NYSE

Elizabeth King
General Counsel and
Corporate Secretary

New York Stock Exchange
11 Wall Street
New York, NY 10005
T[redacted]
F+[redacted]

November 20, 2018

<u>By E-mail and FedEx</u>

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

Re: <u>Transaction Fee Pilot for NMS Stocks, Securities Exchange Act Release No. 82873 (March 14, 2018), 83 FR 13008 (March 26, 2018) (File No. S7-05-18)</u>

Dear Mr. Fields:

NYSE Group, Inc. ("NYSE Group"), on behalf of New York Stock Exchange LLC, NYSE Arca, Inc., NYSE American LLC, NYSE National, Inc., and the Chicago Stock Exchange, Inc., appreciates the opportunity to submit this letter to the Securities and Exchange Commission (the "Commission") to provide comments on a white paper prepared by the Commission's Division of Economic and Risk Analysis ("DERA") that purports to study whether the wider tick sizes associated with the Tick Size Pilot Program (the "Tick Pilot")[1] affected the actual prices of Tick Pilot securities (the "White Paper").[2]

DERA's White Paper and its finding are flawed because it:

- Relies on a selective, narrow, and irrelevant data set; and
- Provides no empirical support that the Transaction Fee Pilot will not harm issuers and the market for their securities.

More specifically, based on a selective and miniscule data set spanning the course of three trading days, DERA found that increased tick sizes had no impact on the prices of Tick Pilot securities and, therefore, did not harm issuers of those stocks. Because the staff in DERA submitted the White Paper in the comment file for the Commission's proposal to adopt a Transaction Fee Pilot under proposed Rule 610T of Regulation NMS (the "Proposal" or "Transaction Fee Pilot"),[3] we assume that staff believes its analysis supports a similar finding that the Transaction Fee Pilot would not harm issuers by adversely impacting their stock prices. As discussed below, NYSE Group believes the White Paper suffers from serious defects as it relates to the analysis of the Tick Pilot and

---

1 Securities Exchange Act Release No. 74892 (May 6, 2015), 80 FR 27514 (May 13, 2015) (File No. 4-657) ("Tick Pilot Approval Order").

2 Does the Tick Size Affect Stock Prices? Evidence from the Tick Size Pilot Announcement of the Test Groups and Control Group, by Salil Pachare and Ilia Rainer, DERA, Commission, dated November 9, 2018, *available at* <u>https://www.sec.gov/files/dera_wp_does_the_tick_size_affect_stock_prices.pdf</u>.

3 Securities Exchange Act Release No. 82873 (March 14, 2018), 83 FR 13008 (March 26, 2018) (File No. S7-05-18) (the "Transaction Fee Pilot Proposal").

therefore should have no bearing on the Commission's determination of whether to adopt the Transaction Fee Pilot. It also begs the question of whether the Commission's own economists anticipate that, in fact, the Transaction Fee Pilot would widen spreads (as NYSE Group and others have identified as a concern with the Transaction Fee Pilot), and that the White Paper is intended to preemptively counter that concern by arguing that wider spreads do not cause issuer harm. This further highlights the Commission's obligation to assess the anticipated costs of the Transaction Fee Pilot to retail and institutional investors.

I. The White Paper Relies on a Selective, Narrow, and Irrelevant Data Set

The Tick Pilot operated over a two-year period in which quoting and trading in Tick Pilot securities were subject to prescribed tick-size increments. Further, detailed and complex data was produced to the Commission monthly by each of the thirteen national securities exchanges subject to the Tick Pilot and the Financial Industry Regulatory Authority, Inc. (the "Participants"). This monthly data production not only covered the two-year duration of the Tick Pilot, but also several months before and after the Tick Pilot's quoting and trading restrictions were in effect.

Yet, for the White Paper, DERA chose to study trading for just a few days immediately following a Labor Day weekend during which the quoting and trading restrictions of the Tick Pilot were *not* even in effect. To claim to study the impact of the Tick Pilot based on only a few days of trading when the Tick Pilot was not yet even in effect is demonstrably insufficient. Focusing on a few days around the time when stocks were assigned to test groups within the Tick Pilot, and not a materially longer period of time during which the Tick Pilot's quoting and trading restrictions were in effect, is a clear indication that DERA narrowly tailored its study to reach a specific and flawed conclusion.

Moreover, the idea that investors in small-capitalization companies, such as retail and long-only institutions, would liquidate positions in Tick Pilot securities during the two to three days coming out of a long holiday weekend based on the unknown outcomes of a trading-related pilot is preposterous.[4] There are far higher costs to the trading of illiquid small-capitalization stocks not limited to the bid-ask spread, such as likely price impact of the trade on the security's market.[5] Therefore, the idea that meaningful change would

---

4 *See* How to Think Bigger About Small Cap Investing, by Raman Aylur Subramanian, Head of Equity Solutions and Research for Americas and EMEA, MSCI, Inc., dated July 15, 2016, *available at* https://www.msci.com/www/blog-posts/how-to-think-bigger-about-small/0405299654 (providing that it can take up to 20 days to adjust positions in a micro-capitalization portfolio). In addition, Vanguard's Small Cap Index Fund turns over just 14.5% of its portfolio annually, meaning most of the portfolio was essentially unchanged during the two-year term of the Tick Pilot. *See* https://investor.vanguard.com/mutual-funds/profile/portfolio/naesx.

