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Via Electronic Delivery

Mr. Brent Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Proposed National Market System Plan to Implement a Tick Size Pilot Program, File Number 4-657

Dear Mr. Fields:

ITG Inc. ("ITG" or the "Firm") appreciates the opportunity to comment on the U.S. Securities and Exchange Commission's ("SEC" or "Commission") notice to solicit comments on the proposed National Market System ("NMS") Plan to Implement a Tick Size Pilot Program ("Pilot"), File Number 4-657, which was filed by the national securities exchanges and the Financial Industry Regulatory Authority ("FINRA") on August 25, 2014, as ordered by the SEC. ITG is an independent execution and research broker that partners with global portfolio managers and traders to provide unique data-driven insights throughout the investment process. In addition, ITG operates an alternative trading system ("ATS") called POSIT® that conducts matches of orders from institutional investors and broker-dealers on a non-displayed basis. ITG is well-positioned to comment on the proposed regulation as we not only operate our own ATS but also execute equities transactions via multiple market venues, including securities exchanges, market makers, and other ATSs.

I. Overview of the Pilot

The national securities exchanges and FINRA ("self-regulatory organizations" or "SROs") are proposing the Pilot program, which would, for a one-year period, change the minimum tick sizes, *i.e.*, quoting and trading increments, for certain NMS common stocks[1] with smaller market capitalizations. The proposal seeks to include in the Pilot those NMS stocks with (1) a market capitalization of $5 billion or less on the last day of a three-month "measurement period";[2] (2) a consolidated average daily trading volume of one million shares or less during the measurement period; (3) a closing price of at least $2 per share at the end of the measurement period; (4) a daily closing price of $1.50 during the measurement period; and (5) a volume weighted average price ("VWAP") of at least $2.00 during the measurement period ("Pilot Securities").[3]

The Pilot program, as proposed, would consist of three groups of 400 Pilot Securities and a control group of Pilot Securities. In the control group, Pilot Securities would be quoted at the current minimum increment ($0.01 per share) and traded at the price increments currently permitted. Pilot Securities in the first test group would be quoted in $0.05 minimum increments and traded at the price increments currently permitted, subject to exceptions for orders priced to execute at the midpoint of the national best bid and/or offer ("NBBO") or those entered into an SRO's retail liquidity program. Pilot Securities in the second and third test groups would be quoted <u>and</u> traded in $.05 minimum increments, subject to the same exceptions available for the first test group and a few other trading exceptions. The third test group will also be subject to a trade-at prohibition, which generally prevents price matching by a trading center, such as a dark pool, that is not displaying a protected bid or protected offer, subject to certain exceptions, such as block size orders, retail orders executed with price improvement of $0.005 or more, negotiated trades and intermarket sweep orders ("Trade-At Prohibition").[4] The proposed program is intended to allow the SEC, SROs, and the public to evaluate and assess "the impact of increment conventions on the liquidity and trading of stocks of small capitalization companies."[5]

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[1] NMS common stock is generally exchange-listed common stock.

[2] "Measurement Period" is defined as "the U.S. trading days during the three-calendar-month period ending at least 30 days prior to the effective date of the [one-year] Pilot Period."

[3] NMS common stock that has been subject to an initial public offering within six months of the start of the Pilot will not be included.

[4] Although the SEC's Tick Size Pilot Plan Order indicated that the trade-at prohibition was "intended to prevent price matching by a trading center not displaying the NBBO," the national securities exchanges and FINRA chose to propose protected quotations as reference points for the trade-at prohibition. *See* Letter from Brendon J. Weiss, Vice President, Intercontinental Exchange, NYSE, to Secretary, SEC at 6-7 (Aug. 25, 2014), *available at* http://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-transmittal-letter.pdf.

[5] Exchange Act Release No. 73511 at 2 (Nov. 3, 2014).

II. ITG's Comments Regarding the Pilot

ITG appreciates the Commission's objective of improving market quality in smaller market capitalization and supports the concept of a pilot program that explores potential benefits of larger minimum quoting/trading price increments. Indeed, the U.S. is one of the few markets in which we trade that pursues a "one-size-fits-all" policy to quoting increments. Specifically, pursuant to Rule 612 of Regulation NMS, orders for exchange listed securities that are priced equal to or greater than $1.00 per share are quoted in minimum increments of $0.01, regardless of price level or liquidity characteristics.[6] ITG welcomes SEC policymaking efforts designed to address an identified problem and conducted within a sound empirical framework to measure the outcome.

