



FIA Principal Traders Group
2001 Pennsylvania Avenue NW
Suite 600 | Washington, DC 20006

T 202 466 5460
F 202 296 3184

ptg.fia.org

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Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: Notice of Filing of a Proposed Rule Change to Add a New Discretionary Limit Order Type
(File No. SR-IEX-2019-15)

Dear Ms. Countryman:

The FIA Principal Traders Group (“FIA PTG”)¹ appreciates the opportunity to provide comments to the Securities and Exchange Commission (the “Commission”) on the Investors’ Exchange, LLC (“IEX”) proposal to introduce a new “Discretionary Limit” order type (the “Proposal”).²

Under the Proposal, a quotation using the “Discretionary Limit” order type will be initially ranked in the order book at its limit price, similar to a standard limit order. However, the quotation will be automatically adjusted by IEX to a less aggressive price if IEX determines that the NBB is likely to decline (or the NBO is likely to increase, as relevant). IEX would make this determination based on its proprietary “crumbling quote indicator” (“CQI”) that uses real-time quoting data from

¹ FIA PTG is an association of firms, many of whom are broker-dealers, who trade their own capital on exchanges in futures, options and equities markets worldwide. FIA PTG members engage in manual, automated and hybrid methods of trading, and they are active in a wide variety of asset classes, including equities, fixed income, foreign exchange and commodities. FIA PTG member firms serve as a critical source of liquidity, allowing those who use the markets, including individual investors, to manage their risks and invest effectively. The presence of competitive professional traders contributing to price discovery and the provision of liquidity is a hallmark of well-functioning markets. FIA PTG advocates for open access to markets, transparency and data-driven policy and has previously made recommendations about a variety of equity market structure issues, including Regulation NMS (See <https://ptg.fia.org/keywords/equity-market-structure>).

² 84 FR 71997 (Dec. 30, 2019), available at: <https://www.govinfo.gov/content/pkg/FR-2019-12-30/pdf/2019-28024.pdf>.

third-party exchanges.³ In the event the limit price is adjusted by IEX, a new limit price would be set at one tick lower than the NBB (or higher than the NBO, as relevant).⁴

When evaluating whether this Proposal is consistent with the Securities Exchange Act of 1934 (“Exchange Act”), it is important to note:

- Displayed quotes will be eligible to use the “Discretionary Limit” order type, rendering this Proposal far different than other “discretionary” order types currently offered by IEX; and
- The combination of the “Discretionary Limit” order type and the existing speed bump on IEX raises many of the same concerns identified by a wide range of market participants with respect to the recent Cboe EDGA Exchange, Inc. (“EDGA”) proposal to introduce an asymmetric speed bump.⁵ This is because the two proposals are almost identical from the perspective of a liquidity taker:
 - EDGA Asymmetric Speed Bump: A *liquidity provider* has a small window of time to determine whether to reprice displayed quotes based on real-time market data, while incoming orders are delayed.
 - IEX Speed Bump and the “Discretionary Limit” Order Type: *IEX* has a small window of time to determine whether to reprice displayed quotes based on real-time market data, while incoming orders are delayed.

As highlighted above, the primary difference between the two proposals is that IEX will be managing the repricing of displayed quotes rather than individual liquidity providers. However, both proposals will lead to increased quote fading by liquidity providers and a less reliable displayed NBBO, negatively impacting institutional and retail investors, as well as overall market competition.

IEX has acknowledged that the Proposal is “novel.”⁶ As a result, it is critical that the Commission carefully evaluate its consistency with the Exchange Act. Below, we detail key concerns, including:

- The negative impact on institutional and retail investors;
- The inappropriate benefits for IEX liquidity providers; and
- The inappropriate benefits for IEX versus member firms.

³ Proposal at 71998.

⁴ Proposal at 72000.

⁵ See <https://www.sec.gov/comments/sr-cboeedga-2019-012/srcboeedga2019012.htm>.

⁶ Proposal at 72004.

In addition, we detail why displayed quotes using the “Discretionary Limit” order type should not be considered protected under Commission rules.

