



December 22, 2014

BY EMAIL

Secretary Brent J. Fields  
U. S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549  
[rule-comments@sec.gov](mailto:rule-comments@sec.gov).

Re: Release No. 73511; File No. 4-657: Proposed National Market System  
Plan to Implement a Tick Size Pilot Program On a One-Year Pilot Basis

Dear Mr. Secretary:

As the voice of the venture industry, the National Venture Capital Association (NVCA) appreciates the Commission's initiative in addressing the crisis of liquidity for secondary trading of small-cap companies.

NVCA represents nearly 400 venture capital firms across the U.S. Our members invest in thousands of startup companies each year. These companies are on high-growth trajectories with the goal of someday being acquired by larger companies or going public themselves through an initial public offering (IPO). Venture backing allows start-ups to conquer technical risk, as well as learn how to produce a product and sell that product in the marketplace. But in order to scale an enterprise so that it has truly global market capability, companies typically need more capital than their venture investors alone can provide. This is the point at which accessing additional capital – either through an acquisition or the public markets – becomes critical to continued growth. In fact, over the last four decades,

92 percent of all job growth in a sample of the leading venture-capital-backed companies has occurred AFTER an IPO. For instance, Intel went from 460 employees to over 107,000 since their IPO. Starbucks added nearly 180,000 since their IPO. For this reason, a strong, vibrant public market is vital to the creation of jobs and our nation's overall economic health.

Unfortunately, rather than face the uncertainties of public markets and the cost of preparation for an IPO, in recent years venture-backed companies have instead too often chosen to be acquired. While an acquisition still drives economic returns for investors, they are far less likely to have a significant impact on job creation than a successful IPO. The average number of IPOs per year from 1990 to 1999 was nearly triple that of the most recent decade, from 2004 to 2013. Further, the median time to exit for a company when it goes public has increased from 2.9 years in 1999 to 7.4 years in 2013. While the JOBS Act has helped to begin the turnaround in the IPO market, it's clear that more must be done.

Recognizing this, NVCA has supported the work of the IPO Taskforce, which led to many of the recommendations in the JOBS Act, and the more recent work of the Equity Capital Formation Task Force. Both of these groups have offered suggestions to improve market conditions for small companies looking to enter the public markets, or that have recently done so. While the IPO Taskforce concentrated on creating a pathway for emerging growth companies to go public, the Equity Capital Formation Taskforce focused on the challenges faced by small-cap companies post-IPO. We firmly believe addressing both ends of this spectrum is critical to maintaining robust, healthy capital markets for all investors.

NVCA firmly believes that greater liquidity in the small-cap market will benefit investors and issuers alike. A more robust secondary trading market will also enhance the entrepreneurial ecosystem upon which much of the country's future growth depends. We therefore support the Commission's decision to order the development of this Pilot program. While we believe that wider tick-sizes for small-cap companies will result in greater liquidity, we recognize that this is a proposition that should be tested in the marketplace. We applaud the decision to create a Pilot rule change to perform this test. However, we are seriously concerned that critical elements of the proposed Pilot could fail to produce the data

necessary to thoroughly and accurately evaluate this worthy proposition. While well-intentioned, the Commission could unfortunately undermine its own objective simply by incorrectly structuring the Pilot.

NVCA's reasons for supporting a pilot program such as this one were set out fully in separate comment letters filed by me and by our then-Chairman Joshua Green to the SEC Investor Advisory Committee.<sup>1</sup> As Mr. Green's letter noted, an important goal of a pilot program should be "to realistically enable institutional investors to return to the small-cap market."<sup>2</sup> We are concerned that the duration and the structural complexity of the Pilot may work against this important goal.

### **Longer Duration**

For the Pilot to provide a fair opportunity to test the new market structure it must be of sufficient duration at the outset to justify the investments necessary to provide a true test of the new rules. Changes can be difficult in an uncertain environment and the default is often to defer investments and hope that others will lead the way. We fear that the proposed one-year duration will not be sufficient to realistically ensure that those we hope will add liquidity to the small-cap market will do so. Therefore, we recommend that the Pilot duration be set at three years or more.

Capital commitments, system changes and training are certainly going to be necessary for market makers and investors to participate meaningfully in the Pilot. These changes will require significant dollar investments on the part of participants, investments which can only be justified if they can generate a reasonable financial return. If the short duration of the Pilot makes such returns unlikely and thus becomes a disincentive for a significant number of these profit-seeking entities, the very data that the Pilot needs to gauge the effectiveness of the policy will never develop. Furthermore, this key opportunity to fully test this approach to enhancing liquidity in the small-cap market segment will have been squandered, potentially a worse outcome than no Pilot at all.

