose costs well in excess of any possible benefits; and
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> Third, the Proposed Plan will not produce information useful for regulatory policy.

<u>The Proposed Plan Is At Odds with the Congressional Mandate</u>

In the JOBS Act, Congress directed the Commission to conduct a review to determine how "decimalization affected the number of initial public offerings and the liquidity and trading of smaller capitalization company securities." In Congressional hearings thereafter, and in draft legislation, Congress clarified that this review should consist of a pilot to test the effects of wider tick sizes than the current one cent minimum price variation promulgated by Reg NMS on emerging growth companies with total annual gross revenues of less than $750,000,000.[4] In contrast, the Proposed Plan consists of three pilots (as well as a control group) encompassing 1,200 stocks, and including stocks with a market capitalization of up to $5 billion.

We respectfully submit that nothing in the JOBS Act or subsequent Congressional mandates permits or suggests that Congress sought to evaluate the market for anything other than small cap stocks. Stocks with a $5 billion market cap cannot be considered "smaller capitalization company securities" by any reasonable definition. By including such a wide range of stocks in the tick size pilot, the Proposed Plan deviates from the mandate prescribed by Congress. We do not believe that Congress intended to authorize such a wide-ranging social experiment on the nation's securities markets.

<u>The Proposed Plan is Onerous</u>

Since the advent of Reg NMS, the securities industry has undergone significant automation in its trade processes. With rare exceptions, prices are submitted and updated by computers. Each of the three pilots that are elements of the Proposed Plan will cause industry participants to incur millions of dollars in programming and testing costs. There will inevitably be trade errors that will be costly to resolve. A single pilot would be a significant and expensive undertaking for the securities industry. Four separate pilots is a crushing burden, and we think goes well beyond what Congress intended by requiring a "review."

These costs are further exacerbated by requiring the industry to collect and submit over 100 different data elements. Computers do not collect data in usable form unless programmed appropriately. There is no one universal data collection and storage program throughout the

[4] 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

securities industry. Different systems collect data in different ways, and to be useful to the Commission, must be submitted in a technical format that can be reviewed for comparable results. All of this programming must be tested, and the results must be stored.

STANY believes the ideal Tick Size Pilot would be limited to one test group that contains only a minimum quoting increment of $.05. However, we do not oppose the approach taken in Test Groups One and Two of the Proposed Plan. Both are not overly complex and designed with one variable- wider tick sizes. In contrast, the Trade-At pilot of the Proposed Plan represents a particularly onerous burden, since its inclusion adds significant complexity and cost to what might be an otherwise straightforward pilot.

The Success or Failure of the Proposed Plan Is Undefined

Worse yet, the Proposed Plan fails to define the metric by which success will be measured. This is particularly troublesome because each of the pilots tend to prefer some business models over others.

For example, Test Group One requires pilot securities to be quoted in $.05 increment, but allows trades to occur at any price increment allowed today, which for most stocks will be one penny increments. This pilot tends to favor wholesale market makers and off exchange trading centers, that can execute trades between the quotes, and disfavor exchanges, which cannot. Test Group Two, on the other hand, would require most trades to occur at stated prices, while Test Group Three, the Trade-At pilot[5], would require most trades to be executed on the exchange where the quote is published.

Test Group Two and especially Test Group Three would tend to favor exchange models, as compared to Test Group One in which broker-dealers would be expected to enjoy a more profitable environment.

Since the stated goal of the JOBS Act review is to create an environment where broker-dealers have sufficient profitability to incur the expense of research for small cap stocks, one measure of the success of any particular pilot would be increased broker-dealer profitability. But the Proposed Plan fails to state how much more profitability would be considered sufficient to encourage broker-dealer research activities, or at what point additional profitability becomes excessive and not in the public interest.

