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Submitted electronically

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

Re: Exchange Act Release No. 34-73511; File No. 4-657

Dear Mr. Fields:

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to respond to the Securities and Exchange Commission's (the "SEC" or "Commission") request for comment concerning a tick size pilot program jointly developed by the U.S. Securities Exchanges and Financial Industry Regulatory Authority (collectively, the "Participants").[2] Among other items, the Participants' one-year pilot program (the "Proposed Pilot") would widen the quoting and trading increments for certain small capitalization securities to allow the Commission to further study and assess decimalization's impact on the liquidity and trading of these securities.[3]

Fidelity believes that the U.S. equity markets are fundamentally strong and that in recent years investors have benefited from numerous advances. Technology and a competitive marketplace of multiple trading centers have led to improved cost, liquidity, speed, and product

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[1]Fidelity is one of the world's largest providers of financial services. Fidelity provides investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 20 million individuals and institutions, as well as through 10,000 financial intermediary firms. Fidelity generally agrees with the views expressed by the Securities Industry and Financial Markets Association ("SIFMA"), Investment Company Institute ("ICI"), and Financial Information Forum ("FIF") in their comment letters. We submit this letter to supplement the SIFMA, ICI and FIF letters on specific issues.
[2]*See* Securities Exchange Act Release No. 73511 (Nov. 3, 2014), 79 FR 66423 (Nov. 7, 2014) (the "Proposed Pilot") *available at*: http://www.gpo.gov/fdsys/pkg/FR-2014-11-07/pdf/2014-26463.pdf Unless otherwise defined in this letter, capitalized terms have the meanings ascribed to them in the Proposed Pilot.
[3]The Proposed Pilot was filed in response to an SEC Order requiring the Participants to act jointly in developing and filing with the Commission a National Market System Plan that, among other items, would widen the quoting and trading increments for certain smaller capitalization stocks. *See* Order Directing the Exchanges and the Financial Industry Regulatory Authority to Submit a Tick Size Pilot Plan. Securities Exchange Act Release No. 72460 (June 24, 2014), 79 FR 36840 (June 30, 2014) *available at* http://www.gpo.gov/fdsys/pkg/FR-2014-06-30/pdf/2014-15205.pdf

innovation. Therefore, any proposed changes to equity market structure should be reviewed carefully to avoid unintended consequences that could compromise the market.

We do not believe that the move to decimal pricing has negatively affected the liquidity of smaller company securities.[4] As we have emphasized in prior comments provided at the SEC's Decimalization Roundtable[5] and in support of the SEC's Investor Advisory Committee's Recommendations,[6] we believe that factors outside of decimalization influence smaller companies' decisions to go public and impact liquidity in their securities. In our experience, macroeconomic and regulatory factors influence a company's decision to go public, not tick size. Similarly, the limited number of outstanding shares and concentrated ownership positions typically found in smaller companies contribute to lower liquidity in these securities. We therefore believe that increasing tick sizes in smaller capitalization securities will increase trading costs for retail investors without improving smaller company access to the public capital markets or the liquidity of their securities.

Given these views, we do not support the Proposed Pilot. Nevertheless, the Commission has clearly signaled its intent to proceed with a pilot, and we appreciate the Commission's effort to collect data before considering potential rulemaking. Unfortunately, the Proposed Pilot is overly broad and unnecessarily complex. If implemented as proposed, we believe that it will obfuscate, rather than clarify, the question of whether an increase in tick size will increase liquidity in smaller capitalization securities.

<u>The Proposed Pilot is overly broad.</u>

The Proposed Pilot will impact a larger universe of issuers than Congress anticipated or intended. In the Jumpstart Our Business Startups Act[7] (the "JOBS Act"), Congress asked the Commission to explore the impact of decimalization on smaller company securities and permits,

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[4]For some time, market participants, legislators, and regulators have discussed the impact of decimalization on the securities of small capitalization companies. Some believe that the move to decimal pricing may have negatively affected the liquidity of these securities in that narrower spreads contributed to less analyst research coverage, which in turn has led to a decline in investor awareness and interest in these securities and a decline in smaller company initial public offerings. If the SEC were to increase the minimum tick size for the securities of smaller companies, then, so the argument goes, market intermediaries would realize greater profits from trading costs, which would in turn lead them to promote these securities, thereby spurring investor demand.

