



December 22, 2014

**Via Electronic Mail: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)**

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

**Re: Proposed NMS Tick Size Pilot Program; File No. 4-657**

Dear Mr. Fields:

Managed Funds Association<sup>1</sup> (“**MFA**”) submits this letter in response to the Securities and Exchange Commission’s (“**SEC**” or the “**Commission**”) solicitation for comments on its “Notice of Filing of Proposed National Market System Plan to Implement a Tick Size Pilot Program On a One-Year Pilot Basis” (the “**Proposing Release**”).<sup>2</sup> On June 24, 2014, the Commission directed the national securities exchanges and the Financial Industry and Regulatory Authority (“**FINRA**”) (together, the “**Plan Participants**”) to develop and file a National Market System plan to implement a pilot program that would widen the quoting and trading increment for certain small capitalization stocks (the “**SEC Order**”).<sup>3</sup> On August 25, 2014, the Plan Participants, in response to the SEC Order submitted to the SEC a plan to implement a tick size pilot (the “**Tick Size Plan**”).<sup>4</sup> The Proposing Release requests for comments on the Tick Size Plan.

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<sup>1</sup> Managed Funds Association (“MFA”) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

<sup>2</sup> 79 Fed. Reg. 66423 (Nov. 7, 2014) (hereinafter, the “Proposing Release”), available at: <http://www.gpo.gov/fdsys/pkg/FR-2014-11-07/pdf/2014-26463.pdf>.

<sup>3</sup> Securities Exchange Act Release No. 34-72460, June 24, 2014, available at: <http://www.sec.gov/rules/other/2014/34-72460.pdf>.

<sup>4</sup> See letter from Brendon J. Weiss, Vice President, NYSE Group, to Secretary, SEC, dated August 25, 2014, regarding Plan to Implement a Tick Size Pilot Program, available at: <http://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-transmittal-letter.pdf>; and Plan to Implement a Tick Size Pilot Program, Submitted to the SEC

MFA appreciates that the Commission has extended the comment period on the Proposing Release from 21-days, as indicated in an earlier Commission press release,<sup>5</sup> to 45-days, providing investors with greater time to analyze it.<sup>6</sup> The SEC Order and the Tick Size Plan are both more extensive and complex in scope than investors originally anticipated. In our letter, we raise concerns that aspects of the Tick Size Plan will harm investors. We respectfully urge the Commission in proposing and implementing market structure initiatives in 2015 to consider MFA's equity market structure recommendations, which we believe will be broadly beneficial for market integrity and market participants. We highlight these recommendations in Section III of our letter and attach a copy of our equity market structure recommendations.<sup>7</sup>

## I. Overview/Executive Summary

MFA supports the Commission's selective and narrow use of pilot programs. As pilot programs are not without costs, the Commission should be mindful of potential risks to investors and market integrity, as well as implementation costs, most of which investors bear in the form of additional fees/costs. In our view, the SEC should design pilot programs to deliberately and carefully test specific changes to market structure.<sup>8</sup> A disciplined, data-driven approach ensures that rulemaking is driven, less by competitive interests among market participants, and more by measurable benefits to liquidity, efficiency, competition and capital formation. To safeguard the integrity of experimental data, however, the Commission must design pilots wisely. Implementing many changes simultaneously will increase market complexity and complicate the Commission's ability to evaluate and draw affirmative conclusions from a pilot.

MFA has deep reservations with the Tick Size Plan as proposed. As investors, we believe that decimalization<sup>9</sup> was an enormous success as it dramatically reduced transaction costs for investors—especially for retail investors who typically trade at or better than the national best

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Pursuant to Rule 608 of Regulation NMS under the Securities Exchange Act of 1934, *available at:* <http://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-final.pdf>.

<sup>5</sup> SEC Announces Pilot Plan to Assess Stock Market Tick Size Impact for Smaller Companies, August 26, 2014, *available at:* <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542761050#.VBzmfFJMvIU>.

<sup>6</sup> See letter from Stuart J. Kaswell, Executive Vice President & General Counsel, MFA, to Brent J. Fields, Secretary, SEC, dated September 20, 2014 (requesting for a 60-day comment period on a Proposed Tick Size Pilot due to the complexities raised by it), *available at:* <https://www.managedfunds.org/wp-content/uploads/2014/09/MFA-Tick-Test-Pilot-ext-9-19-14.pdf>.