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[5] STANY understands that Trade-At was included (although in a different form) at the suggestion of the Commission not the SROs. Below, we discuss the views expressed by the majority of our members who feel that the Tick Size Pilot is not the appropriate vehicle in which to test Trade-At. However; it should be noted that STANY includes among its members persons associated with many of the Participants who support Trade-At. As noted below it could be argued that each of the Three Test Groups "favors" one or more segment of the market over another. As an organization with a diverse membership it is not STANY's intention to favor one business model over another. So while we may point out what could be potential flaws in Test Group Three we do so in an attempt to ensure that whatever tick size pilot is ultimately implemented can best test the impact of wider spreads on small cap stocks as intended by Congress. Our primary concern with Trade-At, as explained below, is that its inclusion will create a greater risk of overall failure of the pilot. Test Groups One and Two are far less complex and less costly to implement and are therefore more likely to be embraced by market participants and liquidity providers.

Another goal of the Proposed Plan is to increase secondary liquidity, which might be defined as creating an environment where the public can interact with larger institutional-sized orders. Test Groups Two and Three can be expected to produce somewhat larger orders. Test Group Three would penalize institutions that fail to expose their orders to public view, and therefore can be expected to facilitate public interaction with institutional order flow. But, the Proposed Plan fails to define the average order size or the amount of institutional order flow that might be considered a success.

We fear that the inevitable result will be that Test Group One will foster broker-dealer profitability and possibly more research (although many market making firms do not have research departments and we consider it unlikely that any increased profit will trickle through to research), while Test Group Two will encourage larger trading sizes, and Test Group Three will facilitate greater public exposure to institutional orders. Each of the various industry business models will be able to lay a credible claim to success. But without a metric to determine success, it will not be possible to determine how the trade-offs between these conflicting goals should be resolved.

It should be stressed that information is costly to produce, submit and evaluate. The Proposed Plan requires the securities industry to gather and submit many terabytes of data. But, without some metric to determine how success will be measured, the industry will be forced to invest millions of dollars in programming and compliance costs to produce a muddle of inconclusive data that will not provide any key to the mysteries of secondary liquidity, let alone provide any useful policy guidance for Congressional lawmakers seeking to improve the environment for capital raising for smaller companies.

<u>The Trade-At Pilot should be Removed from the Proposed Plan</u>

We believe the Trade-At proposal was first suggested by the Commission in its 2010 Market Structure Release. However, the idea has been a darling of the exchanges ever since Reg NMS, which forced exchanges into a highly competitive automated trading environment. The Trade-At rule favors orders that are published in listed markets and therefore restores part of the exchange monopoly that was broken up by the implementation of Reg NMS.

We believe that the Trade-At proposal runs counter to the goals of the JOBS Act–to encourage more research by broker-dealers and improve liquidity for small cap stocks. The Trade-At pilot has been promoted by exchanges because they believe it will direct trade executions away from market makers and off exchange trading centers onto exchanges. The favored environment for exchanges resulting from the Trade-At pilot would necessarily significantly reduce broker-dealer profitability, thereby eliminating incentives by broker-dealers to produce research, and a reduction in market participants, all other things equal must result in less liquidity.

In addition, the Trade-At pilot will require especially complicated computer programming and testing to accomplish. As a result, the inclusion of the Trade-At pilot has turned what could be a successful and well received proposal into a controversial, excessively expensive and complex experiment without any expectation of yielding meaningful results. Each added test increases costs, heightens risks and has the propensity to mask or taint the results of the initial pilot.

This increase in both operational risk and costs comes without a clearly articulated need or explanation as to how the added requirement would provide information by which to judge the effectiveness of wider tick sizes. Whether dealers are allowed to match the NBBO or offer price improvement to the NBBO has no relation to the impact of the size of permissible trading increments.

The Trade-At regimen will require changes to order routing, internalization and matching engines across all market centers as well as changes to pre and post trade validation and surveillance mechanisms of a magnitude not seen since implementation of Reg. NMS. Increasing, the complexity of already complex markets for a one-year Trade-At experiment will likely not be worth the associated costs and will not serve the interests of investors, market participants, or issuers. On the contrary, the costs and complexity of the Trade-At requirement are more likely to cause market participants – especially those whose participation Congress has sought to incentivize–to stop making markets in the securities subject to Trade-At rather than incur the costs to completely change their models for handling customer executions for the subset of subject securities.

