TD Ameritrade

__December 22, 2014__

__Via Electronic Mail__

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

RE: Joint Industry Plan to Implement a Tick Size Pilot Program (File No. 4-657)

Dear Mr. Fields:

TD Ameritrade, Inc.[1] ("TD Ameritrade" or "the Firm") appreciates the opportunity to comment on the national market system plan ("NMS") proposal (the "Proposed Plan" or "Plan") to implement a tick size pilot program ("Pilot") that will allow the Securities and Exchange Commission ("Commission"), market participants, and the public to study and assess the impact of increment conventions on the liquidity and trading of the stocks of small capitalization companies.

While TD Ameritrade fully supports the Commission using a data driven analysis as a basis for determining when rulemaking is appropriate, the Firm is concerned about the inclusion of significant market structure changes that are unnecessary, increase operational risk and, if adopted, will harm retail investors by reducing liquidity and competition among market centers. The Firm also is concerned that enacting the Pilot through an NMS plan controlled by a small sub-group of market participants that includes self-regulatory organization ("SROs") that also operate as for-profit market participants, is inherently biased. Finally, TD Ameritrade requests clarification that the definition of "Retail Investor Orders" is intended to mirror the definition and interpretations that the exchanges have used in developing their individual retail liquidity programs ("RLPs").

I. <u>The Pilot Will Impose Significant Costs on Investors</u>

The Pilot's goal is to determine whether changing the minimum price variation (a/k/a "tick size") at which small capitalization stocks trade will result in greater market liquidity, incent an increase in the amount and quality of research published on small companies, improve the initial public offering market, and lead to the creation and growth of small companies and jobs in the United States.[2] While the goal is

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1 TD Ameritrade is a wholly owned broker-dealer subsidiary of TD Ameritrade Holding Corporation ("TD Ameritrade Holding"). TD Ameritrade Holding has a 39-year history of providing financial services to self-directed investors. TD Ameritrade, provides investing and trading services to over six million client accounts that total more than $663 billion in assets, and custodial services for more than 4000 independent registered investment advisors. During fiscal year 2014, TD Ameritrade's clients placed approximately on average 427,000 trades each day.

2 While the Commission's goal in the Pilot focuses on studying and assessing the impact of increment conventions on the liquidity and trading of stocks of small capitalization companies, others, however, have posited that increasing tick size will have the favorable intended consequences of increasing research reports on small capitalization companies, and improving the IPO market and economy. David Weild, Edward Kim and Lisa Newport, "*The Trouble with Small Tick Sizes: Larger Tick Sizes Will Bring Back*

laudable, the likelihood of increased costs to investors puts into question whether the benefits of the Pilot justify the costs.

Just as decreasing the tick size from trading in eighths to pennies resulted in better economics for investors,[3] increasing the tick size could result in costing investors through price executions at wider spreads. TD Ameritrade estimates that the Pilot could cost investors hundreds of millions of dollars. From November 2013 to October 2014 (the "Test Period"), TD Ameritrade routed for execution 5,153,349 orders and 4,425,735,069 shares in potential Pilot Securities. A sample of 1200 potential Pilot Securities[4] represent approximately 45% of all possible Pilot Securities, or 2,297,184 orders involving 1,972,838,812 shares. Of these Pilot Securities, 1,367,731 orders involving 1,470,796,345 shares had spreads of less than 5 cents. These are the orders where investors will be harmed because of the wider spread.

The average quoted spread on possible Pilot Securities, when excluding stocks with an average spread 5 cents or greater, was 2.5 cents. Widening tick size on these securities to 5 cents could result in an average $.0125 per share price disimprovement for TD Ameritrade clients, which translates to $18,384,954 annually. Given that total trading volume in the sample Pilot Securities was 36,419,931,221 shares during the Test Period, the costs to investors – the transfer of wealth from investors to market participants – could total up to $455,249,140 annually. Even if an optimistic assumption is made that all of these orders would be price improved by the allowable 0.5 cents, the annual cost is still $11,030,973 for TD Ameritrade clients and $273,149,484 for all investors.

II. The Trade-At Provision is Anti-Competitive, Adds Unnecessary Complexity and Should Be Removed from the Pilot

Although the Pilot could be simple – widen the tick size for a group of small capitalization stocks – the Commission has added complexity in the form of the trade-at provision. The Commission explains its basis for incorporating the trade-at provision as follows:

> The Commission preliminarily believes that a trade-at requirement should be included in the Pilot. 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 pretrade transparency by displaying the

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Capital Formation, Jobs and Investor Confidence" (Sept. 2012). In addition, the Jumpstart Our Business Startups Act required the Commission to study the effect that decimalization had on trading in small and middle capitalization companies, and the impact that decimalization has had on the number of initial public offerings since its implementation.

3 As the Commission as noted, "[n]umerous studies have found that, on average, both quoted and effective spreads declined with the advent of decimalization." REPORT TO CONGRESS ON DECIMALIZATION, As Required by Section 106 of the Jumpstart Our Business Startups Act (July 2012).