<sup>7</sup> MFA submitted equity market structure recommendations to Chair Mary Jo White. See letter from Stuart J. Kaswell, Executive Vice President and General Counsel, MFA, to Mary Jo White, Chair, SEC, dated September 30, 2014, *available at:* <https://www.managedfunds.org/wp-content/uploads/2014/10/MFA-cover-ltr-eq-mkt-struct-recommendations-final-9-30-14.pdf>. MFA's Equity Market Structure Recommendations can be found at: <https://www.managedfunds.org/wp-content/uploads/2014/09/MFA-Equity-Mkt-Structure-Recommendations-final-9-30-14.pdf>.

<sup>8</sup> See, e.g., Economic Analysis of the Short Sale Price Restrictions Under the Regulation SHO Pilot, SEC Office of Economic Analysis, February 6, 2007.

<sup>9</sup> SEC's Implementation of Decimalization, *available at:* <http://www.sec.gov/hot/decimal.htm>.

bid or offer.<sup>10</sup> Studies on decimalization show that the average quoted bid-ask spreads for all companies declined from pre- to post-decimalization in both NYSE- and NASDAQ-listed stocks.<sup>11</sup> We believe decimalization achieved the goals set out by the Commission—namely, “enhancing investor comprehension, facilitating globalization of our markets, and . . . reducing transaction costs.”<sup>12</sup> Moreover, the benefits of reduced tick sizes are not unique to the U.S. equity markets; other markets around the world have experienced similar benefits, which are well documented. Research studies from foreign markets have found consistent evidence that reducing tick sizes reduces transaction costs and improves market efficiency.<sup>13</sup>

In fact, we believe the Commission should consider testing half-penny trading increments for the most liquid securities. Recent analyses report that the reduction in tick size for securities in the TOPIX 100 on the Tokyo Stock Exchange have significantly improved quality of the Tokyo Stock Exchange, decreasing transaction costs by 70% and improving price discovery.<sup>14</sup> MFA believes that an appropriately designed pilot could test whether half-penny trading increments in the most liquid securities would improve market quality, without imposing an undue burden on market participants. Study findings lead us to believe that half-penny trading increments for the most liquid securities would benefit investors by greatly reducing transaction costs in the most commonly-traded securities.

MFA is concerned that the Tick Size Plan will harm investors by creating unnecessary market complexity and systems risk. By requiring exchanges and market participants to engage in wholesale redesigns of their trading systems and algorithms, the Tick Size Plan greatly increases the risk of technical malfunctions and market disruptions. Artificially widening spreads and increasing trading costs will make it more expensive for investors to buy and sell pilot securities, and may damage liquid small and mid-cap securities markets. We are also concerned that including a Trade-At<sup>15</sup> variable into a tick size pilot program could meaningfully

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<sup>10</sup> See, e.g., SEC Staff Report to Congress on Decimalization, July 2012, available at: <http://www.sec.gov/news/studies/2012/decimalization-072012.pdf>. See also, Recommendations of the Investor Advisory Committee on Decimalization and Tick Sizes, available at: <http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-decimilization-recommendation.pdf>.

<sup>11</sup> See, e.g., SEC Staff Report to Congress on Decimalization, *supra* n. 5; and Bessembinder, Hendrik, 2003, Trade execution costs and market quality after decimalization, *Journal of Financial and Quantitative Analysis* 38(4), 747-777.

<sup>12</sup> SEC Order and Notice: Order Directing the Exchanges and NASD to Submit a Phase-In Plan to Implement Decimal Pricing in Equity Securities and Options, Release No. 34-42914 (June 8, 2000).

<sup>13</sup> See, e.g., Dionigi Gerace, Ciorstan Smark & Timothy Freestone, Impact of Reduced Tick Sizes on the Hong Kong Stock Exchange, 2012, available at: <http://ro.uow.edu.au/cgi/viewcontent.cgi?article=1185&context=buspapers>; and Kee H. Chung and Jung S. Shin, Tick Size and Trading Costs on the Korea Stock Exchange, January 2005, available at: [http://www.researchgate.net/publication/228723439\\_Tick\\_size\\_and\\_trading\\_costs\\_on\\_the\\_Korea\\_Stock\\_Exchange](http://www.researchgate.net/publication/228723439_Tick_size_and_trading_costs_on_the_Korea_Stock_Exchange).