<u>The Proposed Plan includes several items which are likely to have negative unintended consequences for retail and institutional order flow.</u>

Price improvement for retail orders under both Test Groups Two and Three will likely be impaired. In order to provide price improvement, any trading center handing stocks in Test Groups Two and Three will be required to sign an attestation that "substantially all" orders that receive the minimum required price improvement did not "originate from a trading algorithm or any computerized metrology."

While this seems straight forward; it is anything but. How a trading center, receiving order flow from many natural persons, can design a surveillance system that would allow them to make this attestation with certainty is unclear. The retail definition in the Proposed Plan is too complex and ambitious and as such many retail firms will not sign the attestations. Consequently, and to their detriment, retail clients of these firms will not receive the benefits of the retail exemption.

In requiring this attestation, the Proposed Plan does not take into consideration the realities of trading in 2014. Ordinary investors, as well as those trading on their behalf, are heavily reliant on computerized trading methodology. Complex trading models employed by market makers may for example be set to purchase stock once the stock price crosses certain daily moving averages. The system may be set up such that once the stock crosses the threshold an alert is set off, requiring human intervention and qualifying for price improvement or an order may be generated automatically that does not qualify for price improvement. It is uncertain what benefit will be gained by requiring brokers to distinguish between these results in each case. Likewise, how this exercise will improve trading in small cap companies or test the premises of the pilot is unclear.

Another concern with Trade-At is the possible impact on the execution quality of retail orders. Several of our member firms are concerned that, with wider spreads and price improvement of 10%, effective spreads and spread to quote ratios will be significantly higher. Retail orders are currently often sent to wholesalers that, unlike exchanges, provide capital and stand ready to trade with price improvement. Retail clients therefore are seeing better prices and better executions off exchanges. With Trade-At and minimum price improvements amounting to only 10% of the spread, effective spreads will widen. The incentive will now be to capture the spread as opposed to providing price improvement to retail orders. Retail executions will no longer get a mid-point execution but rather will see smaller price improvements.

In addition to concerns about increased costs occasioned by access fees, institutional investors are also concerned with the added risk of information leakage attendant with the Trade-At regime. Forcing institutions to expose their interest on exchanges will subject them to signaling risk which may negatively impact pre-trade prices. Institutions generally trade large size orders and are therefore more vulnerable to slippage- even when orders are broken into smaller sizes for execution.

Costs and potential risks need to be reduced to ensure maxim participation by market makers and investors

In addition to omitting the Trade-At pilot, the Commission should drop larger capitalized stocks from the pilot, eliminate securities which already trade efficiently with reasonable liquidity, and reduce the data collection items to only those necessary to measuring the success of the pilot.

1. Reduce the market capitalization thresholds to limit the pilot to "small cap" companies.

We suggest that, to lower costs and minimize potential risks associated with the pilot, should focus on the segment of the small cap market that would stand to benefit most from changes in market structure. Using a threshold of market capitalization of $5 billion or less includes stocks which are already highly liquid and do not properly fall within a reasonable definition of "small cap" companies.

As suggested by Charles Collver in an SEC Staff Paper [6] the trading characteristics of small and mid-cap stocks (those with capitalization below $5 million) exhibit considerable differences in their liquidity and spreads with stocks with capitalization below $100 million exhibiting the least liquidity and mid-cap stocks with capitalization between $2 billion and $5 billion exhibiting the greatest liquidity. We suggest that those stocks whose trading characteristics more closely resemble the trading of large capitalization stocks be eliminated from the pilot.

As a threshold, we suggest, consistent with the Congressional mandate of the JOBS Act, only those stocks with market capitalization of $750 million and under be included in the pilot. Including stocks of companies with capitalization of $1 billion to $5 billion will add layers of complexity to the pilot and significantly increase the data to be analyzed. It will also raise trading costs for a number of stocks which currently do not have liquidity concerns.

