The Security Traders Association of New York, Inc.

71 Broadway, 2K
New York, NY 10006
P. 212.344.0410
F. 212.943.8478
www.stany.org

KIMBERLY UNGER, ESQ.
Executive Director

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Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NW
Washington, DC 20549-1090

Via e-mail

Re: Tick Size Study mandated by the Jumpstart Our Business Startups (JOBS) Act of 2012

Dear Ms. Murphy:

The Security Traders Association of New York, Inc. ("STANY")[1] respectfully submits this letter in response to the Securities and Exchange Commission's ("SEC" or the "Commission") request for comment on the Tick Size Study that the Commission has been required to conduct pursuant to Title 1 of the Jumpstart Our Business Startup ("JOBS") Act.

At the outset, STANY would like to commend the President, Congress and the Commission on recognizing the importance of Initial Public Offerings (IPOs) to the US economy and to the creation of jobs and wealth for those willing to commit capital. We believe that the fundamental goal of the JOBS ACT—to facilitate IPOs by private companies—is laudable as well as important.

We appreciate the effort which the Commission undertook in its study pursuant to the mandates of the JOBS Act. While we are disappointed that the Commission has opted to defer rulemaking regarding minimum trading increments for the securities of emerging growth companies, we can appreciate that the 90 day study of the impact of trading and quoting in one penny increments on the liquidity of small and mid-cap company's securities is inadequate to support changes in the minimum price variation ("MPV" or "tick size") as contemplated by Congress. From the outset it seems unlikely that a 90 day study would be adequate to reasonably determine whether alternative MPVs could be effective in achieving the goals of the JOBS Act, especially since the Act mandated that any determination by the SEC to change tick sizes must result in rulemaking within 180 days of completion of the study.

Our disappointment is tempered; however, by the Commission Staff's suggestion that the SEC "should solicit the views of investors, companies, market professionals, academics and other interested parties on the broad topic of decimalization, how best to study its effects on IPOs, trading and liquidity for small and middle capitalization

[1] STANY is the voice of the trader in the New York metropolitan area and represents approximately 1,000 individuals who are engaged in the trading of securities. As such, we are uniquely qualified to discuss proposed rules and regulations affecting trading. STANY is the largest affiliate of the Security Traders Association ("STA"), a multinational professional association that is committed to being a leading advocate of policies and programs that foster investor trust, professional ethics and marketplace integrity and that support education of market participants, capital formation and marketplace innovation. As an industry organization of individuals employed in the securities markets, STANY does not represent a single business or business model, but rather provides a forum for trading professionals representing institutions, broker-dealers, ATSs, and trading centers to share their unique perspectives on issues facing the securities markets.

companies, and what, if any changes should be considered."[2] It is in this spirit that STANY is submitting this letter. We hope to keep the dialogue regarding tick sizes initiated by the JOBS Act open and are happy to submit some preliminary comments at this time.

Discussion

The state of the IPO market in the United States today is lamentable. Since 2001 the average annual number of IPOs in the US has dropped drastically. Between 1991 and 1996 the US averaged 520 IPOs annually. From 1996 to 2001 the average annual number of IPOs rose to 539. However, since 2001, with the introduction of decimalization, and the passage of the Sarbanes-Oxley Act and Reg. NMS, the average annual number of IPOs in the US has fallen to 134. [3]

Although the venture capital industry has remained robust since 2001, the medium age of venture backed companies at IPO in 2007 was 8.6 years. This is longer than at any other period dating back to 1991. This trend is disturbing. Private companies are either not interested in, or are hampered from, seeking public status. In reality private companies, and the venture capitalists who have invested in them, have been seeking alternatives to IPOs such as acquisition by larger companies.

While some businesses have been fortunate to obtain financing through venture capital providers, we believe that it would be a mistake to accept venture capital as a substitute for the IPO market. Both forms of investment are essential to capital creation and economic growth. Industry and the economy are not well served if the primary avenue of funding requires that there exist potential buy-out candidates prior to investment. Many of today's most successful and innovative public companies would not have come to the market if they had not had the opportunity to seek funding through an IPO.