<sup>14</sup> Tick Size Boosts Japanese Market Efficiency, Capital Markets Cooperative Research Centre, October 28, 2014, available at: <http://www.mondovisione.com/media-and-resources/news/tick-size-boosts-japanese-market-efficiency-cmcr/>.

<sup>15</sup> See SEC Order at p. 22:

impact the pilot data by drastically changing market participant behavior, and frustrate the Commission's ability to assess the impact of increased tick sizes on liquidity for small-cap stocks.

After careful consideration of the Proposing Release, as discussed further below, MFA makes the following recommendations:

- In the best interests of investors, the Commission should not proceed with the Tick Size Plan to widen tick sizes, but should pursue alternative proposals to enhance liquidity and trading in small-cap securities. Nevertheless, if the Commission determines to proceed with a pilot to test tick sizes as a means to increasing liquidity, we believe the Commission should design a pilot program that is more surgical in scope and unencumbered by novel and extraneous changes to market structure.
- MFA recommends that the Commission limit Tick Size Plan pilot securities to those of small capitalization companies, defined as companies with total annual gross revenue of \$750 million or less.
- MFA recommends that the Commission amend the Tick Size Plan to only test illiquid small-cap securities—specifically, securities that currently trade at a spread of five cents or more.
- MFA recommends that the Commission amend the Tick Size Plan to exclude Test Group Three, *i.e.*, the test group with the Trade-At provision, as this deletion would reduce the complexity, systems risk and costs associated with the pilot.
- MFA respectfully urges the Commission to propose the Tick Size Plan as rulemaking subject to the protections of the Administrative Procedures Act and for the Commission to conduct a rigorous cost-benefit analysis.

## II. Comments

### A. Targeting Pilot to Small Capitalization Stocks and Limiting Market Risk

The SEC Order states that “the Commission believes that it is in the public interest for the Commission to further study and assess decimalization’s impact on the liquidity and trading of the securities of **small capitalization companies**” (emphasis added), and discusses concerns expressed from a variety of sources with respect to small-cap companies.<sup>16</sup> The Proposing Release states that the purpose of the Tick Size Plan is to study and assess “the impact of increment conventions on the liquidity and trading of stocks of small capitalization

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Under a trade-at requirement, a trading center that was not displaying the NBBO at the time it received an incoming marketable order could: (1) execute the order with significant price improvement (such as the minimum allowable \$0.05 increment or the mid-point between the NBBO), (2) execute the order at the NBBO with significant size improvement if the size of the order was of block size, or (3) route intermarket sweep orders to execute against the full displayed size of protected quotations at the NBBO and then execute the balance of the order at the NBBO price.

<sup>16</sup> See SEC Order at p. 13.

companies.”<sup>17</sup> We note that the SEC Order and the Proposing Release, however, set the market capitalization size for pilot securities as \$5 billion or less, capturing not only small-cap companies but mid-cap companies as well, and add a Trade-At component to the pilot program. As proposed, the scope of the Tick Size Plan is significantly more expansive than the stated intent and justification of the SEC Order, and has the potential to cause significant market disruption.

In MFA’s view, the Commission should design any pilot program narrowly to test a discrete hypothesis or address a specific concern. Pilot programs carry real costs, risks to markets and investors, and are expensive to implement.<sup>18</sup> We believe that a primary concern should be for a pilot program to first, do no harm. We appreciate the Commission’s desire to balance the interests and needs of different constituents as it “believes that it should assess, through a targeted short-term pilot program, whether wider minimum tick sizes for small capitalization stocks would enhance market quality to the benefit of market participants, issuers and U.S. investors.”<sup>19</sup> Given the empirical evidence on the benefits of reduced tick sizes for investors, we believe it is especially important for a pilot program that increases tick size to be targeted in its approach.

