January 27, 2014

NEA.

Honorable Mary Jo White, Chair
Joseph Dear, Chairman Investor Advisory Committee
United States Securities and Exchange Commission
100 F Street
Washington, DC 20549

RE: Recommendations to the Investor Advisory Committee by its Market Structure Subcommittee regarding Decimalization and Tick Size

Chair White and Chairman Dear:

We are all partners in New Enterprise Associates, the largest early stage venture capital firm in the United States. Our business is to provide capital, CEO mentoring and board of director governance to young, entrepreneurial technology and health care companies. It has been well documented that these fast growing companies are the engines of job growth and innovation in the U.S. economy.

We understand that the SEC's Investor Advisory Committee will, at its Friday, January 31st meeting, discuss and then vote on a number of recommendations designed to promote capital formation and enhanced liquidity for smaller capitalization public company securities. One of these recommendations, which we understand is controversial within the IAC, is to ask the SEC to conduct a test program for small-cap public companies to require their stocks to trade at mandated minimum tick increments. The purpose of this letter is to voice our strong support and encouragement for the SEC to define, conduct and monitor this test program of mandated higher tick sizes.

THE PROBLEM

Many small cap public companies in the U.S. are suffering from illiquidity in the trading of their stock. This means that these companies have difficulty raising fresh capital to fund their high growth potential, that their stock prices are often highly volatile, and that mutual funds that want to take meaningful positions in certain small-cap companies they favor can't do so because the trading volumes of those companies do not meet the "liquidity test" that their firms set (a liquidity test is necessary so that a mutual fund can get into and out of their desired stock position quickly enough to meet their internal liquidity requirements). All of these factors erode the value of the stock so that individual investors are disadvantaged; and of course it is the individual investor who is the source of the vast majority of capital raised by these small cap companies. Frankly, for buy and hold investors (as compared to traders), the pennies saved from buying and selling their position under current decimalization rules are immaterial compared to the potential appreciation in the stock that they may not realize because illiquid stock is hard to sell, requiring an "illiquidity discount." This is a serious problem that needs attention in our economy.

New Enterprise Associates, Inc.
2855 Sand Hill Road
Menlo Park, CA 94025
www.nea.com
P: 650.854.9499
F: 650.854.9397

THE HYPOTHESIS

We need to find a way to increase the depth of liquidity for small cap public stocks. There are a number of positive suggestions being considered by the IAC that we endorse, but we also would like to see the SEC conduct a thoughtful, well defined and carefully monitored test program to see whether mandated wider tick sizes can also be a factor to improve liquidity for small-cap stocks.

Our discussions with broker/dealers and small-cap mutual funds have convinced us that with a mandated higher tick size (in the 5 cent to 10 cent range), institutional investors and market makers would be willing to materially increase the amount of capital that they offer to acquire positions in the companies whose business fundamentals they find attractive. This mandated minimum tick increment would give them confidence that electronic traders wouldn't "jump in front" of the natural order flow and steal away the trade for a fraction of a cent, only to offload it seconds later. The thesis is that a mandated higher tick size will foster stability in trading, and with such stability, more capital would be put to work and increase the depth of the liquidity. We should test this thesis.

We fully acknowledge that this is a complex issue. There are many factors that have caused the decline in liquidity for small-cap public stocks, and it would be arrogant for anyone to say that they fully understand all the factors involved, let alone the respective impact of each factor. And of course, this presumes that the fundamental performance of a particular small-cap company is attractive enough to be an investment candidate; in the absence of solid fundamental performance, all the tick size proposals in the world won't help liquidity. Suffice it to say, in our view, that there is enough evidence that higher tick size is worth a serious test program to determine its impact. We are sure our appeal is one among many you have received from credible firms in support of this test program-other firms who, like NEA, care deeply about fueling innovation and growth within the US economy and strengthening our capital markets. We were encouraged last November to see the House Financial Services Committee, focusing on the critical issue of promoting job growth in our country, propose legislation, with a 57-0 bipartisan vote, that called for a pilot program with higher tick sizes for small cap companies.

THE KEY ISSUES FOR A TEST PROGRAM

This test of the impact on liquidity of mandated higher tick sizes needs to be done right. How it is done may be the most important issue of all. Following are several factors that we believe are important for determining an appropriate methodology, which we hope you will consider:

1. This test should be focused on small companies. The data we have seen is that the pool with the largest percentage of companies with poor liquidity is small cap stocks, the smallest 2% of all the public companies.
2. The test needs to be for a time period that is sufficiently long to ensure that meaningful results will be achieved. We recommend three years.
3. All investors, no matter how or where they buy or sell the stock, must adhere to the same mandated tick size rule.

4. The process for implementing the test needs to be carefully crafted, reviewed and monitored by the SEC. Some of the considerations would be:
    a. How is liquidity to be measured so we can, over the three years of tests, clearly see whether the mandated tick size has had a positive effect?
    b. Would it make sense to track for each company the degree to which institutional investors have stepped in to take meaningful positions?
    c. Should the tests apply to every small cap company or should control groups be created by segmenting the universe in a statistically random way?
    d. Would it be beneficial to track the volume of research coverage for the companies tested to gauge whether there is an increase concurrent with the testing (reversing a decade-long deterioration in coverage)?

With so many factors to consider and a great deal hanging in the balance, it is essential to ensure that a test program is thoughtfully designed, carefully managed, and properly monitored. We view this as the SEC's principal role, and it seems to us quite desirable for the SEC, with this test program, to compile its own data on this critical issue of how to create more liquidity for small cap companies.

As you consider this request, please do not lose sight of the fundamental issue here: High growth small-cap companies are the engines of job growth and innovation for our economy. Many of these companies have been ravaged by declining liquidity in their stocks, and their numbers are dwindling at an alarming rate. With so much at stake, how can we justify not conducting a thoughtful test program to determine the impact of a step that we honestly believe can have a material impact on improving this situation? We owe that to our great country.

We urge the IAC and the SEC to move forward without delay and develop a test program to determine the impact of higher mandated tick sizes on the liquidity of small-cap companies. We would be happy to help you in any way.

Respectfully submitted,

The Partners of New Enterprise Associates

Peter Barris

Louis Citron

Tony Florence

Dayna Grayson

Justin Klein

Ed Mathers

Sara Nayeem

Tim Schaller

C. Richard Kramlich

Mark Perry

Forest Baskett

Scott Sandell

Rohini Chakravarthy

Mohamad Makhzoumi

Jake Nunn

Frank Torti

Ron Bernal

Brooke Seawell

Chetan Puttagunta

Rick Yang

Ryan Drant