2. Use existing reporting regimes whenever possible and only require additional reporting when necessary to prove or disprove a specific, articulated theory.

[6] See SEC Staff Paper, A characterization of market quality for small capitalization US equities, Charles Collver (September 2014) available at http://www.sec.gov/marketstructure/reserach/small_cap_liquidity.pdf

Costs of implementation of the pilot should be further reduced by eliminating duplicative and unnecessary reporting. The Proposed Plan includes an onerous list of items required to be collected and reported by trading centers and market makers. Many of the items required are not presently part of the already vigorous reporting obligations to market participants and will require costly and time consuming programming challenges for market participants. Other data items are already collected through some existing reporting regime—such as MIDAS, OATS, 605 reporting—and should not be required to be reported as part of the Proposed Plan. Simplification of the Proposed Plan will lead to greater participation by market makers, easier understanding by investors, less risk for issuers and will produce cleaner results from which to judge the effectiveness of wider spreads. We recommend that in the first instance the Commission use existing reporting systems to gather information needed to judge the results of the pilot. After that, only data that is determined to be absolutely necessary to measure the success of the pilot should be added to the list of collection requirements.

3. <u>Eliminate Market Maker profitability calculations and reporting.</u>

Market maker profitability calculations and reporting are entirely unnecessary for the analysis of the tick size pilot. The requirement is patently unfair to market makers and not likely to yield data which would help determine the impact of wider spreads on small cap stocks.

Market makers are already subject to wide ranging order and trade reporting requirements-including requirements under OATS, trade reporting, short interest reporting, preparing for CAT, etc. Compliance with these existing requirements is both expensive and labor and resource intensive The proposed reporting and profitability calculations will add an increased burden on market makers without any explanation of the purpose of gathering profitability data. We have serious reservations about claims that increased profitability by market makers will lead to increased research coverage and certainly would not expect to see any such changes within the limitations of a one year pilot. We would expect however that the added costs and burdens of yet another reporting requirement will reduce market makers ability to provide price improvement to customers.

Furthermore, the Commission has failed to explain why this information should be submitted by market makers and not required of other market participants such as exchanges. Profitability is highly confidential and proprietary. Currently this information is not disclosed except in a public company context. Requiring maker makers to share this information with their direct competitors (exchanges) especially while these competitors are not required to share their profitability information is anti-competitive and extremely disadvantageous to market makers. We would not be surprised if market makers, rather than calculate profitability, simply refuse to trade in stocks subject to the Proposed Plan. This is the exact opposite of what Congress hoped to achieve when it suggested widening spreads.

Profitability calculation is complex and subject to interpretation. Firms are likely to use different methodologies in calculating "profitability." There are too many variables between firms which would render the information useless to the Commission in its evaluation of the success or failure of the tick size pilot. If the Commission decides that profitability information is necessary, the Commission should ask for raw data and perform the calculations itself.

We strongly urge the Commission to eliminate market maker profitability calculations and reporting; however, if the Commission elects to require these calculations we urge that 1. exchanges and other market participants also be required to report profitability calculations to the Commission and 2. profitability calculations and reporting not be disseminated to the public, but rather used only internally by the Commission in its determination of whether to extend the tick size pilot.

<u>A one year pilot is too short to test the intentions of the JOBS Act.</u>

The pilot creates a potentially enormous burden on the industry to test a theory that increasing tick sizes might help small and mid-cap companies raise capital. Commitments to enhanced underwriting, research, and market making take time. One year is not long enough to see whether there is an increase in the number of small and mid-cap companies coming to market as a result of wider spreads. There is also a danger that the short duration of the pilot—combined with its costs and complexity—will cause some participants to drop stocks (especially those in Test Group Three) rather than make the systems changes required by the pilot. The one year pilot may not provide sufficient time to justify the cost of systems changes—especially given that the pilot will only apply to a small segment of the market. Various alternatives to the one year pilot, ranging from 18 months to 5 years, have been suggested and our members do not necessarily agree on the "ideal" length of time for the study.

