# FINANCIAL INFORMATION FORUM

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***Via Electronic Delivery***

Mr. Brendon Weiss, Chair of the Tick Size Pilot Plan Operating Committee, representing: NYSE Group, Inc., on behalf of New York Stock Exchange LLC, NYSE MKT LLC, NYSE Arca, Inc., BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, and The Nasdaq Stock Market LLC (collectively, the "Participants")

August 28, 2015

Re: FIF industry member concerns regarding timeframe for Tick Size Pilot Plan implementation

Dear Brendon,

This letter is written on behalf of Financial Information Forum ("FIF") non-exchange industry members to express our utmost concern regarding the timeframes that have been dictated by the *Plan to Implement a Tick Size Pilot Program* (the "Plan") as approved by the Securities and Exchange Commission (the "SEC") pursuant to Rule 608 of Regulation NMS under the Securities Exchange Act of 1934.[1]

FIF industry members who represent a large portion of the broker/dealer trading centers and market makers that will be impacted by this Plan, wish to make it clear to the Participants and the SEC, that the information necessary to meet the requirements for data collection and reporting, as well as full implementation of the Tick Size Pilot, has not been provided to the industry in a timely manner, rendering it impossible to perform analysis, develop software systems and procedures, and conduct adequate testing within the remaining timeframe mandated by the Plan. While we do greatly appreciate the fact that leaders and members of the Participants' working groups have been working very closely with FIF to solicit input and provide feedback, unfortunately the most fundamental questions have not been answered with any degree of certainty. It is apparent to all involved that the number, scope and depth of questions that have been submitted to the Operating Committee and Participants' working groups, and the time needed to respond to those questions is indicative of the Plan's complexity.

With only ten weeks remaining until the data collection process is set to begin on November 6, 2015, issues related to scope and definition of activities, reporting formats and other essential details continue to be considered by the Operating Committee and the SEC. Industry members have not received any documentation upon which they can rely to:

- Identify the specific securities that will be included in the Pilot and determine how their firms are impacted based on their trading behaviors and capacities (e.g. agency or principal) with respect to those securities
- Understand the definitions of data to be collected and reported (that is, what is included/excluded in each field)

[1] SEC Release No. 34-74892; File No. 4-657, page 121.
https://www.sec.gov/rules/sro/nms/2015/34-74892.pdf

- Begin analysis to determine if the data is currently available, or if it must be created/derived in some other manner
- Complete coding to capture the data and generate files in the format dictated by the DEA to whom the data will be reported; or for those working with third party service providers, to establish a process for providing necessary data to service provider
- Establish testing with appropriate DEA

FIF industry members also believe the May 6, 2016 start date for the Pilot is in jeopardy, given that:

- Data collection and reporting is required for a full six months prior to the start of the Pilot; therefore, a delay in the start date for data collection will push out the start date for the full Pilot
- No guidance has been provided and there remain many unanswered questions related to various “Trade-At” scenarios, and rules around quoting and order handling
- New SRO rule filings and significant system changes must be made by exchanges to support the new constraints placed on quotes, orders and executions
- Industry members must fully understand and analyze the impacts of new order types and rules for each exchange/trading center and program accordingly
- Listing exchanges must publish and industry members must download daily from each exchange, any changes to impacted securities, maintain the securities and associated groups in their securities master files, and link those securities to their front end order management systems (OMS) and execution management systems (EMS)
- Both retail and institutional investors must be educated about the orders they may/may not enter, including mid-point priced orders; the educational process and functional changes to support order entry cannot begin until the requirements are fully understood
- Extensive testing by exchanges and industry members will be required to ensure proper orders are not rejected (based on the specific security’s group assignment) and ISOs are routed appropriately

Until complete requirements for the Pilot including the answers to outstanding questions, technical specifications and exchange rule filings are made public, firms are limited in what they can do to prepare for the many changes needed to manage the wide variety of customer and exchange order types, routing and execution parameters impacted under the Tick Size Pilot Plan. FIF industry members cannot wait until data collection and reporting is operational to begin work to meet the quoting and trading requirements. FIF had expected to receive written specifications and FAQs by the third week of August. Any additional delay in receiving full requirements will further delay Pilot implementation.