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<sup>1</sup>Letter to IAC Chairman Joseph Dear from Bobby Franklin, President and CEO, NVCA, dated January 29, 2014. *See also*, Letter to IAC Chairman Joseph Dear from Joshua Green, Partner, Mohr Davidow Ventures and Chairman, NVCA, dated January 24, 2014. Both letters are available at <http://www.sec.gov/comments/265-28/265-28.shtml>.

<sup>2</sup> *Id.* Green letter, page 1. [emphasis supplied].

Indeed, given the severity of illiquidity in the small-cap market, strong arguments can be made for a “change-and-monitor” approach rather than a pilot program. This in fact was the conclusion of the SEC Advisory Committee on Small and Emerging Companies. The Committee’s formal recommendation to the Commission stated:

“In order to allow sufficient time for the effects of such rule changes to be evaluated, they should not be adopted on a temporary or pilot basis, although the Commission should commit to reviewing the effects of the changes in the future and making such adjustments as needed.”<sup>3</sup>

While we do not advocate so profound a change to the Pilot, we believe that the concerns of the Advisory Committee support a significantly longer duration for the Pilot.

We know that the Commission could extend the Pilot period and we are aware that other SEC pilot programs have been extended in the past. However, given the commitment required by market participants in this case, piecemeal extensions would be an unrealistic solution should the one-year period prove too short. We do not see a rational basis to expect that organizations, which did not see sufficient benefit to make the necessary investment to participate in a one-year Pilot will do so for the second year of a Pilot that is extended at some point near the end of the first year.

In addition, even if all potential participants engaged in the one-year Pilot, it may not obtain appropriate data over such a short period. As a brief review of the last twenty years of equity market volatility readily shows, a single year can be an aberration consisting of exuberant rises or despondent declines, or both. A three-year duration offers a far better assurance that the Pilot will have an opportunity to operate in a variety of market conditions, producing far better data.

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<sup>3</sup> See U.S. Securities and Exchange Commission, Advisory Committee on Small and Emerging Companies, Recommendations Regarding Trading Spreads for Smaller Exchange-Listed Companies. (February 1, 2013). Available at <http://www.sec.gov/info/smallbus/acsec/acsec-recommendation-032113-spread-tick-size.pdf>. We are also aware that the recent SEC Small Business Capital Formation Forum will make a recommendation that the Commission make the Pilot’s duration three to five years and publish all the data from the Pilot.

It bears repeating in this context that much will be lost if at the end of an aberrant year, the Commission decides to extend the Pilot. If the short initial duration caused critical market participants to sit out the first year, they are likely to do the same for a second. Therefore, the idea that the Commission can adjust should the Pilot operate in an aberrant market is unrealistic and potentially wasteful.

The very nature of a pilot suggests a default to the *status quo* should the Pilot results be inconclusive. We know that influential voices have argued that the proposition embodied on the Pilot should be abandoned.<sup>4</sup> We applaud the Commission's sensible decision to test the proposition. However, given that the default is to the *status quo*, we believe prudence demands that the Commission err on the side of a full and fair test. It seems reasonable that if the Commission has made the decision to act on the Pilot, then the design of the program should provide every chance for success and robust evaluation. Therefore, we strongly encourage the Commission to make a prudent choice and extend the duration of the proposed Pilot to at least three years.

## **Structure**

We strongly encourage the Commission to prioritize simplicity and clarity in designing the parameters of the Pilot.<sup>5</sup> We hope the Commission will give due weight to the comments of those upon whom the potential success of the pilot depends. In particular, we think that the recommendations of small-cap experts, institutional investors and potential market makers should have significant weight in the Commission's review of its proposal.<sup>6</sup>

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<sup>4</sup> Recommendation of the Investor Advisory Committee Decimalization and Tick Sizes (January 1, 2014) Available at <http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-decimalization-recommendation.pdf>. *But see*, A Dissenting Opinion and Alternative Recommendation #1 regarding the Market Structure Subcommittee's Recommendation #1 Decimalization and Tick Size. (January 31, 2014) Available at <http://www.sec.gov/spotlight/investor-advisory-committee-2012/dissenting-opinion-decimalization-iac.pdf>.

<sup>5</sup> It appears to us that the inclusion of companies with up to five-billion market capitalization may be unnecessary and that the complexity of some criteria may make result more difficult to analyze.

<sup>6</sup> One group representing this perspective is the Equity Capital Formation (ECF) Task Force. *See generally*, ECF Task Force Report to the US Treasury, "From the On Ramp to the Freeway: Refueling Job Creation and Growth by Reconnecting Investors with Small Cap Companies." (November 2013).