[5]*See* Decimalization Roundtable, Exchange Act Release No. 68510, 77 FR 76572 (December 28, 2012). Brian B. Conroy, President, Fidelity Capital Markets participated in *Panel 1: Evaluating Concerns Relating to Tick Size for Small and Middle Capitalization Companies*. Transcript *available at*: https://www.sec.gov/news/otherwebcasts/2013/decimalization-transcript-020513.txt.

[6]*See* SEC Investor Advisory Committee ("IAC"), Recommendation of the Market Structure Subcommittee, Decimalization and Tick Sizes (January 14, 2014). The IAC recommended that the Commission should not reverse its decimal pricing policy to widen the tick size for smaller capitalization company securities. Recommendations *available at*: http://www.sec.gov/spotlight/investor-advisory-committee-2012/decimal-pricing-draft-recommendation-iac.pdf. Fidelity's comment letter *available at*: http://www.sec.gov/comments/265-28/26528-70.pdf

[7]Pub.L.No. 112-106, 126 Stat.306.

but does not require, the Commission to change the tick size for these securities.[8] In the JOBS Act, Congress focused on issuers with gross annual revenue of less than $1B.[9] The Small Cap Liquidity Reform Act of 2014 (H.R.3448), which passed the U.S. House of Representatives in February 2014, provided for the Commission to develop an optional tick size pilot program for issuers with total annual gross revenue of less than $750M. The Proposed Pilot defines "Pilot Securities" -- the securities of those smaller capitalization issuers to be included in the Proposed Pilot -- as securities with a market capitalization of up to $5B.

The Proposed Pilot is far broader than prior legislative activity suggested, and will include a number of liquid securities that have market capitalizations significantly larger than traditional definitions of "small cap" securities.[10] Pilot Securities should be defined more narrowly to focus on those issuers that may benefit from wider tick sizes.

<u>The Proposed Pilot is unnecessarily complex.</u>

The Proposed Pilot consists of four different trading frameworks and includes three experimental groups, each with its own set of quoting and trading rules and multiple exceptions.[11] This complexity will make it difficult and expensive for firms to code. Coding changes for the Proposed Pilot will need to take into consideration the four very different trading frameworks with multiple exceptions and variables, while interacting with current trading systems.

Moreover, the Proposed Pilot asks firms to undertake this work for a small group of securities that are not frequently traded today, for a one-year pilot, without any expectation that any potential changes to tick size regulation will look like any of the various trading frameworks. That is, at the end of the one-year pilot period, depending on its results, the Proposed Pilot could be extended, terminated or modified and firms forced to undertake further significant and costly programming work to either further change systems or bring systems back to their status quo.

The Proposed Pilot's complexity also adds operational risk to the market by adding new layers and requirements onto already complex and interconnected systems. The changes

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[8] JOBS Act §106(b), 15 U.S.C.§78(k)-1(c)(6)(2012).
[9] JOBS Act §101(a), 15 U.S.C.§77(b)-(a)(19).
[10] For example, the average market capitalization ($-WTD) of securities in the Russell 2000® Index is $1.87B and the median market capitalization of securities in the S&P SmallCap 600® Index is $1B.
[11] The Proposed Pilot will randomly assign Pilot Securities into three test groups of 400 securities each and will contain one control group in which the remaining Pilot Securities will be placed. Control group Pilot Securities will be permitted to quote and trade in any increments permitted today. Pilot Securities in Test Group 1 are to be quoted in $0.05 minimum increments, subject to certain exceptions; Pilot Securities in Test Group 2 are to be quoted in the same quoting increments as Test Group 1, along with applicable quoting exceptions, and are to be traded in $0.05 minimum increments, subject to certain exceptions; Pilot Securities in Test Group 3 would be subject to the same quoting and trading increments (and exceptions) as Test Group 2, but would also be subject to a "Trade-At" component which would allow non-Exchange trading centers to execute an order for a Pilot Security at a price equal to the protected bid or protected offer only if one of 13 exceptions was met.