The decline in the number of IPOs in the US in the last decade can be attributed to a number of market factors, but perhaps none more so than the introduction of decimal pricing and a MPV of $0.01. David Weild and Edward Kim detail the "Perfect Storm" of market and regulatory conditions which collectively affected the market for IPOs. As they aptly note, the change from fractions to decimals and

> "[t]he resultant loss of 96 percent of the economics from the trading spreads of most small cap stocks–from $0.25 per share to $0.01 per share–was too much of a shock for the system to bear. Trade executions had to be automated. Market makers no longer exchanged information over the phone scrambling to match buyers with sellers on the other side of a trade. Liquidity, supported by capital commitment, was quickly a thing of the past…."

In today's markets, with trading spreads and commissions close to zero, it is no longer profitable for broker dealers to commit capital or to support research in small cap stocks. This lack of after-market support specifically— continuous market making and research—translates into diminished liquidity and increased volatility, all of which makes investors reluctant to enter the market for these small cap companies' shares. [4]

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[2] Report to Congress on Decimalization, July 2012 at P. 22

[3] Why are IPOs in the ICU? Grant Thornton, Weild, David and Kim, Edward http://www.grantthornton.com/staticfiles/GTCom/files/GT%20Thinking/IPO%20white%20paper/Why%20are%20IPOs%20in%20the%20ICU_11_19.pdf at P. 1

[4] While there is no question that the tightening of spreads and automation of the markets has produced benefits for retail and institutional investors in well capitalized liquid stocks. Costs are down; efficiency is up; the markets are preforming well. However, with the move from trading in fractions to trading in decimals came a one-size-fits-all MPV (for stocks priced above one dollar) which was applied equally to large cap liquid stocks and small cap stocks with little natural liquidity.

The lack of a robust IPO market inhibits innovation, decreases the opportunities for wealth accumulation by investors and has a negative impact on job formation.[5] It would be in the best interests of economic growth to encourage and revive the once thriving market for IPOs in the US.

How to revive the IPO market through changes in Tick Size

As noted previously, STANY is pleased that Congress and the Commission are exploring ways in which to revive the IPO market in the United States. We commend Congress for its "out of the box" thinking with respect to the hurdles that emerging growth companies must clear in order to qualify for public status. We believe that it is appropriate to engage this same out-of-the-box thinking when fashioning rules for how stocks of emerging growth companies can and should trade in the after IPO marketplace.

STANY did not anticipate that the Commission would be able to reach a definitive conclusion supported by empirical data on such a potentially important move as a change in MPVs within the time frame set by the JOBS Act. Therefore, while we are disappointed, we understand the conclusion presented in the Commission's study and its rationale for refraining from rulemaking at this time.

The limitations of the 90 day study mandated by the JOBS Act are magnified by the fact that much of the academic literature available to the Commission is limited in its scope and outdated. As the Commission notes "the limited theoretical literature on tick sizes focuses on how they affect market maker profits." Likewise, the empirical analysis on the impact of decimalization focuses on the period surrounding the adoption of decimal pricing. All of the studies cited by the Commission in its Report to Congress were written prior to 2005, with the vast majority of them having publication dates prior to 2003.[6]

The lack of more recent study is not surprising. It was not especially difficult for academics and economics to study the immediate short term impacts of the move to decimal pricing in the early 2000s. To accurately judge the impact of a penny MPV established with the adoption of Reg. NMS and the market structure changes that post-date its implementation is quite another thing. It is even more difficult, absent any empirical and practical evidence, to ascertain what impact a move from a penny MPV to some other MPV might have on trading in small and mid-cap stocks and on IPOs.

We are heartened however by the Commission's recognition that there may yet be value in setting different MPVs based upon the trading characteristics and capitalization of individual stocks. STANY believes that a change in the MPV from a penny to some larger increment will have a positive impact on market making and research available to small companies post IPO. We would be truly loath to see the consideration of a change that could positively impact the US economy either put on the back burner or given short shrift. Therefore, we encourage the Commission to continue to explore the use of multiple tick sizes and to make this inquiry a priority.

There appears to be agreement, both among STANY's diverse membership and market participants–including issuers– that "one tick size does not fit all." Without exception, our members strongly support a move to variable tick sizes. It may, however, be extremely difficult to "put the genie back in the bottle" and seemingly impossible to do so without some serious anticipated, as well as unforeseeable, consequences for the markets. Nevertheless, if the US economy is to recover and new jobs are to be created, it behooves the government and private sector to explore creative ways to foster IPOs, incent market making and encourage investors to support business through investment.