## Data Collection and Reporting Required Under Appendix B and C

The complexities of the data collection effort and reporting of trading center activity and market makers’ profitability have been seriously underestimated in the Rule filing, evidenced by the fact that the scope, definitions and other details have not yet been finalized by the Plan Participants after months of discussion. To expect the industry to analyze, code and test software and procedures in less than three months is not reasonable, is putting undue stress on trading centers and market makers, and ultimately leaves small cap companies at risk of being left with fewer firms choosing to make markets or trade in those securities.

The timing of selection of the companies to be included in the Pilot creates additional uncertainty as to which market participants will be impacted. If a firm internalizes orders in selected securities, they would be defined as a “trading center” and be required to collect data and report on their activities beginning in November. Without knowledge of the specific securities, a firm may be forced, at a significant cost, to prepare for Tick Size Pilot, when in fact they do not trade or make markets in any of the securities selected for inclusion in the Control Group or Test Groups 1, 2 or 3. Firms may determine that in the interest of time and expense, it is more prudent not to trade in any of these securities at all; they will therefore "opt out" of data collection, trade only as agent and suspend any internalization and market making activities in these securities during the pilot period. It is worth noting that the reverse could be true, where a firm that is currently not a trading center in these stocks decides to become a trading center in a Pilot stock after the securities have been assigned to Pilot Groups and the data collection process has already begun. Will such a firm be precluded from becoming a trading center or market maker because pre-pilot data was not collected and reported? If not, in what timeframe must a potential trading center or market maker begin the data collection and reporting process?

While FIF has said in the past that our industry members generally would require a bare minimum of three months for implementation of data collection, that estimate was based on the assumption that the scope and functional requirements would be fairly straightforward and in keeping with existing rules and reporting requirements such as Rule 605. In fact, the farther Tick Size Pilot deviates from those guidelines, the more complex the initiative becomes, and more time is needed for development and testing. For instance, the expansion of Appendix B, Section I data to include extended trading hours, diverges significantly from 605 reporting which considers only regular trading hours. What might be considered a simple redefinition of B-I reporting could have many implications. Determination of marketability and various B-I calculations including B-I a (31), (32), and (33) will become more unclear when there is no NBBO. For firms relying on their third party 605 providers to generate Tick Size Pilot reports, new post-close transaction files would need to be produced as well.

As another example, there would be major implications from a time and cost perspective should the decision be made by Regulators that it is not acceptable to utilize post-execution market data from the SIP to determine marketability and order categorization. In addition to losing the ability to have external validation of the marketability categorization, it would require all order management and execution management systems to make major changes. These changes include adding aggregation of all displayed bids and offers at the NBBO to their internal market data feeds (as opposed to keeping track of the NBBO) and storing the "snapshot" of all the market data on every record processed. Such changes, which involve changes to the internal data schema used by these systems, would be quite extensive and require major efforts in development and testing for all firms trading these securities. It is conceivable that the prospect of these changes for the purposes of the Tick Size Pilot would discourage firms from participating as a trading center or market maker in Pilot securities, thereby reducing liquidity.

Without the benefit of FAQs and technical specifications, it is not possible for the industry to determine if three months is sufficient to be ready for Appendix B, Section I and Section II reporting. Additionally, the scope of work may increase greatly if the burden of reporting under Section IV shifts from the Participants to market makers, as current discussions seem to indicate.

Another example that could potentially double the three month estimate for development and testing would be the requirement in Appendix C to apply LIFO-like tracking of market making trades for profitability reporting. LIFO is not an accounting method widely used in this application, and programming for this or any other methodology that requires multi-day tracking of carry-over positions will be burdensome, expensive and add significantly to the implementation timeframe. A schedule of monthly reporting will compound the challenge of carrying positions from one month to the next. Because the purpose of this exercise is to measure change over time and the impact on Pilot stocks under varying trading conditions, we believe the prescriptive method contemplated by the Plan adds workload but no additional value. FIF industry members have suggested an alternative approach using a simple, straightforward method to achieve the same goal. Requirements to create a more complex approach will extend the implementation timeframe. Furthermore, third party service providers that firms may rely on to meet these reporting obligations may not have the ability to carry position details from one day to the next. FIF members are still waiting for clarification on how market maker profitability reporting should be implemented.

