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Comments Regarding Minimum Tick Size

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Panel 2

What impact has decimalization had on the securities market in general?

During my career, I had run several equity and institutional trading departments over a 30 year span, including Fidelity Investment's NASDAQ Trading Department, which I founded and managed. Additionally, while at Fidelity, for a period of time I also oversaw the execution of all public NASDAQ agency orders on behalf of Fidelity's public customers and correspondent network. As a result, I am familiar with the impact of decreasing spreads from the vantage point of the public customer, the dealer, as well as the issuer.

In my opinion, decimalization has resulted in a decrease in the spread between the bid and offer, which has translated into more favorable executions for the public customer whose order is approximately 500 shares or less. However, the public customer comprises a smaller and smaller segment of the marketplace.

The institutional customer is no longer able to seek depth of liquidity from the "traditional market maker" whose business model is otherwise dependent upon large enough spreads between the bid and offer to compensate for the risk of providing liquidity. The number of "traditional market makers" has fallen in the past ten years, and the existing market makers are unwilling to provide the same depth of liquidity they provided while spreads were $1/16^{\text{th}}$ or $1/8^{\text{th}}$ of a point. As a result, the institutional customer is now seeking this liquidity in alternative venues, such as dark pools. This has resulted in a decentralization of the market, and increased complexity.

Lastly, the market is now dominated by "High Frequency Trading" (HFT) firms who use proprietary algorithms to enter thousands of orders in milliseconds, and whose model is dependent upon tight spreads encouraged by decimalization. While these orders collectively provide enhanced liquidity, during market disruptions the HFT firms tend to withdraw rather than provide stabilizing liquidity, a role more reminiscent of the "traditional market maker".

Therefore, decimalization has been largely responsible for creating the environment which has almost eliminated the traditional market maker who pursued a business obligation to provide liquidity for its clients, in favor of the “new market makers”, the HFT shops who more likely walk away during a market vacuum. This combination makes the current market vulnerable to a repeat performance of the “Flash Crash” which occurred in May of 2010.

Is it advisable to broadly re-evaluate minimum tick sizes in the U. S. securities market?

In my opinion, I believe that it is advisable to re-evaluate the minimum tick sizes. My contention is that the system “worked better” when the spreads were wider and the traditional dealer model was healthy and the dealer segment was populated with more competition. Multiple dealers provide a buffer to falling (or rising prices) and are especially crucial during market disruptions, as they are willing to take proprietary positions, and/or more readily transact with institutions. In addition to the wider spread providing compensation to the dealer, the wider spread encourages the sales force to deal with institutions as lucrative concessions keyed to the spreads may provide an incentive to the sales force. This incentive rarely exists in the current marketplace.

Should the minimum tick size vary with the price of a security, its liquidity, the size of the issuer, or other characteristics?

I believe that the minimum tick size should vary between securities based on some measure of volatility (or correlation to a benchmark index). A \$10 stock which has a spread of \$0.05 and moves within a ½ point range per day, is likely to be a profitable stock to provide liquidity in, whereas a \$10 stock with the same \$0.05 spread which moves within a \$2 range per day is a more difficult candidate to provide liquidity profitably. I believe one way to address this is to base the spread on the stock’s beta, and any beta which exceeds 1.2, for example, would be traded with a \$0.10 spread as opposed to a \$0.05 spread. Ultimately basing the spread simply on price is a “one size fits all” inappropriate fix.

Should the minimum tick size be mandated for all securities, or should issuers or primary listing markets be allowed to choose?

If the goal is to revive the traditional dealer model in order to create a robust, competitive, dealer environment then I believe that minimum tick sizes should ultimately be mandated for all securities, as a small universe may not be enough to re-create an environment robust enough to foster competition between dealers, in an effort to provide greater execution quality and greater depth of markets.

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