The SEC Order does not identify concerns with respect to mid-cap securities, nor does it present any data supporting the need to increase tick sizes for mid-cap securities. We believe the security-size set forth in the Tick Size Plan at \$5 billion or less is too large, and that a pilot focused on the impact of increasing tick increments on small-cap securities should be limited to companies that truly have a small capitalization. By expanding the scope of the Tick Size Plan to mid-cap securities, the Commission unnecessarily increases the likelihood for disruption and harm to investors and raises implementation costs. The Tick Size Plan also includes a Trade-At provision, which we believe will greatly increase the risk of market disruptions and systems

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<sup>17</sup> Proposing Release, p. 66423. Some have argued that increasing the minimum tick size for the small-cap securities would provide market intermediaries with greater profits on the theory that they would then increase their promotion of such securities and encourage initial public offerings (“IPOs”). See SEC Report to Congress on Decimalization, July 2012, at p. 21 referencing David Weild & Edward Kim, 2010, Market structure is causing the IPO Crisis – and More, Grant Thornton Capital Markets Series, available at: <http://www.grantthornton.com/staticfiles/GTCom/Public%20companies%20and%20capital%20markets/Files/IPO%20crisis%20-%20June%202010%20-%20FINAL.pdf>. For the reasons stated in the Recommendation of the Investor Advisory Committee on Decimalization and Tick Sizes, we do not believe a tick size pilot program would be effective in assessing the impact on the sell-side research following of small-cap securities or on the number of initial public offerings. Many factors have influenced the IPO market and it would be difficult to ascertain the impact of a larger tick size on the number of IPOs. See SEC Staff Report to Congress on Decimalization, at p. 22. Moreover, recent studies suggest that the number of IPOs in 2013 and 2014 have greatly increased and are at an all-time high over the previous six or seven years. See, e.g., 2014 IPO Report, Wilmer Cutler Pickering Hale and Dorr LLP, available at: [http://www.wilmerhale.com/uploadedFiles/Shared\\_Content/Editorial/Publications/Documents/2014-WilmerHale-IPO-Report.pdf](http://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/Publications/Documents/2014-WilmerHale-IPO-Report.pdf); and EY Global IPO Trends, 2014 Q3, available at: [http://www.ey.com/Publication/vwLUAssets/EY-global-ipo-trends-2014-Q3/\\$FILE/EY-Global-IPO-Trends-2014-Q3.pdf](http://www.ey.com/Publication/vwLUAssets/EY-global-ipo-trends-2014-Q3/$FILE/EY-Global-IPO-Trends-2014-Q3.pdf).

<sup>18</sup> See *infra* section C (discussing complexity and costs associated with a Trade-At component).

<sup>19</sup> SEC Order at p. 14.



issues by significantly increasing the complexity of the pilot program (discussed further in section II.C below). By eliminating Test Group Three, the Tick Size Plan can be more targeted and affect fewer securities. This would mitigate the risk of investor harm, while still ensuring the Tick Size Plan yields statistically robust data. Moreover, the Commission should consider that including a much broader universe of securities as well as a Trade-At provision will add multiple variables to the Tick Size Plan, including a change in market structure that may drastically change market participant behavior. This broader scope will likely frustrate the Commission's ability to assess the impact of increased tick sizes on liquidity for small-cap stocks.

Accordingly, we recommend that the Commission limit Tick Size Plan pilot securities to small capitalization companies, defined as companies with total annual gross revenue of \$750 million or less—as contemplated in recent measures with respect to small-caps by Congress, and prescribed in other contexts, such as the Jumpstart Our Business Startups (“JOBS”) Act.<sup>20</sup>

## **B. The Tick Size Test Will Harm Investors**

MFA is concerned that increasing tick sizes will damage market quality and raise transaction costs. A pilot program should not harm liquid markets in order to test a working hypothesis with respect to illiquid securities. The Tick Size Plan proposes to include 1,200 small and mid-cap securities in test groups, which means that more than 20% of all U.S. listed companies will be impacted by the Tick Size Plan.<sup>21</sup> While a majority of securities that qualify for the Tick Size Plan may already trade wider than five cents, many of the securities have spreads smaller than five cents.<sup>22</sup>