As designed, the Proposed Plan anticipates that upon conclusion of the one year pilot, MPV's will revert back to pre-pilot levels while data is analyzed. In the event that the program is discontinued, no problems would result. However, if the Commission agrees to turn the pilot into a permanent rule, stopping the pilot during the review period will require turning off system changes and then re-tooling leading to unnecessary costs, potential confusion and greater risks of system errors. We therefore suggest that data be evaluated at the one year mark. Regardless of the pilot period ultimately decided upon by the Commission, during the months of review following the active pilot period, the pilot should continue until a decision as to its future status is reached by the Commission.

<u>The Commission, as opposed to the SROs, should implement the pilot, collect and analyze the data, and conduct a cost/benefit analysis of the results.</u>

To initiate a tick size pilot as envisioned by Congress and to implement the Commission's decision to subject small cap stocks to nickel spreads, the Commission took the procedural path of issuing a Pilot Order directing the Participants to submit a plan under Reg. NMS. Given the major market structure impact and costs of implementing the Proposed Plan, STANY believes, as opposed to granting one segment of the industry the right to fashion market structure initiatives and exclusively influence the design of the Proposed Pilot, the tick size pilot should have been designed by the Commission.

At this stage, STANY feels strongly that the tick size pilot should be implemented and analyzed by the Commission as opposed to SROs. Exchanges, acting as SROs and for-profit businesses, directly compete with other market participants, including broker dealers, ATSs and market makers for market share and order flow. No one market participant or group of participants should collect, review and interpret data that may have a direct impact on their business model and the business models of their competitors. Implementation, review and analysis by one group—in this case exchanges—would present obvious conflicts of interest and may taint the pilot.

We do not mean to imply that the Exchanges would do anything untoward in the collection and analysis of the data, but any results that could be construed to benefit the exchange model could be subject to questions and looked at askance by competitors. The test pilot results will be cleaner without this potential for conflict; this is especially true if the Commission goes forward with Test Group Three and the Trade-At experiment.

<u>Summary</u>

STANY supports a tick size pilot to the extent that it is conducted as a data driven experiment with clearly designed measures of success. We urge the Commission to define these measures prior to implementation of the pilot and to make sure that the design of the pilot tests the impact of a single variable: the tick size increment.

While we prefer that the pilot consist of only one test group with minimum quoting increments of $.05, we would be comfortable with the approach taken in both Test Groups One and Two. We would however, suggest that both groups be subject to the same exceptions.

We believe that investors and issuers would be better served by limiting the pilot to those companies most likely to benefit from wider spreads. As such, we urge the Commission to follow the recommendation in the JOBS ACT and include only those securities of companies with capitalization of $750 million or less.

We opposed the inclusion of a test group with a Trade-At component. Trade-At detracts from the focus of the pilot, adds complexity and cost to an otherwise straightforward test of alternative tick sizes, increases operational risk, adds a potential for conflicts of interest, runs the risk of negative unintended consequences including non-participation from market makers and brokers, and will increase costs for investors. We do not believe that the tick size pilot is the appropriate way in which to test the efficacy of such a controversial and significant market structure change as Trade-At.

We urge the Commission to review and eliminate many of the redundant items of data collection mandated in the Proposed Plan. Only that data which is not already reported and which is essential to determine the success or failure of the pilot should be required. The requirement pertaining to market maker profitability should be omitted. In the alternative profitability calculations should also be required of exchanges and neither market maker nor exchange profitability should be publicly disclosed.

Finally, STANY suggests the pilot should be longer than one year and should continue during the review phase and that the Commission and not the SROs should implement and analyze the results of the pilot.

STANY appreciates the opportunity to provide comments on the Proposed Plan for a tick size pilot. If you have any questions or require further information please contact me at 212.344.0410 (kimu@stany.org)

Respectfully submitted,

Kimberly Unger
CEO and Executive Director