required by the Proposed Pilot will add considerable complexity to matching, order routing and associated systems. This complexity will necessarily decrease system performance, further compounding overall risk and exposure for both market participants and the public. The Proposed Pilot's complexity is also contrary to the SEC's increased focus on operational risk in the markets in light of several high profile technology issues.[12]

Given this complexity, cost, and operational risk, many broker-dealers may not participate, or not participate fully, in the Proposed Pilot. We believe that many broker-dealers may decide not to trade in Pilot Securities at all, and others may only allow certain types of trading in Pilot Securities on their platforms. This lack of participation, or even partial participation, will impact the integrity of the results of the Proposed Pilot, and frustrate the market structure experiment that the SEC is trying to run. Given the many variables outstanding, Fidelity is assessing the operational risks associated with the Proposed Pilot and determining customer expectations of full participation if the SEC determines to proceed.

Even where broker-dealers choose to participate fully in the Proposed Pilot, the complexity of Proposed Pilot will present challenges for retail investors. If a retail investor simply wants to trade any smaller capitalization security[13], in advance of placing an order, he or she will need to understand (1) if the security is a Pilot Security, (2) in which test group the Proposed Pilot Security is placed, and (3) which trading and quoting restrictions, as well as applicable exceptions, apply to that particular test group. Faced with this complexity, and increased trading friction, many investors will likely simply forgo trading in Pilot Securities, impairing liquidity in these securities.

The Commission can improve the Proposed Pilot.

We do not believe that any tick-size pilot can avoid all of the concerns noted above, which leads us once again to reiterate our recommendation not to experiment with larger tick sizes. If the Commission nevertheless proceeds, the tick-size pilot should be structured as simply as possible, given that added complexity leads to higher costs, greater risks of investor confusion and potentially less useful data. We offer the following recommendations to improve the Proposed Pilot:

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[12]For example, the SEC has addressed operational integrity at broker-dealers with its adoption of the Market Access Rule 75 FR 69792 (November 15, 2010) and the SEC has sought to strengthen the technology infrastructure of the U.S. securities markets with its adoption of Regulation Systems Compliance and Integrity 79 FR 72252 (December 5, 2014).

[13]Unfortunately, a retail investor cannot simply rely on a rule of thumb that only a market cap of $5B or less triggers this review, as market caps will fluctuate over the year of the Proposed Pilot, which means that some "smaller" cap stocks could grow substantially greater than $5B in market cap (and of course, other companies will see a decline in market cap below the $5B level).

- The Commission should remove Test Group 3 (the "Trade-At" test group) from the Proposed Pilot because it is not necessary to achieve the goals of the Proposed Pilot, adds operational risk, and is not the right forum in which to test "Trade-At";

- The Commission should work with industry participants to clearly define the market quality measurements that will be used to determine the success of the Proposed Pilot; and

- The Commission should provide market participants a significant time period for implementation.

Each of these comments is discussed in greater detail below.

<u>Test Group 3 should be removed from the Proposed Pilot.</u>

For some time the Commission has expressed an interest in investigating whether the quality of public price discovery may be harmed by undisplayed liquidity. We have yet to see evidence that price formation is deteriorating or data establishing that the quality of public price discovery is harmed by undisplayed liquidity.

Even if there were data indicating that the quality of public price discovery was harmed by undisplayed liquidity, we do not believe that the Proposed Pilot can adequately test "Trade-At" in isolation. We suggest that a review of "Trade-At" should contemplate many different variables, such as access fees, maker-taker fees, and internalization, which are properly not part of the Proposed Pilot. The Proposed Pilot is quite complex even without the "Trade-At" test group, but the 13 different exceptions within the "Trade-At" test group dramatically increases the pilot's complexity and the operational risk it presents to the markets.