We understand that the Tick Size Plan may increase spreads for the most liquid securities eligible for the pilot by 500%.<sup>23</sup> This change will greatly increase costs for, and harm, investors. Artificially increasing the tick size for securities with spreads less than five cents will raise transaction costs for investors, making it more expensive and less appealing for investors to invest in these securities. In addition, the Tick Size Plan may harm liquid markets by deteriorating market quality and making it less cost-effective for investors to invest in these

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<sup>20</sup> See, e.g., U.S. House, 113<sup>th</sup> Congress. “H.R. 3448. Small Cap Liquidity Reform Act of 2014” available at: <https://beta.congress.gov/bill/113th-congress/house-bill/3448>. H.R. 3448 provides that issuers eligible for the liquidity pilot program are emerging growth companies with total annual gross revenues of less than \$750,000,000. See, e.g., JOBS Act, Pub. L. No. 112-106 (defining an “emerging growth company” as an issuer with total annual gross revenues of less than \$1,000,000,000), available at: <http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf>.

<sup>21</sup> See, e.g. Market Structure, The Great Liquidity Divide, Credit Suisse, August 7, 2014 (noting that as of August 2014 there were about 5100 companies listed in the U.S.).

<sup>22</sup> See, e.g., A characterization of market quality for small capitalization US equities, Charles Collver, September 2014, available at: [http://www.sec.gov/marketstructure/research/small\\_cap\\_liquidity.pdf](http://www.sec.gov/marketstructure/research/small_cap_liquidity.pdf); and Today's Spreads Make More Sense Than Nickels, KCG, August 2014, available at: [https://www.kcg.com/uploads/documents/Todays\\_Spreads\\_Make\\_More\\_Sense\\_Than\\_Nickels.pdf](https://www.kcg.com/uploads/documents/Todays_Spreads_Make_More_Sense_Than_Nickels.pdf).

<sup>23</sup> KCG, Today's Spreads Make More Sense Than Nickels, August 2014, available at: [https://www.kcg.com/uploads/documents/Todays\\_Spreads\\_Make\\_More\\_Sense\\_Than\\_Nickels.pdf](https://www.kcg.com/uploads/documents/Todays_Spreads_Make_More_Sense_Than_Nickels.pdf).

markets. For example, a key development from Japan's TSE tick size reduction has been greater interest amongst investors in trading mid cap names.<sup>24</sup> This raises the concern that widening tick size could decrease interest amongst investors in pilot securities and harm these markets.

We echo Chair Mary Jo White's views that the SEC "must evaluate all issues through the prism of the best interest of investors and the facilitation of capital formation for public companies."<sup>25</sup> We are concerned that the Tick Size Plan will harm investors and liquid markets. In our view, the Commission should not proceed with the Tick Size Plan, but should pursue alternative proposals to enhance liquidity and trading in small-cap securities. In the alternative, the Commission should amend the Tick Size Plan so that it imposes the least amount of harm possible to institutional and retail investors. To this end, if the Commission proceeds with a tick size pilot program, it should narrowly design the pilot to only test illiquid small-cap securities—securities with total gross market capitalization of \$750 million or less that trade at a spread of five cents or more.

### C. Complexity and Costs Associated with a Trade-At Component

The Tick Size Plan proposes four different trading schemes, including three test groups and one control group.<sup>26</sup> The pilot securities of the third test group in the Tick Size Plan ("Test Group Three") will be subject to a five cent quoting and trading increments and a Trade-At prohibition, subject to fourteen exceptions.<sup>27</sup> We are concerned that Test Group Three exponentially increases the complexity and cost of the Tick Size Plan.

Test Group Three requires significant changes from current Regulation National Market System ("**Reg NMS**") rules and will require trading centers and market participants to implement extensive systems development and/or reprogramming. Implementing a quoting increment change requires making a narrow unit change (*e.g.*, one cent to five cents), whereas implementing a Trade-At provision will require an entire redesign of a trading system's trading logic or algorithm. We anticipate that implementing a Trade-At provision will be on par in complexity with implementing the trade-through provisions (the "Order Protection Rule")<sup>28</sup> of Reg NMS due to the modifications that will need to be made with respect to order types and trading logic. Since publication of Reg NMS in June 2005, the Commission issued two extensions for the implementation of the Order Protection Rule and the Intermarket Access Rule<sup>29</sup> and an extensive set of FAQs on the two rules, before the completion of Reg NMS in

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<sup>24</sup> TSE Tick Sizes: Phase 2 Outcomes, Makoto Nagahori, COO Chi-X Japan, October 20, 2014, *available at*: <http://fixglobal.com/home/tse-tick-sizes-phase-2-outcomes/>.

