Crisil
Coalition
Greenwich

Lessons We Can Learn from the Failure of the Tick Size Pilot Program

September 27, 2018

The SEC recently announced that the Tick Size Pilot Program will expire[1] on September 28th. After two years, various studies have estimated that the cost to investors of this experiment range from $350mm[2] to $900mm[3]. And these estimates do not include the implementation costs to the industry in terms of rewriting the computer code at exchanges, brokers, technology vendors, market data providers, and other market participants. These costs also likely ran into the hundreds of millions of dollars.

For many in the industry, the unceremonious demise of the tick size pilot did not come as a surprise. As I wrote in FT Alphaville in 2016: "The Tick Size Pilot Program… will likely end up as a costly failure[4]."

Nevertheless, it is important that the time, money and effort spent on this endeavor are not completely wasted. Let us look to this as a case study in bad decision-making and learn from it, so that similar mistakes are not made again in the future.

Problem #1 is that the rule was conceived in Congress, not the SEC. Originally inserted into the JOBS Act as an idea to test, it was initially rejected as a bad idea by the SEC in a thoughtful 27-page analysis[5] of the academic literature. Unsatisfied with this expert opinion, the House of Representatives passed the Duffy-Carney Bill in 2014, advancing the tick size pilot forward from an idea to near decree. This led then-Commissioner Michael Piwowar to say, "Even if we don't [launch the pilot program], Congress is going to mandate that we do it."

Problem #2 was that the idea didn't even pass the most basic of smell tests. The rationale was that wider tick sizes would increase the profit of market makers, which would, in turn, spur brokerage houses to produce more research on these companies, which would thereby attract more investor interest, which would lead to increased capital formation, which would create jobs. Like a magical chain reaction, one action is supposed to trigger a sequence of downstream events, until we get the desired outcome. Not even Hollywood movies have plots that tortuous. Industry practitioners recognized this, of course, but proceeded anyway, tweaking the new rules and hoping that some trading or liquidity benefits might accrue. This was **Problem #3**—there was not a clear objective of the pilot.

Problem #4 was that no cost benefit analysis of any kind was performed. For a regulation that was supposed to be business friendly, one might expect some basic "Business School 101" analysis would be included as part of the planning process. And while I recognize that (because of problem #1) the pilot program was effectively a mandate, a thorough analysis of the expected costs may have been enough to change the minds

of our elected representatives.

In addition, there are some other facts to consider. As with many SEC initiatives, the agency sought public comment. I analyzed the 63 comment letters[6] submitted to the SEC prior to the launch of the pilot and noted that only 11 were opposed. Most were either supportive or supportive with some specific modification.

Did our industry experts really get it so wrong? Or was supporting the pilot simply the safe thing to do (because of problem #1)? Or perhaps, the comment letter process is not a reliable way to assemble opinion on these important topics. For an industry with tens of thousands of brokers and asset managers and other organizations employing hundreds of thousands of people, 63 comment letters represent a tiny fraction of the market.

Indeed, as I read the comment letters for the proposed Transaction Fee Pilot[7] (a new proposed rule change almost as large in scope as the tick size pilot), I notice that there are over 30 from issuers using similar or identical language in opposition to the pilot. These issuers have likely been encouraged by a market participant to write these letters, in the hope that opinion can be swayed in the favor of this participant's position. This should again cause us to question the efficacy of the comment letter process in deciding important market structure issues.

The tick size pilot has indeed ended up as a costly failure. To avoid bad decision-making in the future, it is important that we learn from the mistakes that were made. The most important takeaway is that Congress should set the policy, and the SEC should make the rules.

Let the tick size pilot be the poster child for the separation of policy and rulemaking. In addition, when considering future market structure changes, we should ensure that the mission and objectives are well-defined, a thorough cost-benefit analysis is performed, and that industry opinion is solicited and evaluated in the most effective manner.

Source: https://tradepractices.files.wordpress.com/2012/01/gesture-despair-with-monitors.jpeg

[1]https://www.sec.gov/news/public-statement/tm-dera-expiration-tick-size-pilot

[2]https://www.pragmatrading.com/resource/tick-size-pilot/

[3]https://www.barrons.com/articles/sec-tick-size-pilot-program-1536961160

[4]https://ftalphaville.ft.com/2016/09/20/2175469/guest-post-small-cap-trading-revamp-is-no-more-than-a-costly-distraction/

[5]https://www.sec.gov/news/studies/2012/decimalization-072012.pdf

[6]https://www.sec.gov/comments/4-657/4-657.shtml

[7]https://www.sec.gov/comments/s7-05-18/s70518.htm

---

www.greenwich.com | ContactUs@greenwich.com

Coalition Greenwich, a division of CRISIL, an S&P Global Company, is a leading global provider of strategic benchmarking, analytics and insights to the financial services industry.