Three aspects of the Pilot's structure are of particular concern to our members with a deep knowledge of secondary market trading. While we believe that others will offer more detailed comments on these points, we wish to add our voice regarding the scope of the Pilot.

#### Size of Test Group Companies

From a venture capital perspective, the liquidity crisis for small cap companies is most pronounced for companies with market capitalizations of under \$1 billion. We fear that the addition of companies with multi-billion dollar market capitalizations will change the focus of the Pilot from where it is most needed and can dilute the results of the test. Limiting the Pilot to companies with market capitalizations of less than \$1 billion would help ensure that the focus of the Pilot will remain on the set of companies facing the most dire liquidity constraints.

We appreciate that the proposed one-million-shares-per-day trading volume filter is intended to ensure the test securities are representative of those companies facing the liquidity crisis, and thereby accomplish our shared priority of focusing the Pilot on the companies that most need liquidity. However, we understand that stocks with lower trading volumes can still have higher share prices and comfortable amounts of liquidity. There are a number of examples of specific companies currently trading below 1 million shares per day with a share price over \$40 per share. As you know, this would generate daily trading volume of at least \$40 million dollars, a higher level of liquidity than those securities which we view as suffering the brunt of the liquidity crisis. We are therefore concerned that including these companies could water down the results and obfuscate the impact of the Pilot.

We appreciate the Commission's reasons for wanting to include a larger group of companies than those with less than one billion market capitalization. Therefore, we suggest using an alternative filter based upon daily dollar volume in place of the proposed share-based filter. We suggest as an opening position using a filter of less than \$10 million in daily dollar trading. A number of market participants who focus on small capitalization securities have expressed broad agreement that the concept of using a maximum daily dollar value

filter will more accurately focus the Pilot and ensure that it achieves its objectives.

### Complexity of Test Group Three

In addition, we note that Test Group Three seems to add an unnecessary level of complexity to the Pilot. We believe that the “trade-at” rule is unnecessary to accomplish the stated objectives of the Pilot while introducing significant complexity that could prove detrimental. Further, the various exceptions within the Pilot’s trade-at prohibitions only add to its complexity. Therefore, we believe that the Pilot will be more effective if Test Group Three is eliminated.

### Measuring Liquidity

As the participating exchanges make clear, the purpose of the Pilot is to study and assess “the impact of increment conventions on the liquidity and trading of stocks of small capitalization companies.”<sup>7</sup>

The Participants also note the importance of a full pre-Pilot data set in their decision to exclude companies that were initially listed less than six months prior to the beginning of the Pilot.<sup>8</sup> It seems that a full year of data prior to the beginning of the Pilot would provide a more valid baseline for measuring the impact of the Pilot on liquidity.

Since the problem that the Pilot hopes to address is a lack of liquidity, it is crucial that the Pilot’s metrics for measuring liquidity are sound and that the data generated are valid for that purpose. In order to measure success, we recommend that a measurable definition of liquidity be agreed to among stakeholders at the outset of the Pilot. We further recommend that the SEC measure and track this data through the duration of the Pilot.

Changes in this data over the course of the Pilot period will determine if the type of liquidity most needed in the small-cap market increases as a result of any of the test parameters.

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<sup>7</sup> Letter from Brendan J. Weiss on behalf of the Participants, RE: Plan to Implement a Tick Size Pilot Program (the “Plan”) <http://www.sec.gov/divisions/marketreg/tick-size-pilot-plan-transmittal-letter.pdf> . (August 25, 2014)

<sup>8</sup> *Id.* Page 3.

## **Conclusion**

We commend the Commission's efforts to increase liquidity opportunities for small businesses. The public markets remain a very difficult place to grow emerging companies due to liquidity issues facing small businesses. Accessing additional capital through a merger or acquisition or IPO is critical to the continued growth of the next generation of American success stories, including companies that can create entirely new industries, as we have seen for instance with the biotechnology or semi-conductor sectors.

A well-designed Pilot with a longer duration that will facilitate a fair evaluation has significant potential to positively impact job creation and global competitiveness in the American economy. We will continue to work to make participation in the public markets a more effective opportunity for venture-backed businesses to grow and succeed. We thank the Commission for taking the bold steps of proposing a Pilot that could create significant benefits for the entrepreneurial ecosystem and urge that the program be structured in the most effective manner possible to realize its significant potential.

Respectfully submitted,

A handwritten signature in cursive script that reads "Bobby Franklin".

Bobby Franklin  
President & CEO