

MEMO# 28588

December 17, 2014

Draft Comment Letter on SEC Decimalization Pilot Proposal

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TO: ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 18-14
EQUITY MARKETS ADVISORY COMMITTEE No. 19-14
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 33-14
SEC RULES COMMITTEE No. 42-14 RE: DRAFT COMMENT LETTER ON SEC DECIMALIZATION
PILOT PROPOSAL

The SEC has published for comment a proposal filed by the national securities exchanges and the Financial Industry Regulatory Authority ("FINRA") that would establish a national market system plan to implement a one year pilot program that will widen minimum quoting and trading increments for certain stocks with smaller capitalization.

Attached is the draft ICI comment letter on the proposal. Comments on the proposal are due to the SEC on Monday, December 22; please provide any comments you may have on the draft letter to me by e-mail at aburstein@ici.org or by phone at 202-580-5934 by COB Friday, December 19.

A. Purpose and Goals of Pilot Program

The draft letter lends support, in general, to the examination of issues surrounding the widening of minimum trading increments. The draft letter, however, notes that the pilot program, as proposed, goes beyond what was originally envisioned by Congress, introduces complexity and costs that may outweigh many of the benefits of the pilot, and may result in unintended consequences for investors when trading. The draft letter therefore states that if the Commission determines to move forward with the pilot, it make certain changes to the pilot to reduce the complexity, costs and burdens on market participants.

B. Scope of the Pilot Program

The draft letter discusses several aspects of the scope of the pilot program.

1. Trade-At Provision

The draft letter generally supports examining the impact of a trade-at requirement on liquidity in the markets but states that such a requirement may not be an appropriate regulatory tool for the proposed pilot program. Instead, examining the impact of a trade-at

requirement in the markets deserves its own pilot program, where the Commission can fully examine the impact of a trade-at requirement on a wider range of securities and on a wider test group. The draft letter also states that including a trade-at requirement in the pilot program would be difficult and costly to implement, may overly complicate the pilot program, and may reduce execution certainty. The draft letter therefore recommends that the Commission not include the trade-at requirement in the proposed pilot program. It recommends, however, that the Commission make it a priority to establish a pilot that would examine the impact of a trade-at requirement on the broader securities markets (along with other aspects of the current market structure that may impact the amount of liquidity in the lit markets such as liquidity rebates, access fees and broker-dealer internalization).

2. Other Issues Relating to the Scope of the Proposal

The draft letter states that we would not object to lowering the market capitalization for stocks to be included in the pilot from the proposed market capitalization threshold of \$5 billion. The draft letter also recommends that stocks in the pilot be limited to those of operating companies, i.e., ETFs should not be included in the pilot program.

The draft letter also states that we would not object to allowing the Commission an option for an additional year for the pilot, beyond the one year duration proposed, if they believe it is necessary. We would object, however, to the pilot being extended longer than such a time period.

Finally, the draft letter states that the \$0.05 increment to be tested in the proposed pilot is appropriate and that the minimum increment should not be any wider than \$0.05, as some have suggested.

C. The Pilot May Result in Unintended Consequences

The draft letter states that as the Commission considers whether, and to what extent, to move forward with a pilot program, it is imperative to keep in mind the risk of unintended consequences. The draft letter specifically notes that the pilot may lead to changes in trading behavior by market makers or other market participants as well as raise costs for investors.

D. Need to Address Other Market Structure Issues

The draft letter states that it is important for the Commission not to overlook the other changes necessary for the markets that are equally, if not more, important as widening the minimum trading increment. Significantly, the draft letter recommends that the SEC work with the exchanges and other market participants to establish a pilot program where a certain set of securities would be prohibited from being subject to liquidity rebates.

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[Attachment](#)

abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.