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[5] Whether you believe the National Venture Capital Association's estimate that after IPO employment increases by 90% or the Kauffman Foundation Report released in May, 2010, which estimates a 60% increase in the number of jobs in the 10 years following an IPO, it is clear that IPOs contribute significantly to job creation. Kauffman Report available at http://www.kauffman.org/uploadedfiles/post_ipo_report.pdf

[6] It was not until 2004 that the Commission proposed and reproposed Rule 612 of Reg. NMS to establish a minimum price variation of one penny. Regulation NMS, 69 Fed. Reg. 77424 (Dec. 27, 2004)

We believe that a stronger after-market for lesser capitalized newly public companies will encourage more companies to seek public status. Moreover, it is likely that a resurgence of committed continuous market making and after-market research will not only benefit emerging growth companies, but will give investors the confidence needed to return to the market and support the growth of American business through investment.

Considerations for a Pilot Program to Test the Impacts of Multiple Tick Sizes in the US Markets

As we see it, the question should not be whether variable MPVs for emerging growth companies, and/or companies with differing capitalization, is a good idea, but rather how can such a plan be implemented effectively and with as little unintended negative consequences as possible?

In order to compile sufficient evidence of the merits of alternative tick sizes, we suggest that the Commission implement a pilot program in which numerous stocks including those that would meet the definition of "emerging growth stocks" as well as small and mid-cap stocks, illiquid and orphan stocks are tested.[7] Because the resurrection of IPOs is extremely important to the American economy, we believe it is critical that any study or test include a variety of stocks and be of sufficient length to reasonably bring market makers, block traders and research commitment back to the subject stocks. Without a reasonable pilot period we are afraid that a test, which would likely prove positive given sufficient gestation, may very well fail.

The language of the JOBS Act suggests that Congress envisions that emerging growth company stocks subject to the Act would both **quote and trade** at spreads wider than a penny.

Section 11(A) of the JOBS Act states that:

> [i]f the Commission determines that the securities of emerging growth companies should be quoted and traded using a minimum increment of greater than $0.01, the Commission may, by rule, not later than 180 days after the date of enactment of this paragraph, designate a minimum increment for the securities of emerging growth companies that is greater than $0.01 but less than 0.10 for use in all **quoting and trading** of securities **in any exchange or other execution venue**. (Emphasis added.)

Assuming that the Commission concluded (either in its study or in the future) that changes in tick sizes for emerging growth companies' stocks would be beneficial, we are unclear as to whether Congress envisioned that the Commission would change the tick sizes in which certain stocks can be quoted, or if it is anticipated that the Commission would also prohibit execution venues from printing trades in increments other than a newly designated tick size. On its face, the Act suggests the latter, which is inconsistent with current trading practices. While stocks priced above a dollar must be quoted in penny increments, execution in dark pools, crossing engines, and through internalization (offering price improvement), result in executions or trades in increments of less than the current MPV— or in sub-pennies.

This distinction between quotes and trades is extremely significant especially when presented with an MPV greater than a penny. Quotes are the publically displayed prices of a security which indicate levels of interest on the buy and sell side of the market. Today quotes are expressed in minimum increments of a penny. Trades (or executions or prints) represent the actual price at which a security has been bought and sold. Because of competition, price improvement, discounts for block orders, etc. trades are frequently executed at increments less than the MPV. Were the Commission

[7] While it seems attractive to permit issuers to determine their own MPV and while it is clear that there are a multitude of stocks that may benefit from MPVs other than a penny, we do not suggest that the SEC consider a plan that would affect the majority of stocks. The repercussions on the markets may be too great. We believe that the potential unintended consequences to the markets require that the Commission select only those stocks that truly justify a change in MPV. As with a move to decimals, a move to larger spreads could be too great a shock for the markets.

to consider changing the MPV for emerging growth company stocks (or for the stocks of any listed company) a preliminary question, and one with profound implications for the market, is whether trades or executions will be permitted in increments less than the MPV?

Prior to the move to decimal trading in 2001, market makers in NASDAQ stocks would buy blocks of stock at the bid and sell those stocks to brokers and sales traders at the ask. For committing capital, assuming risk and supporting an orderly market, market makers could earn the spread (or some negotiated portion thereof)—which for most stocks was $0.25 per share. This provided sufficient incentive to market makers to commit capital and also funded research coverage which in turn attracted order flow. Quotes on NASDAQ served as indicators of where the stock would trade, but often, customers received a better price by negotiating and executing the trade between the quoted “bid” and “ask“ price.