Most importantly, the Commission doesn't need "Trade-At" for the market structure experiment that the Proposed Pilot is designed to test, as we do not believe that there is a connection between tick sizes and the migration of trading volume away from "lit" markets.

<u>The Proposed Pilot should clearly define the market quality measurements that will be used to determine its success.</u>

The Proposed Pilot calls for market participants to submit a significant amount of data for the duration of the one-year Proposed Pilot period and for six months pre/post Proposed Pilot. Despite this large amount of data, the Proposed Pilot has not clearly indicated *which* market quality measurements will be used to determine its success. We believe that measurements of market quality should be clearly defined prior to the start of the Proposed Pilot in order to avoid post hoc justifications and arguments about success and failure.

To this end, we recommend that the Commission gather a cross-section of the industry, including broker-dealers, asset managers, Exchanges, academics and others, to determine which specific measurements constitute the Proposed Pilot's success. We would welcome participating in this discussion.

A significant implementation period is needed.

If the Commission proceeds with the Proposed Pilot, market participants will need time to plan and implement changes to systems and to alert customers. As a diverse financial services company, Fidelity has experience with many types of investors and trading venues impacted by the Proposed Pilot. We offer 401(k) and stock plan services to smaller companies, and our mutual funds invest in the securities of smaller companies, as do our retail, retirement, adviser and broker-dealer customers. Moreover, our trading platforms execute trades in smaller company securities across all of our business lines.

By way of example, some of the implementation work that will need to occur at our firm includes the following:

- Our retail broker-dealer will need to build landing pages explaining the pilot and error messages for customer orders that do not comply with the particular trading framework appropriate for the Pilot Security the retail customer wishes to trade, create FAQ's for customers on the pilot, implement coding changes as well as train registered representatives on the pilot to effectively answer customer questions;

- Our clearing broker-dealer will need to communicate changes in trading smaller company securities due to the pilot to our adviser and broker-dealer clients so that they can, in turn, inform their clients of these changes; and

- Our institutional trading platform will need to make code changes, test those changes, implement trading protocols, establish policies and procedures, educate their client base on how trades will be routed under pilot, and work with vendors on the pilot.

Implementation of the Proposed Pilot will also affect our retirement business. Many retirement plans offer a self-directed brokerage window to their plan participants which enables plan participants to purchase individual securities for their retirement plan. When the Commission issues its list of Pilot Securities, we will need to determine if any retirement plans record kept by Fidelity hold or have the capability to purchase Pilot Securities and notify and educate plan sponsor(s) and plan participant(s) regarding the Proposed Pilot as appropriate. Similarly, many plan sponsors offer their plan participants company stock in their 401(k) plans. Once published, we will need to review the list of Pilot Issuers, determine if any are Fidelity plan sponsors that offer this option, and communicate accordingly.

We provide these examples to show that a significant implementation time period of at least one year is needed to help firms prepare for the Proposed Pilot. This partial list of how we and other firms will need to react to the Proposed Pilot underscores the need for the SEC to keep the design simple. Additionally, if the Commission proceeds with the Proposed Pilot, we urge the Commission and Participants to undertake a broad investor education campaign on the Proposed Pilot, to supplement other efforts to educate customers.

Additional comments.

We offer the following additional comments regarding certain operational features of Test Group 2 and Appendix C in the Proposed Pilot.

Pilot Securities in Test Group 2 may only be traded in $0.05 minimum increments, but may trade in increments of less than $0.05 in certain circumstances. For example, "Trading may occur at the midpoint between the National Best Bid and the National Best Offer ("NBBO") or the midpoint between the best protected bid and the best protected offer." We believe that the Commission should clarify why trading may occur at the midpoint between best protected bid and best protected offer, as we believe that in most cases this will be the same quote at the NBBO.