We specialize in providing unique, high-value and actionable information to help our clients improve their business performance.

Our suite of analytics and insights encompass all key performance metrics and drivers: market share, revenue performance, client relationship share and quality, operational excellence, return on equity, behavioral drivers, and industry evolution.

About CRISIL

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better. It is majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics, and data to the capital and commodity markets worldwide.

CRISIL is India’s foremost provider of ratings, data, research, analytics, and solutions with a strong record of growth, culture of innovation, and global footprint.

It has delivered independent opinions, actionable insights and efficient solutions to over 100,000 customers through businesses that operate from India, the U.S., the U.K., Argentina, Poland, China, Hong Kong, and Singapore.

For more information, visit www.crisil.com

Disclaimer and Copyright

This Document is prepared by Crisil Coalition Greenwich, which is a part of Crisil Ltd, a company of S&P Global. All rights reserved. This Document may contain analysis of commercial data relating to revenues, productivity and headcount of financial services organisations (together with any other commercial information set out in the Document). The Document may also include statements, estimates and projections with respect to the anticipated future performance of certain companies and as to the market for those companies’ products and services.

The Document does not constitute (or purport to constitute) an accurate or complete representation of past or future activities of the businesses or companies considered in it but rather is designed to only highlight the trends. This Document is not (and does not purport to be) a comprehensive Document on the financial state of any business or company. The Document represents the views of Crisil Coalition Greenwich as on the date

of the Document and Crisil Coalition Greenwich has no obligation to update or change it in the light of new or additional information or changed circumstances after submission of the Document.

This Document is not (and does not purport to be) a credit assessment or investment advice and should not form basis of any lending, investment or credit decision. This Document does not constitute nor form part of an offer or invitation to subscribe for, underwrite or purchase securities in any company. Nor should this Document, or any part of it, form the basis to be relied upon in any way in connection with any contract relating to any securities. The Document is not an investment analysis or research and is not subject to regulatory or legal obligations on the production of, or content of, investment analysis or research.

The data contained in the Document is based upon a particular bank's scope, which reflects a bank's data submission, business structure, and sales revenue Reporting methodology. As a result, any data contained in the Document may not be directly comparable to data presented to another bank. For franchise benchmarking, Crisil Coalition Greenwich has implemented equal ranking logic on aggregate results i.e., when sales revenues are within 5% of at least one competitor ahead, a tie is shown and designated by = (where actual ranks are shown). Entity level data has no equal ranking logic implemented and therefore, on occasion, the differences between rank bands can be very close mathematically.

The data in this Document may reflect the views reported to Crisil Coalition Greenwich by the research participants. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Crisil Coalition Greenwich compiles the data received, conducts statistical analysis and reviews for presentation purposes to produce the final results.

THE DOCUMENT IS COMPILED FROM SOURCES CRISIL COALITION GREENWICH BELIEVES TO BE RELIABLE. CRISIL COALITION GREENWICH DISCLAIMS ALL REPRESENTATIONS OR WARRANTIES, EXPRESSED OR IMPLIED, WITH RESPECT TO THIS DOCUMENT, INCLUDING AS TO THE VALIDITY, ACCURACY, REASONABLENESS OR COMPLETENESS OF THE INFORMATION, STATEMENTS, ASSESSMENTS, ESTIMATES AND PROJECTIONS, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE ARISING OUT OF THE USE OF ALL OR ANY OF THIS DOCUMENT. CRISIL COALITION GREENWICH ACCEPTS NO LIABILITY WHATSOEVER FOR ANY DIRECT, INDIRECT OR CONSEQUENTIAL LOSS OR DAMAGE OF ANY KIND ARISING OUT OF THE USE OF ALL OR ANY OF THIS DOCUMENT.

Crisil Coalition Greenwich is a part of Crisil Ltd., an S&P Global company. ©2025 Crisil Ltd. All rights reserved.