5 *See* Trading Costs and Taxes, by Professor Aswath Damodaran, Professor of Finance at the Stern School of Business at New York University *available at* http://people.stern.nyu.edu/adamodar/pdfiles/invphiloh/tradingcosts.pdf (showing that the total cost of trading the smallest quintile of stocks (NYSE-listed) was 3.80%, versus 0.31% for the largest quintile).

occur two to three days after the assignment of Tick Pilot securities into test groups is unsupportable.

The Tick Pilot was intended to improve the overall trading conditions for small-capitalization companies, and there was no forecast or evidence that the Tick Pilot would be detrimental to stock prices.[6] A valid study to determine whether the Tick Pilot impacted an investor's decision to buy or sell Tick Pilot securities and any resulting effect on price would have to focus on a longer time period during which the Tick Pilot's quoting and trading restrictions were actually in effect. If commenters were debating whether a one- or two-year pilot was sufficient to alter behavior, it seems absurd to claim a three-day window *before the Tick Pilot even commenced* has any validity.[7] Cherry-picking data covering a few days a full month before the Tick Pilot's implementation is not a comprehensive analysis.

II. <u>The White Paper Provides No Empirical Support that the Transaction Fee Pilot Would Not Harm Issuers and the Market for Their Securities</u>

In the White Paper, DERA draws a conclusion about the Tick Pilot's impact on stock returns based on a few days of data during which the Tick Pilot was not in effect. Its submission by DERA staff in the comment file for the Transaction Fee Pilot appears to be designed to respond to other comments that raised concerns about the impact of that proposal on issuers.

In that regard, NYSE Group does not believe that the White Paper supports any conclusion regarding the impact of the Tick Pilot on investors or the potential impact of the Transaction Fee Pilot on issuers. As the NYSE Group stated in its first comment letter on the Transaction Fee Pilot, issuers of securities that are subject to the Proposal's price restrictions would face increased costs associated with raising capital due to wider spreads.[8] Consequently, transactions in those securities would be more expensive and less attractive to investors, which would negatively impact issuers' ability to raise capital.

---

[6] *See* Tick Pilot Approval Order, *supra* note 1 at page 27515 (stating that, "The Commission believes that altering tick sizes could result in significant market-wide benefits and improvements to liquidity and capital formation").

[7] *See* letters to Brent J. Fields, Secretary, Commission, from James J. Angel, Ph.D., CFA, Associate Professor of Finance, Georgetown University, McDonough School of Business, dated December 22, 2014 *at* page 7 (arguing the long term effects of the Tick Pilot will take time to realize, and stating that the "decision to invest in information production does not occur instantly and will take time to build up"); Kimberly Unger, CEO & Executive Director, The Securities Traders Association of New York, Inc., dated December 22, 2014 *at* 9; *and* Scott Kupor, Managing Partner, Andreessen Horowitz and Jeffrey M. Solomon, CEO Cowen and Company; Equity Capital Formation Task Force, dated December 18, 2014, *at* 1 (arguing that "[a] significantly longer time period is required to gather meaningful data around whether the changes to the market structure are having the desired effects"). *See also* letter to Elizabeth J. Murphy, Secretary, Commission, from Rob Flatley, CEO and Dave Weisberger, MD, Head of Market Structure Analysis, CoreOne Technologies LLC, dated December 19, 2014, at 2 (stating "it remains unclear if the [Tick] Pilot could generate meaningful data . . . given the [Tick] Pilot's length among other things").

[8] *See* letter from Elizabeth K. King, General Counsel and Corporate Secretary, NYSE

Further, the anticipated harm that issuers would experience under the Transaction Fee Pilot is *not* limited to its impact on stock prices. Issuer harm extends to Proposal's impact on the competitive dynamic between issuers whose securities are subject to the Proposal's price restrictions and those issuers whose securities are unrestricted.[9] Those securities subject to the Proposal's pricing restrictions would trade at wider spreads than comparable, unrestricted securities.[10] Thus, throughout the duration of the Transaction Fee Pilot, issuers of those restricted securities would likely be forced to offer larger discounts to raise capital through secondary follow-on offerings in order to remain competitive with issuers offering comparable, unrestricted securities.

* * * * *

NYSE Group appreciates the opportunity to comment on the proposed Transaction Fee Pilot and the DERA White Paper.

Respectfully submitted,

Elizabeth K. King

cc: Honorable Jay Clayton, Chairman
Honorable Kara M. Stein, Commissioner
Honorable Robert J. Jackson, Jr., Commissioner
Honorable Hester M. Peirce, Commissioner
Honorable Elad L. Roisman, Commissioner
Brett Redfearn, Director, Division of Trading and Markets

Group, to Brent J. Fields, Secretary, Commission, dated May 31, 2018 *at* footnote 51.

> In 2017, NYSE-listed companies conducted 250 secondary offerings of common stock. Companies with average spreads under 20 basis points paid an average discount to market price of 2.6%; companies with spreads above 20 basis points had to discount their offerings nearly twice as much, to 4.9%, based on an analysis conducted using vendor-provided pricing data for secondary offerings and NYSE TAQ data for spread calculations. The analysis included all NYSE-listed secondary offerings of common stock in 2017, and grouped the listed companies by their 2017 average spread. *Id*.

9 *Id*. *at* page 6.

10 The NYSE Group's first letter described this competitive issue in the context of Exchange Traded Products ("ETPs") where multiple issuers sponsor ETPs based on the same or similar indices, and thus directly compete with each other for investment funds. *Id*. *at* pages 6-7. The increased costs associated with an ETP subject to the Proposal's pricing restrictions would impose an inappropriate burden on that ETP's ability to compete with other comparable ETPs. *Id*.