In this spirit, it is imperative that the Pilot: (1) employ reasonable conditions that are devised by un-conflicted parties; and (2) use well-defined and relevant metrics to determine if tick size modifications would improve U.S. market structure and assist emerging growth and /or smaller companies in raising capital. The proposed Pilot suffers from three deficiencies in this regard. First, in stark contrast to past policymaking initiatives relating to fundamental aspects of equity market structure, the proposed Pilot is being implemented through an NMS Plan, as opposed to SEC rule. Second, the Pilot introduces unnecessary levels of complexity—and associated unintended consequences—to the marketplace by imposing a "Trade-At Prohibition," which could also skew the results of the Commission's empirical analysis of the Pilot. Third, the Pilot exposes market participants and their respective clients to significant operational risk and logistical issues by requiring the rejection of limit orders that are priced in sub-nickel increments.

Accordingly, ITG offers three suggestions to improve the Pilot. First, the Pilot should be recast as a proposed SEC rule, subject to the usual public notice and comment process that is required under the Administrative Procedures Act ("APA").[7] Second, the "Trade-At Prohibition"—at best unnecessary, at worst a dangerous impediment to competition and source of unintended consequences—should be removed from the Pilot. Third, the Pilot should afford broker-dealers flexibility to re-price order prices that do not comply with the nickel increment, in order to avoid confusion and inefficiencies in order handling and execution.

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[6] 17 CFR §242.612(a).

[7] 5 U.S.C. §551.

A. ***The Pilot Should Be Implemented via SEC Rule, Not NMS Plan***

The Pilot should be implemented as an SEC rule under the public notice and comment requirements of the APA, as opposed to an NMS Plan devised by the SROs. ITG understands that market participants have been given an opportunity to comment on the currently proposed NMS Plan to implement the Pilot. The SEC order that required the SROs to implement the NMS Plan and the Pilot's parameters were not subject to the notice and comment process afforded under the APA, however. In addition, a rule amendment that is submitted under the APA would require a thorough cost-benefit analysis, which neither the SROs nor the Commission staff would be required to perform under the NMS Plan approach. Moreover, since the Pilot's Trade-At Prohibition would significantly modify existing trade-through obligations under Regulation NMS for certain securities, the Commission should carefully consider the potential impact of such changes on U.S. market structure, in accordance with traditional rule amendment procedures. NMS Plans should implement SEC policy directives, however, they should not amend SEC regulations established under the federal securities laws.

ITG also maintains that implementing the Pilot though an NMS Plan provides certain advantages to the SROs, who are the architects of the Plan, over other market participants such as ATSs and market makers. This arrangement creates potential conflicts of interest because the SROs include national securities exchanges, which are not disinterested, objective parties. On the contrary, at times, certain exchanges openly compete with ATSs and market makers, which will be subject to the Pilot. For these reasons among others, the Commission has historically been the governing body that establishes the parameters and requirements for policymaking that implements major equity market structure change.[8] The Pilot should be implemented in the same manner.

B. ***The Pilot Should Not Include a Trade-At Prohibition***

ITG strongly believes that the Pilot should not include a Trade-At Prohibition. At its essence, the Trade-At Prohibition is a material expansion of the trade-through rule of Regulation NMS under the Securities Exchange Act of 1934 ("Exchange Act")[9]. In general terms, the Trade-At Prohibition is designed to prevent a market center from internally trading at the NBBO, unless it is quoting at the same price and executing in the

[8] *See* Exchange Act Release No. 34-51808 (Jan. 9, 2005); Exchange Act Release No. 34-61595 (Feb. 26, 2010); Exchange Act Release No. 34-73639 (Nov. 19, 2014).

[9] Rule 611 of Regulation NMS at 17 CFR §242.611.

same size as the NBBO. Currently, Rule 611 of Regulation NMS prevents a market center from trading through the best quote of a protected market center. The Trade-At Prohibition extends the trade-through provisions of Regulation NMS by preventing trades at the best quote of a protected market center, unless the executing venue is quoting at that price. ITG believes that inclusion of the Trade-At Prohibition undermines the Pilot in three ways: by increasing complexity, preventing straightforward empirical analysis, and accommodating anti-competitive mischief.

Inclusion of the Trade-At Prohibition will increase exponentially the complexity of the Pilot—and therefore amplify the resources required for implementation and risks of associated unintended consequences. Notably, those exchanges that provide order routing will be required to make profound changes to routing logic in order to access the displayed prices of competing exchanges ahead of internal hidden liquidity—from both reserve and hidden orders—at equivalent prices. The commitment of resources required to re-engineer order routing logic industry wide to accommodate the Trade-At Prohibition will substantially lengthen the time required to implement the Pilot. Unprecedented, far-reaching change will also increase scope for associated unintended consequences at the Pilot's launch.