4 The Pilot will include three test groups of 400 securities each, hence, 1200 securities total.

best-price quotations to "dark venues" that do not provide such public pre-trade price transparency.[5]

The Commission then references the overall increase in trading in the "dark venues" as the basis for this "possibility." The Commission states,"[t]he percentage of trading 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."[6]

As a result, the Commission includes the trade-at provision in the Pilot to counter the *general* increase in trading in the dark venues. The problem to be solved with regard to trading in dark venues, however, has yet to be articulated. TD Ameritrade strongly believes the Plan should focus on the impact on widening the spread, not whether a trade-at rule can reverse competitive market forces and thereby protect the exchanges from off-exchange competition. Almost 40 years ago, Congress recognized competition among market centers as a pillar of the national market system.[7] Competition among market centers continues to be vital to the national market system by driving market makers to continually increase their execution quality as compared to their peers. This competition flows naturally to investors in the form of better execution quality and reduced transaction costs. For these reasons, TD Ameritrade strongly supports the role that market makers play in driving competition among market participants. The competing exchanges that comprise the SROs participating in the Proposed Plan, however, have submitted a Pilot that includes a trade-at provision that decreases competition and that favors exchanges over market makers.

Moreover, the proposed trade-at provision is overly complex as evidenced by the three examples used to explain how orders must be routed under the trade-at regime. With 14 exceptions included in the trade-at group, firms could simply avoid the programming costs required for the trade-at portion of the Pilot by not transacting in the trade-at group securities. In addition, the required re-programming entails

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5 *Order Directing the Exchanges and the Financial Industry Regulatory Authority To Submit a Tick Size Pilot Plan*, Securities Exchange Act Rel. No. 34-72460, 79 FR 36840 at 36846 (June 30, 2014) (emphasis added).

6 *Id.*

7 Section 11A(a)(1) of the Securities Exchange Act of 1934 provides:

(C) It is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure—

(i) economically efficient execution of securities transactions;
(ii) *fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets*;
(iii) the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities;
(iv) the practicability of brokers executing investors' orders in the best market; and
(v) an opportunity, consistent with the provisions of clauses (i) and (iv) of this subparagraph, for investors' orders to be executed without the participation of a dealer.

(emphasis added).

unnecessary technology risks – risks highlighted by Knight Capital Group's flawed programming related to the rollout of the NYSE's RLP.[8]

The SRO's version of the trade-at goes even further than what the Commission envisioned. The SROs did so by adding depth of book price protection – which will create a virtual central limit order book for the securities in the trade-at group. Under the trade-at regime as proposed by the SROs if a trading center is displaying a quotation at a price equal to the trade-at protected quotation, it can only execute up to the market center's full displayed size; and if the quotation is displayed through an exchange, the execution must occur against the displayed size on that exchange.

The inclusion of the trade-at provision is unnecessary for the study. While the Plan has the goal of incenting market makers to post more liquidity at the NBBO, the trade-at provision prohibits market makers from filling orders at the NBBO with increased size (*i.e.*, added liquidity) if there are protected quotes sitting at other price protected market centers. Therefore, the trade-at provision runs counter to increasing the size of executions in securities, and will result in increased routing of small orders to execute against the depth of book. The trade-at provision is not a tick size study feature; it is a feature aimed at determining if such a mechanism can reverse the movement of liquidity into the undisplayed trading centers and back to the lit venues. Such a provision simply should not be included in a study on the impact of varying tick size.

III. <u>The Plan Should Be Simplified</u>

There may be a consensus that the Commission should conduct a pilot program to study the effects of increasing tick for small capitalization securities. The Firm, however, does not believe that the same consensus exists for including an experiment to determine whether trade-at has the effect of moving liquidity away from undisplayed trading centers. In fact, the Commission states that the trade-at provision including in Test Group Three is included to compare to Test Group Two if Test Group Two trading volume moves to undisplayed trading centers. Rather than designing a Pilot with three groups, TD Ameritrade believes one test group is all that is needed.

IV. <u>The Exchange SROs Design and Measurement of the Results of the Pilot Is Flawed</u>

TD Ameritrade is concerned that the Commission has chosen to require the SROs to submit an NMS plan, rather than proceeding through the Commission's own rule making authority. Under the Exchange Act, NMS plans are limited to exchanges and FINRA, thus precluding participation by other market participants. By structuring the Pilot as an NMS plan, the Firm is concerned that the Commission would unfairly give more control of the Pilot to one set of market participants (exchanges) over others (*e.g.*, alternative trading systems ("ATSs"), market makers and other broker-dealers). This is exacerbated by the impact of the Pilot being assessed by the same entities that devised it – the exchanges and FINRA.