<sup>25</sup> Mary Jo White, Chair, SEC, Enhancing Our Equity Market Structure, June 5, 2014, *available at*: <http://www.sec.gov/News/Speech/Detail/Speech/1370542004312#.VHNgrFJMuM8>.

<sup>26</sup> Proposing Release at p. 66424.

<sup>27</sup> *Id.* at p. 66427.

<sup>28</sup> Rule 611 of Reg NMS (requiring trading centers to obtain the best price for investors when such price is represented by automated quotations that are immediately accessible).

<sup>29</sup> Rule 610 of Reg NMS (establishing a uniform market access rule that would promote non-discriminatory access to quotations displayed by self-regulatory organization trading centers through a private linkage approach).

October 2007.<sup>30</sup> Similarly, implementing the Tick Size Plan as proposed will likely take twelve months or more and require extensive testing by market participants.

At a time when many are calling for a more simplified market structure, the Tick Test Plan will greatly increase complexity by creating four different trading schemes that will need to be implemented by trading centers and institutional investors. Market participants will also need to develop customized order routing and execution algorithms for each trading scheme. We are concerned that the fundamental systems changes and the numerous trading schemes the Tick Size Plan requires will introduce substantial unnecessary systems risk to markets and investors.

In addition to the complexity, we are concerned about the costs associated with implementing the Tick Size Plan. The financial cost for such significant systems development, coding, reprogramming and testing are likely to be meaningful. Plan Participants and market participants are likely to redirect resources and staffing from different departments in order to implement the Tick Size Plan. We question whether this change would increase risk in other respects. We are also concerned that investors may shy away from trading certain Tick Size Plan pilot securities because of the complexity, systems risk, higher transaction costs and other costs associated with implementing a trade-at provision. This would harm investors currently invested in these pilot securities, adversely impact liquidity, and run counter to the stated goals of the Tick Size Plan's proponents.

We believe Test Group Three greatly increases the complexity, systems risk and costs for the Tick Size Plan to the extent that it outweighs the benefits of implementing a temporary pilot program. Accordingly, we recommend that if the Commission determines to proceed with a tick size pilot, it should amend the Tick Size Plan to exclude Test Group Three.

#### **D. The Tick Size Plan Should be a Rule Proposal**

The Tick Size Plan raises a number of substantial issues, such as changes to equity market structure, transaction costs for investors, market efficiency, pricing fairness, potential harm to issuers, systems risk and market complexity. As such, we believe the Commission should have published the Tick Size Plan as a proposed rulemaking under the Administrative Procedures Act, subject to public notice and comment, and in particular, a cost-benefit analysis.<sup>31</sup> We think it is critical that the Commission conducts a cost-benefit analysis with respect to the Tick Size Plan. We are concerned that the costs of the Tick Size Plan greatly outweigh any perceived benefits and that proceeding with a Tick Size Plan would be harmful to investors.

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<sup>30</sup> See Extension Release, 71 *Fed. Reg.* 30038 (May 24, 2006), available at: <http://www.gpo.gov/fdsys/pkg/FR-2006-05-24/pdf/06-4797.pdf>; Extension Release II, 72 *Fed. Reg.* 4202 (Jan. 30, 2007), available at: <http://www.gpo.gov/fdsys/pkg/FR-2007-01-30/pdf/E7-1384.pdf>; and Responses to Frequently Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS, Division of Trading and Markets, April 4, 2008 Update (previously updated on June 8, 2007), available at: [http://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm#P636\\_130626](http://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm#P636_130626).

<sup>31</sup> See, e.g., SEC description of Reg SHO Pilot Program, available at: <http://www.sec.gov/spotlight/shopilot.htm>.