On the NYSE, before the move to decimal trading and the implementation of Reg. NMS, NYSE specialists would maintain quotes at the bid and ask. They would buy at the “bid” and sell at the “ask”, committing capital on both sides of the market. Unlike in the NASDAQ market, quotes and trades on the NYSE would be at the “bid” and at the “ask” and securities did not execute on the floor of the NYSE between spreads. “Upstairs” traders, who made markets in NYSE listed stocks, did however negotiate trades and execute them at prices between spreads.

Since the implementation of Reg. NMS, trades on Exchanges- NYSE,[8] NASDAQ, BATS, etc. are executed at the bid or ask and are not executed in fractions of the tick size of a penny. Broker dealers were no longer able to accept orders in increments of less than the MPV (or sub-pennies) except for implicit midpoint orders which fluctuated with displayed SIP pricing. However broker dealers were not precluded from executing trades in sub-pennies to provide price improvement and best execution to their customers. Transactions executed off exchanges, in ATSs, and other off-exchange venues, quote in penny increments, but can and do trade in increments less than a penny.

Assuming that the Commission determines that the MPV or tick size for a security should be $0.05, shares of that security would be quoted in $0.05 increments. For example the NBBO could be $10.05- $10.10, but presumably it could also be $10.05–$10.15 or $10.20, $10.25 and so on. The spread may or may not be equal to the MPV. If a stock is quoted $10.05–$10.20 we assume it would be permissible for orders to be entered and stocks to trade in increments of a nickel—or for $10.05, $10.10, $10.15, $10.20 etc. The distinctions between quoting and trading and the requirements on quoting and trading relative to the MPV will be extremely important. Whether trading will be permissible in increments less than the designated tick size of a stock— for example at levels of $10.06, $10.07, $10.08, $10.09 —will make a significant difference to the markets, and may also impact how effective changes in tick sizes will be to the IPO market.

Market makers will commit capital and support after-IPO trading in emerging growth companies if there is sufficient economic reason to do so. Financial services firms are not going to commit capital and take risk unless there is the possibility of return. This is true for publicly listed companies, at which shareholders demand intelligent and profitable use of resources, as well as for privately held broker dealers, where trading desks are accountable to owners. As one of our members, whose firm actively makes markets in thousands of stocks, noted: “tickets, cost of carry, systems, personnel, compliance costs, etc. all contribute to the erosion of any profitability available by handling order flow in securities with razor thin margins.” As a consequence, his firm, which believes in the value of capital formation as well as a reasonable profit that permits the firm to prosper, seeks to make markets in securities in which the effective captured spread is greater than $0.01. We believe that as long as there is economic incentive, both firms that have been displaced by decimalization and new firms with capital to commit will enter the market to provide execution and capital services to the market place.

[8] The NYSE’s Retail Liquidity Program (RLP), attempts to put the Exchange and its participants in a position to trade within the penny spread, by allowing Exchange order flow to interact with retail orders in between the quote.

The opportunity to offer price improvement to customers gives broker dealers a way to compete on price. As such, it is likely that market makers would expect to be allowed to trade or print within the MPV regardless of the MPV set by the Commission. Many of our members believe that consistent with the rules relating to trading today, broker dealers should not be prohibited from executing trades in increments smaller than the MPV. For example, if customers were limited to sending orders in $0.05 increments[9] and the market was $10.05 x $10.10 a broker dealer should be permitted to offer price improvement and execute that order at $10.08.

These market participants do not believe that the rationale for setting the MPV of a stock at sizes larger than a penny should preclude trading at better prices when in the interest of customer order flow. Rather the objective of assigning different MPVs to different securities should be to provide incentive to market makers to commit more capital at those displayed MPVs. Today with penny spreads customers often receive prices that are inferior, for at least part of their order, to the publically displayed price because liquidity at that price point is often insufficient to fulfill customer interest. Having wider MPVs will provide incentives for market makers to take additional risk and fill the entire order at the displayed price since there will be a real possibility the risk they are assuming can lead to a profitable outcome. Moreover quoting at MPVs in excess of a penny will lead to a greater depth of liquidity at each displayed price point.

In preparing this letter, we questioned whether the contemplated benefits of after-market support are likely to occur without the economic incentives which a wider spread consistent with a requirement to trade as well as quote in MPVs would provide. While we were concerned that allowing trading between the MPV may reduce the incentive for market makers, market makers with whom we spoke consistently favored retaining the opportunity to trade between MPVs. They repeatedly told us that even if they do not capture the full spread, with MPVs $0.05 or more, there will likely be enough incentive to drive market makers back to the markets to support emerging growth stocks.

