

MEMORANDUM

TO: Equity Market Structure Advisory Committee (EMSAC)
FROM: EMSAC Market Quality Subcommittee
DATE: April 3, 2017
SUBJECT: Market Quality Subcommittee Interim Report on Areas of Examination and Continued Work

The Subcommittee on Market Quality has met and discussed a variety of issues concerning market quality and market structure.

- I. Limit up/Limit down Follow-up. Following our recommendation about adopting a no halt limit up/limit down (lu/ld) construct, the Exchanges have started a working group to examine the implications of introducing this change to the lu/ld regime. This working group has held several meetings over the winter, but no final recommendations have yet been developed. We appreciate the work of the Exchanges and look forward to continuing to work with them on this. Eric Noll, Chair of the Market Quality Subcommittee, has and will continue to participate in working group meetings.

- II. Tick Size Pilot. The Subcommittee has reviewed the results so far of the tick size pilot and its progress. While we find that bid and offers have increased since the introduction of the tick size pilot, there has been very limited improvement in trade size and overall volume in the stocks in the pilot. The increase in bid /offer size was to be expected given the wider increments and is consistent with that. While data sources are not clear on this, there does not appear to be a wider engagement or activity in these names spurred on by the tick size pilot. Additionally, as was anticipated, the costs of execution have increased for market participants and the volatility of the names in the tick size pilot has also increased. As the pilot remains relatively unseasoned, the other proposed positive effects of the pilot have yet to mature or even appear – such as – increased research coverage and an increased IPO pipeline. We would urge the Commission to perform an interim review of the progress of the tick size pilot and its positive and negative effects to make a determination if the pilot should be changed or eliminated as the higher costs and volatility have meaningful impacts on customer activity. Additionally, it has been brought to the attention of some members of the Subcommittee that some of the listed companies in the tick size pilot are unhappy with their inclusion and the impacts on the trading of their securities. While we have no specific recommendation to be made

at this point concerning that issue, we did want to make sure we noted it for the larger Committee.

- III. **Small Cap Liquidity/Market Structure.** The Subcommittee has briefly discussed alternatives to consider in the small cap liquidity and market structure arena. While there was far from unanimity on these topics within the Subcommittee, the Subcommittee has and will continue to explore the notion of an exclusive listing venue(s) for the small capitalization securities. Variations on this could include exclusivity without off-exchange trading, exclusivity with off-exchange trading, limited exclusivity that would disappear upon achievement of certain trading metrics or with time seasoning, or various combinations of all of the above. We intend to continue these discussions with the goal of making some final recommendations to the full EMSAC.

- IV. **Closing Auctions.** The Subcommittee has previously identified a key single point of failure in our existing market structure. That single point of failure is the closing auction process for securities where the listing venue can neither conduct nor process closing auction orders at the end of the trading day. Recently, just such an event occurred on the ARCA exchange which impacted listed securities on ARCA, primarily ETFs. While the impacts to market participants appeared to have muted on this occasion (low volume/low volatility day), the issue clearly needs to be addressed in a more comprehensive way to prevent larger issues from appearing in a larger event or in the event of large market swings. As an essential part of the market structure, the Closing Auction process will be considered by the Subcommittee with the goal of making recommendations for substantive protections for market participants in the event of a re-occurrence.

Thank you for allowing the Subcommittee the opportunity to work on these issues and we look forward to making recommendation on these topics in the coming months.