Thus, we respectfully urge the Commission to propose the Tick Size Plan as rulemaking and for the Commission to conduct a rigorous cost-benefit analysis.<sup>32</sup>

### **III. Equity Market Structure Reforms**

MFA supports the SEC's plans for a holistic review of equity markets and to assess whether regulatory enhancements are needed to address new or changing vulnerabilities. As discussed, we think the Tick Test Plan as currently proposed would be harmful to investors and markets; significantly increase market complexity and risk; and threaten market integrity. We believe the Commission should focus on other ways to enhance market structure. We submit a number of market structure recommendations, which we believe are cost-effective and would provide the greatest benefits to investors and markets. Highlighted below and discussed in further detail in our attachment are MFA's equity market structure recommendations:

#### **Improving Market Resilience and Risk Management**

- **Pre-trade controls** – The SEC or FINRA should provide more specific guidance on pre-trade risk controls to increase transparency to investors, encourage greater uniformity of controls among broker-dealers and reduce concerns with respect to discrepancies in latency.
- **Standardized kill switches** – The SEC should direct the exchanges to develop a standardized mandatory kill switch protocol, methodology and rules. This step would simplify implementation and use by exchange members and create a level playing field with respect to latency discrepancies.

#### **Increasing Disclosure and Transparency**

- **Trading venue transparency** - FINRA should expand its alternative trading system (“ATS”) transparency initiative to include publishing the number of trades and weekly volume information on a stock-by-stock basis for equity securities traded over-the-counter.
- The SEC should also enhance disclosure requirements by requiring an ATS to make its Form ATS publicly available on its website along with general information on how it operates and how its orders interact. The SEC should also include on its website a list of all ATSs and links to their Form ATS to improve information flow to investors and to allow them to more easily compare ATS venues.
- **Timely market data** - The SEC should request Plan Participants of the Securities Information Processors (“SIPs”) to improve the reliability, resilience, connectivity and latency of the data processors—integral components of the equity market structure to address recent outages and other issues.

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<sup>32</sup> MFA believes that the Commission's review of a National Market System plan is subject to the standards of Section 3(f) of the Securities Exchange Act of 1934.

- **Order routing disclosure** – The SEC should require broker-dealers to provide more detailed disclosure of order routing and execution practices. Exchanges should also provide clearer disclosure on order routing, order type interaction and execution volume from orders.
- **Exchange Order Types** – The SEC should continue to ensure that order types promote just and equitable principles of trade, protect investors and the public interest, and ensure that order type information is readily accessible to market participants, including clear descriptions on function, use, and benefits.

#### IV. Conclusion

As investors, MFA remains concerned with the implications of increasing tick sizes. MFA believes that the Commission, in the best interests of investors, should not proceed with implementing the Tick Size Plan to widen ticks sizes, but should instead consider other ways to enhance market structure, such as MFA's equity market structure recommendations. If the Commission determines to proceed with a tick size pilot, however, we recommend that the Commission propose for rulemaking a pilot program that is designed first and foremost with investors in mind and that limits harm to investors. Such pilot should be narrowly designed and targeted to test a wider tick increment in securities of companies with total annual gross revenue of \$750 million or less and that trade at a spread of five cents or wider. Finally, MFA recommends that the Tick Test Plan or any tick size pilot the Commission proceeds with exclude Test Group Three or a Trade-At component.

We appreciate the opportunity to provide the Commission with our comments on the Tick Size Plan. If you have questions or comments, please do not hesitate to contact Jennifer Han, Associate General Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell  
Executive Vice President & Managing Director,  
General Counsel

CC: The Hon. Mary Jo White, Chair  
The Hon. Luis A. Aguilar, Commissioner  
The Hon. Daniel M. Gallagher, Commissioner  
The Hon. Kara M. Stein, Commissioner  
The Hon. Michael S. Piwowar, Commissioner  
Stephen Luparello, Director, Division of Trading & Markets  
Gregg Berman, Associate Director, Office of Analytics and Research, Division of  
Trading and Markets  
David Shillman, Associate Director, Division of Trading and Markets

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Daniel Gray, Senior Special Counsel, Division of Trading and Markets  
Mark J. Flannery, Director and Chief Economist, Division of Economic and Risk Analysis