Similarly, Pilot Securities in Test Group 2 may trade in increments of less than $0.05 if they are Retail Investor Orders "provided with price improvement that is at least $0.005 better than the best protected bid or best protected offer…" It does not appear that there are any restrictions on the counterparty of the trade with the Retail Investor Order. We agree that there should be flexibility with respect to counterparties to a Retail Investor Order to allow either institutional buyers and sellers or wholesalers to affect the contra side of the trade. We recommend this point be clarified to avoid confusion.

We recommend that Test Group 2 include a trading exception for "Block Size" orders and that the Proposed Pilot's definition of "Block Size" be changed to help protect orders in Pilot Securities placed by institutional investors from information leakage. Pilot Securities do not currently have significant trading volume. As currently proposed, if an institutional investor such as a mutual fund places a large order relative to Pilot Securities on an Exchange, others will be alerted to trading in the security, which may compromise fund investor interests.

The Proposed Pilot uses the same definition of "Block Size" as that provided in Rule 600(b)(9) of Regulation NMS under the Securities and Exchange Act of 1934.[14] We examined trading in securities that met the "SEC Pilot Group Criteria" from October 1, 2013 through September 30, 2014 ("time period").[15] We found that on each day during the time period, 36%

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[14]17 CFR 242.600(b)(9) states that Block size with respect to an order means it is: (i) of at least 10,000 shares; or (ii) for a quantity of stock having a market value of at least $200,000.

[15]Fidelity's analysis started with 5, 234 US-Listed common stocks (excluding OTC/BB). We filtered this group by applying the "SEC"s Pilot Group Criteria" (i.e. stock price >$2 as of the end of the time period; stock price not

of the securities examined had a "Block Size" trade. These "Block Size" trades represented .07% of the total number of trades and 9% of the shares traded of the securities examined during the time period. Based on the limited number of trades that met the "Block Size" definition, we do not consider the definition meaningful and recommend that the Commission lower it to recognize current market conditions in the case of smaller company securities. For example, the Commission might consider a definition of "Block Size" in the Proposed Pilot as those orders (i) that are less than 5K shares; or (ii) for a quantity of stock having a market value of less than $100K. Under our analysis, using this definition of "Block Size", these trades represented .18% of the total number of trades and 12% of the shares traded of the securities examined during the time period.

Lastly, Appendix C contains certain Market Maker Profitability Data to be collected under the Proposed Pilot, including among other items, raw market maker realized trading profits, market maker realized trading profits net of fees and rebates, and raw market maker unrealized trading profits. One of the primary motivations for the Proposed Pilot was the theory that wider spreads would allow market makers to make more money on smaller capitalization securities, spend more money on research and take more small companies public. Information on market maker profitability is an indirect way of capturing this broker activity.

Rather than make a connection indirectly through profitability, we suggest that the Proposed Pilot should include a market maker/investment bank score card. This score card would include metrics and important drivers of liquidity such as the number of small capitalization research analysts by sector, new initiations of research, new research hires, number of non-deal roadshows and conferences dedicated to small capitalization companies, number of IPOs and follow-on offerings, and the performance of those offerings. In particular, this score card would be helpful to tracking and measuring bulge bracket and boutique investment banks that participate in the Pilot as market makers. Adding these metrics for the duration of the Proposed Pilot as well as six months pre/post-Proposed Pilot will capture more directly whether market makers are using profits from wider spreads to help smaller companies.

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under $1.5 anytime during this time period; market capitalization of <$5B as of the end of the period and ADV <1M shares during this period). After applying these criteria, we arrived at 3,235 stocks on which this analysis was performed. When looking at Block Size trades, we excluded the open and close trades.

We appreciate the opportunity to comment on the Release. Fidelity would be pleased to provide any further information or respond to any questions that the Staff may have.

Sincerely,

Scott C. Goebel

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

Mr. Stephen Luparello, Director, Division of Trading and Markets
Mr. David S. Shillman, Associate Director of Trading and Markets
Mr. Gregg E. Berman, Associate Director, Office of Analytics and Research, Division of Trading and Markets