Unlike size of quotation price increment, there is no obvious nexus between a Trade-At Prohibition and market quality for smaller capitalization stocks. Incorporating a Trade-At Prohibition in the Pilot will not only distort the findings concerning changes to the minimum quoting and trading increments, but will also produce corrupt and unreliable data concerning the effect of a Trade-At Prohibition on market quality. It will be a highly complicated, if not impossible, endeavor to analyze Pilot results and differentiate between the effects of the wider trading increments and those of the Trade-At Prohibition.

The Trade-At Prohibition would fall particularly hard on three types of market participants: internalizing broker-dealers, market makers that execute off-exchange the order flow from other broker-dealers, and ATSs that do not display quotes in the public quote stream (*i.e.*, "dark pools"). The rule would not permit these entities to trade at the NBBO unless they began to display quotes in the public quote stream. Although the Pilot proposing release claims that the Trade-At Prohibition is designed to incentivize quote competition, it will in fact diminish competition between market centers and impede market innovation. Proposed regulations that introduce anti-competitive effects are a serious concern as they could cause an increase in execution costs for investors. ITG asserts that under the competitive landscape of today's markets that balances displayed liquidity offered by national exchanges with un-displayed liquidity resting in ATSs and market makers (as well as exchanges themselves), the cost of executing large orders for institutional investors has dramatically decreased over the past decade.[10]

C. The Pilot Should Allow Price Adjustment of Limit Orders to Comply

Although certain stocks under the Pilot will be priced in five-cent increments, it is inevitable that some customers will still submit orders in such stocks priced at increments less than $0.05. For example, if the NBBO for a Pilot stock is $10.00 to $10.05, a customer might submit a buy order for $10.04. In our experience, this situation could arise for manifold reasons, including but not limited to: the customer is executing a large basket of orders, including a small minority in stocks subject to the Pilot; the customer or its vendor did not account for Pilot pricing limitations in its order management system; or the customer is manually transmitting orders by telephone, unaware that the security is subject to the Pilot. Under the Pilot, a broker such as ITG would have to reject the order, and the customer would have to resubmit the order at a compliant price—a process that will create logistical and operational problems for brokers and their clients.

To avoid this situation, we recommend that the SEC permit broker-dealers and ATSs to adjust the price of a limit order so that it is priced in a permissible increment.[11] Using the example above, a broker-dealer or ATS could "slide" the customer's buy order at $10.04 to a price of $10.00. If the customer's order was to sell at $10.04, the price would be slid to $10.05. Such modification would enable the customer's order to be handled in compliance with the five-cent minimum quoting increment. A broker-dealer or ATS would be required to obtain a customer's approval, through negative consent, to permit that customer's order to be re-priced to the next level permissible under the Pilot (*i.e.*, priced better than the customer's initial limit price).

The concept of order price sliding already exists in the marketplace for certain situations. For example, when a short sale circuit breaker is in effect under Rule 201 of

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[10] For institutional investors, the costs of executing large orders, measured in terms of price, were more than 10% lower in 2013 than in 2006. *See* Mary Jo White, SEC Chair, Enhancing Our Equity Market Structure, Address Before Sandler O'Neil & Partners, L.P. Global Exchange Brokerage Conference (June 5, 2014). *See also* ITG Global Cost Review Q4/2013 (June 6, 2014), *available at* http://itg.com/marketing/ITG_GlobalCostReviewQ42013_20140509.pdf. The ITG report indicates that U.S. implementation shortfall costs declined from 63 basis points in Q3 2003 to 44 basis points in Q1 2006 to 36 basis points in Q3 2013.

[11] ITG's proposal would also permit exchanges to adjust limit order prices if broker-dealers and/or ATSs are permitted to engage in such activity.

Regulation SHO of the Exchange Act, exchanges use a program to re-price the order so that it is permissible. If the inside bid is $10.00 when such a circuit breaker is in effect, and an exchange receives an order to sell short at $10.00, the exchange would slide the price of the limit order to $10.01 because the rule prohibits short sales at the inside bid when the circuit breaker is in effect. Because the concept is well-understood by the industry, adopting it here could significantly reduce the amount of implementation time for the Pilot, in addition to the foregoing benefits.

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ITG thanks the Commission for the opportunity to comment on the proposed Pilot. We support the SEC's efforts to implement a well-designed test to see if larger quoting increments have a beneficial market quality effect for less liquid stocks. While we wait to examine the Pilot's results before speculating on its effect, we recommend the three changes detailed above to improve its operation. An improved Pilot that is implemented under the APA, does not include a risky and unrelated Trade-At Prohibition, and affords brokers flexibility to modify customer limit order prices to effect Pilot compliance would benefit from greater industry support and require less operational preparation than the current Pilot proposal.

Should you require further information or have any questions regarding the above, please do not hesitate to contact me at (212) 444-6306 or jamie.selway@itg.com.

Very truly yours,

James P. Selway III
Managing Director
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cc: Stephen Luparello
Director
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