INVESTMENT COMPANY INSTITUTE

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SEC Announces Tick Size Pilot Program

[28250]

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TO: ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 15-14
ETF ADVISORY COMMITTEE No. 13-14
EQUITY MARKETS ADVISORY COMMITTEE No. 12-14
SEC RULES MEMBERS No. 30-14 RE: SEC ANNOUNCES TICK SIZE PILOT PROGRAM

On June 25, the Securities and Exchange Commission (the "Commission") announced that it had ordered the national securities exchanges [1] and FINRA (the "Participants") to act jointly to develop and file with the Commission a national market system plan to implement a pilot program that will widen minimum quoting and trading increments (tick sizes) for certain small capitalization stocks. [2] The Commission plans to use the program to assess whether these changes would enhance market quality for the benefit of U.S. investors, issuers, and other market participants.

The U.S. equity markets completed the implementation of decimal pricing in 2001. [3] The Commission, the exchanges, and NASDAQ made this change because they believed that the reductions in tick size would provide multiple benefits to the equity markets, including better pricing and greater liquidity. In 2005, the Commission adopted Regulation NMS Rule 612, and since that time the one penny minimum price variation ("MPV") per share has applied to all listed stocks priced at $1.00 or more per share. The Commission has continued to evaluate tick sizes in the equity markets. [4] Since the move to decimalization, some have raised concerns that the one penny MPV may have had a detrimental impact on trading and liquidity of small- and mid-cap stocks. The Commission believes that the pilot program "should facilitate studies of the effect of tick size on liquidity, execution quality for investors, volatility, market maker profitability, competition, transparency and institutional ownership."

The Order sets forth the basic terms of the pilot program to be established by the Participants. The pilot program will last for one year and include stocks with: (i) a market capitalization of $5 billion or less; (ii) an average daily trading volume of one million shares or less; and (iii) a share price of $2 per share or more. The pilot program will consist of one control group and three test groups with 300 securities in each test group, as follows:

- Securities in the control group will be quoted at the current tick size increment ($0.01 per share) and trade at the increments currently permitted.
- Securities in the first test group will be quoted in $0.05 minimum increments, and

trading would continue to occur at any price increment that is currently permitted.
- Securities in the second test group will be quoted in $0.05 minimum increments and traded in $0.05 minimum increments, subject to certain exceptions.
- Securities in the third test group will be subject to the same minimum quoting and trading increments (and the same exceptions) as the second test group, and would also be subject to a “trade-at” requirement. [5]

The Order directs the Participants to collect and transmit data to the Commission and make the data available to the public. After the end of the pilot period, the Participants will complete an assessment of the impact of the pilot program and submit their assessment to the Commission.

The Order requires the Participants to submit a national market system plan detailing the pilot program by August 25, 2014. The Commission will then publish the plan for public comment, and then determine whether to approve it.

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endnotes

[1] BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., The Nasdaq Stock Market LLC, Nasdaq OMX BX, Nasdaq OMX Phlx, National Stock Exchange, Inc., New York Stock Exchange LLC, NYSE Arca, Inc., and NYSE MKT LLC.

[2] See Order Directing the Exchanges and the Financial Industry Regulatory Authority To Submit a Tick Size Pilot Plan, SEC Release No. 34-72460 (June 24, 2014) (the “Order”), available at www.sec.gov/rules/other/2014/34-72460.pdf.

[3] Prior to decimalization, the minimum pricing increment had generally been 1/8 or 1/16 of a dollar.

[4] See e.g., Report to Congress on Decimalization (July 2012) available at www.sec.gov/news/studies/2012/decimalization-072012.pdf. In addition, in February 2013 the Commission staff held a Decimalization Roundtable to discuss the impact of decimal-based stock trading on small and mid-sized companies, market professionals, investors, and U.S. securities markets.

[5] Generally speaking, a “trade-at” requirement prevents price matching by a trading center that is not displaying the best bid or offer. The Commission believes that increasing tick sizes, in the absence of a trade-at requirement, “could migrate [trading volume] away from ‘lit venues’—trading venues that provide public pre-trade transparency by displaying the best-priced quotations—to ‘dark venues’ that do not provide such public pre-trade price transparency” and wishes to test whether the trade-at requirement would stem this migration.