While broker dealers and market makers believe that the retention of the ability to trade between MPVs will be important to incentivize the support after-market trading in emerging growth stocks, not all market participants believe that this is necessary or advisable.

Concerns have been expressed by those market participants who favor both quoting and trading in minimum increments only. Specifically, there is concern that allowing off-exchange trading between the MPV will draw a significant amount of trading activity away from exchanges. Lit markets will arguably be at a disadvantage if trades in lit markets will only be permitted in increments equal to the MPV, while trades away from lit markets can trade between the MPV. [10]

Partly in response to this disadvantage, the NYSE recently sought and obtained approval for its Retail Liquidity Program (RPL) which permits the Exchange to accept retail orders in increments less than the MPV and interact with those retail orders away from the lit market. The RLP only goes so far in leveling the playing field between the NYSE and non-exchange execution venues; however, as its only applies to customer orders entered between the spread.

Concern has also been expressed that permitting trading between tick sizes away from exchanges will render the NBBO quoted on exchanges, which is currently used as a pricing tool for off-exchange liquidity, less meaningful and may consequently negatively impact price discovery. Likewise, those favoring an MPV for both quoting and trading question whether changes in MPVs will be meaningful if they are not applied to both quoting and trading. Just like the current MPV of a penny is not a mandate but a floor, there is concern that unless MPVs apply to quotes and trades competition is likely to drive trading down to the smallest increment. This may leave the markets exactly where they are now and fail to provide the incentives needed by market makers and broker dealers to support trading and research in the post IPO secondary markets.

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[9] With a tick size in excess of a penny, we assume that the customer orders would only be accepted in increments equal to the tick size.

[10] While this distinction exists today, the disadvantage will become more significant as the MPV becomes larger.

It is clear to us that, as the Commission explores the merits of multiple MPVs, the distinction between quoting and trading will be significant. We anticipate that there will be much debate as to how best to handle the distinction and how to promulgate rules which balance the best interests of investors with the need to incentivize market making and research necessary for capital formation and a robust IPO market.

Alternative Approaches to a Pilot

We believe that, even with round table discussions and analysis of foreign markets on which stocks trade at more than one MPV, it may be extremely difficult to judge the positive impact and/or negative unintended consequences of changes in tick sizes in a post Reg. NMS world without experience gained through trading. The last time that stocks traded at MPVs greater than $0.01 was before the passage of Reg. NMS, before dual listings, and before a virtually fully electronic marketplace. As a consequence, we believe that the SEC should consider implementing a pilot program or sufficient length and depth to test and study the impact of changes in the MPV in a real world setting.

One possible approach to a pilot program would be to test alternative methods of designing multiple MPVs side by side. Two sets of stocks could be tested. For one set both quoting and trading MPVs (as seemingly contemplated- or at least mentioned- in the JOBS Act) at various intervals in excess of a penny would be established. The other group of stocks would be required to quote in MPVs ranging from a penny to ten cents, but would be permitted to trade between the spreads.

Another way to maximize the possibility that changes in tick sizes will further the goals of the JOBS Act while minimizing the potential impact on competition among market participants would be to limit the change in tick sizes to emerging growth stocks. Certainly the JOBS Act addresses alternative MPVs for emerging growth stocks only. Nevertheless, there has been discussion (in Congressional hearings, in the press, among industry participants, and in response to the request for comments on the JOBS Act) about the possibility of instituting varying tick sizes for securities beyond those designated as "emerging growth companies" under the JOBS Act.

While in theory varying tick sizes, in recognition of the fact that listed companies have different trading characteristics and require different levels of incentive for capital formation and liquidity makes sense, we believe that it would be more prudent for a pilot to test only those stocks which would closely resemble emerging growth stocks. At the outset, the Commission should limit any pilot of alternative tick sizes to a small set of stocks of emerging growth companies, or companies which are similar to those that will fall under the JOBS Act. After such a pilot, and depending upon its outcome, the Commission and industry would likely be in a better position to judge whether to customize tick sizes for other stocks.

STANY appreciates the opportunity to provide guidance to the Commission as it continues to explore the potential benefits of changing the "one-size-fits-all" approach to tick sizes currently emblematic of the US equities markets. If you have any questions or comments concerning the thoughts expressed in our letter, please do not hesitate to contact us.

Respectfully submitted,

Kimberly Unger
Executive Director
STANY