Please keep in mind also, that many firms do rely on third party service providers to capture the transaction data and/or format for reporting. This process often requires a double layer of development and testing; first a service provider must develop and test their software, then the service provider must prepare and deploy the software to numerous clients (trading centers) for integration and testing in their own internal systems. It is not possible to accomplish this in the limited time before the data collection period is set to begin.

It is also important to understand that the data collection process cannot be applied "retroactively". In other words, it would not be viable to postpone the first reporting date, but require that the data included in the first reports go back to November 6, 2015. There are still outstanding questions about how to define certain elements required by the Plan and their applicability to non-exchange trading centers. Until those questions are answered there may be various elements ultimately required for reporting that are not currently collected by firms in the normal course of business, which firms cannot plan to save proactively, and the information will not be able to be reconstructed. For example: the process to determine and indicate if an account is a retail investor in the broader sense as it pertains to non-exchange programs; if that information is later determined to be required, is not able to be recreated. Also, there are nuances to the special handling codes and artifacts that if not captured in November, could not be recreated. There are also instances where events and relationships must be established across orders, such as separating riskless principal flow and proprietary orders for accurate reporting of market making activity. Where an indicator must be added to establish the relationship or define it internally, such trades cannot be linked retroactively. We believe that after-the-fact reconstruction will be prone to error, which would call into question data validity and undermine the goals of the Pilot.

FIF industry members maintain that the appropriate data collection and reporting start date can only be accurately determined after all final data requirements have been published including FAQs, tech specs, and SRO filings.

## Tick Size Pilot Quote, Order and Trade Requirements

The focus of FIF's Tick Size Pilot Working Group has been on data collection and reporting due to the immediacy of the start date, but FIF industry members are equally concerned with the full Pilot implementation date of May 6, 2016. We expect significant work will be required to implement the new requirements, despite the similarities to Reg NMS in some respects. It is the many differences between the Tick Size Pilot and Reg NMS that make this project more complex. Specifically, much of the complexity relates to the new requirement that trades conform to tick size increments for Test Groups 2 and 3; the exception for orders priced to execute at the mid-point, for all test groups; and the quoting exception to the trade at requirement for Test Group 3. One example: firms that receive orders from other broker-dealers may desire to handle them, when applicable, as retail orders subject to the trade price exemption for Test Groups 2 and 3. To do this firms will need to agree on how to enrich order messages to indicate the wholesale order is for a retail investor.

One of the primary concerns of FIF industry members is the way each of the SROs will adapt their systems differently to handle the parameters and constraints on each of the Pilot Groups. Each exchange may create new order types, and may have a variety of methodologies in which they intend to handle orders priced to execute at the mid-point. These directives must be published in advance, well understood and fully tested by all trading centers and market makers.

While some FIF industry members have indicated a six month development and testing timeframe could be adequate, most believe it will take longer. All FIF industry members agree that it is difficult to estimate the time required for Pilot implementation without the benefit of the final Plan requirements, FAQs, and SRO rule changes. SRO rule filings will specify trading behaviors, so it is important to fully understand the rules in order to assess the full impact of the requirements at the firm level. Some firms may conclude the effort is too large, and others may not be ready to handle the variety of scenarios for quoting and trading that must be applied differently to the four groups of securities included in the Pilot. Those firms may choose to reject the business entirely, to the detriment of investors and the Pilot companies.

In summary, all the basic information necessary for firms to begin requirements analysis and development has not been made publically available. File formats, connectivity details and test environments have not been established to enable industry members and trading centers to prepare adequately. FIF non-exchange industry members respectfully request that an extension be granted, for a time period which can only be determined upon publication of the full set of requirements. While FIF had initially indicated a minimum of three months development and testing following the release of complete data collection and reporting requirements might be sufficient, it will likely take longer as the complexity of the requirements currently under discussion has substantially increased. Similarly, a minimum of six months following publication of requirements for development and testing of the quoting and trading aspects of the rule may not be sufficient, depending on the rules and documentation when released, and any feedback FIF receives on the trading scenarios and the new SRO order types.

FIF industry members would be happy to meet with Plan Participants and SEC staff to further discuss these concerns. Please do not hesitate to contact me at 212 652 4483 with questions or to arrange for follow up discussions.

Regards,

Mary Lou Von Kaenel

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Managing Director
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cc: Stephen Luparello
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