For years, market participants have raised concerns that the exchanges act as both SROs and for-profit businesses, particularly when they compete with broker-dealers. One of the more troubling aspects of the Proposed Plan is the conflicted role of the exchanges – the exchanges would be able to design, implement, influence and measure outcomes of these market structure initiatives, despite their own competitive interests as market participants. As with the short sale pilot program, TD Ameritrade

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8 *In the Matter of Knight Capital Americas LLC*, Securities Exchange Act Rel. No. 70694 (Oct. 16, 2013).

believes that the Commission should adopt the Pilot as a Commissioned-issued rule and not as an SRO-sponsored, and controlled, NMS plan. Alternatively, if the Pilot must proceed as an NMS plan, the brokerage community should be included in the Plan committee.

V. Collected Data Should Measure Overall Liquidity in Small Capitalization Stocks

The Proposed Plan is devoid of clear metrics for measuring whether the Pilot is a success or failure. Given the number of elements that can comprise a successful trade, the need for clear metrics is imperative. For example, the Proposed Plan might state that the Commission will consider the Pilot a success if it increases liquidity at the best quotes, or near them. But, what happens if there is a slight increase in liquidity at or near the best quotes in the market, but investors receive worse prices (on average 1.25 cents per share)? How will the Commission evaluate the costs of worse price executions, but at a larger trade size? The latitude ambiguous measurement parameters afford the developers and judges of the Pilot's success cannot be defended in light of the concerns expressed above.

Moreover, if, as TD Ameritrade believes, the primary goal of the Plan is to measure overall liquidity in small capitalization stocks, then the data requested in the Proposed Plan is overly broad. The Proposed Plan imposes numerous mandates for data collection but does not explain the need for the specific data points, nor restrict how the data may be used. The Plan seeks profitability information from all market makers but never explains why this data is important, what theory is being tested or what impact this may have on increased liquidity. Any information that does not go toward measuring improvements or degradations of overall liquidity in small cap stocks should not be mandated.

To the extent the Commission believes market center profitability is necessary to understand the results of the Pilot, TD Ameritrade believes that the Exchange Act requires that the Proposed Plan also mandate data collection concerning the profitability of exchanges and ATSs. How else can the competitive effect of the Pilot be properly assessed against all participants? To the extent such data is collected from any market participants, the Exchange Act requires that the Commission collect data on market makers, exchanges and ATSs to measure the competitive impact of the Pilot.

VI. The Plan's Definition of "Retail Investor Orders" Should be Clarified

TD Ameritrade requests clarification that "Retail Investor Orders" as defined in the Proposed Plan mirror the definition used by various exchanges as part of their RLP programs. The Proposed Plan includes an exemption for "Retail Investor Orders," which are defined 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 response to price or side of market and the order does not originate from a trading algorithm or any other computerized methodology." At least one exchange has adopted the additional interpretation that "Retail Investor Orders" under its RLP may include orders submitted by non-natural person (*e.g.*, corporations and limited liability company accounts) as long as the submission of orders is not through algorithmic or computerized methodology. For example, NYSE Arca Equities, Inc. ("NYSE Arca") uses a "Retail Member Organization – Broker-Dealer Customer Agreement" that further provides:

> The term "natural persons" refers to the origination of the order from a request made by a human as opposed to the generation of an order by a computer algorithm. An order from a "natural person" can include orders on behalf of accounts that are held in a corporate legal form, such as

Individual Retirement Account, Corporation, or a Limited Liability Corporation that has been established for the benefit of an individual or group of related family members, provided that the order is submitted by an individual.[9]

In addition, the NYSE Arca customer agreement provides that "substantially all orders sent to an RMO [Retail Member Organizations] as Retail Orders meet the definition of a Retail Order and that those orders not meeting the definition are agency orders that cannot be segregated from Retail Orders due to system limitations and are *de minimis* in terms of the overall number of Retail Orders submitted."

TD Ameritrade requests that the Commission define "Retail Investor Orders" under the Proposed Plan to mirror the definition used by the exchanges for retail orders that are eligible for exchange-sponsored RLPs.

VII. Conclusion

TD Ameritrade supports the Commission's pursuit of data driven analysis as a basis for its decision making process, but the Proposed Plan as structured will be harmful to retail investors, is unnecessarily complex, and overly burdensome to implement. TD Ameritrade believes that the Proposed Plan could be simplified greatly by removing Test Groups Two and Three. In particular, the Firm believes incorporating a trade-at provision to determine whether the Commission can incent liquidity away from the undisplayed trading venues is misplaced and should be eliminated from the Pilot.

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9 https://www.nyse.com/publicdocs/nyse/markets/liquidity-programs/Arca_RMO_Broker_Dealer_Customer_Agreement.pdf

TD Ameritrade appreciates the opportunity to comment. Please feel free to contact Paul Jiganti, at 773-244-7185, or John Markle, at 443-539-2128, with any questions regarding our comments.

Respectfully Submitted,

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Managing Director, Market Structure and Client Advocacy

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cc: The Honorable Mary Jo White, Chair
The Honorable Daniel M. Gallagher, Commissioner
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