I. Institutional and Retail Investors Will Be Negatively Impacted

A wide range of commenters expressed concerns about the negative impacts on institutional and retail investors that result from an asymmetric speed bump,⁷ particularly in the case of larger orders that are sent to more than one venue for execution. The IEX Proposal creates the same concerns.

As a larger order is executed across multiple trading venues, IEX would be able to observe these executions using real-time data feeds. While incoming orders seeking to access displayed liquidity on IEX are delayed in the speed bump, IEX would be able to use this information regarding away executions to determine whether to reprice displayed quotes on IEX prior to the incoming orders exiting the delay. In the event IEX reprices a displayed quote, it will be repriced less aggressive than the NBBO. As a result, institutional and retail investors sending a portion of a larger order to IEX are likely to experience increased quote fading and declining fill rates due to the “Discretionary Limit” order type. The Proposal neglects to address this specific concern, including whether IEX would expect investors to route larger orders to IEX first in order to mitigate quote fading.⁸

The Proposal seeks to assuage institutional and retail investor concerns by making a number of unsupported assertions about improving overall market quality and liquidity.⁹ For example, IEX asserts that it is addressing a deficiency in current market structure, one which is visible when comparing markout data for executions when its CQI signal is on (i.e. the NBB is likely to decline, or the NBO is likely to increase, as relevant) versus when the CQI signal is off. However, similar to the markout data provided by EDGA in support of its asymmetric speed bump proposal, this data is self-evident, merely showing that liquidity providers will try to cancel their quotes more often when the market price is about to move than when it is stable, and in instances where they fail to do so, will be more likely to experience a short-term loss. Instead of demonstrating a deficiency in current market structure, the data shows the reality of being a liquidity provider: there are risks and rewards and not every execution will be immediately profitable.

With respect to overall market quality and liquidity, it is also important to note that the “Discretionary Limit” order type loses much of its value for a displayed quote on IEX that is alone at the NBBO. This is because a top-of-book quote can be expected to be routed to first, reducing the ability of IEX to observe executions on other venues before incoming orders exit the speed bump. Therefore, the Proposal should not be expected to narrow market-wide spreads; instead, we would expect IEX liquidity providers to often match prices posted by liquidity providers on other exchanges.

⁷ See <https://www.sec.gov/comments/sr-cboeedga-2019-012/srcboeedga2019012.htm>.

⁸ We note this was a solution proposed by certain supporters of the EDGA asymmetric speed bump in order to address similar quote fading concerns.

⁹ See, e.g., Proposal at 71999.

In light of the above, we conclude that the Proposal does not protect investors and the public interest, and does not improve overall market quality, inconsistent with Section 6(b)(5) of the Exchange Act.

II. The Proposal Inappropriately Favors IEX Liquidity Providers

A wide range of commenters expressed concerns about the negative impacts on market competition that result from an asymmetric speed bump.¹⁰ The IEX Proposal raises many of the same concerns. In particular, IEX liquidity providers are advantaged vis-à-vis:

1. Liquidity Providers on Other Exchanges.

The Proposal gives IEX liquidity providers using the “Discretionary Limit” order type a unique mechanism to avoid unfavorable executions, which should allow them to increase their profitability compared to liquidity providers on other exchanges.

In addition, the Proposal will enable IEX liquidity providers to free-ride on the price discovery occurring on other exchanges by posting quotes equal to the NBBO while knowing that IEX will be observing away executions and will reprice these displayed quotations if favorable to do so. Permitting such free-riding leads to many negative consequences, including discouraging innovation and investment.

Both competitive effects suggest that other exchanges will feel significant pressure to provide similar advantages to their own liquidity providers, which will further increase the magnitude of all the concerns detailed herein. For example, the Proposal neglects to consider the consequences for liquidity takers seeking to execute large orders if multiple exchanges adopt mechanisms that allow liquidity providers to fade in such a situation. In addition, market resiliency may be negatively impacted if market-wide systematic quote fading is allowed.

2. IEX Liquidity Takers.

Since the “Discretionary Limit” order type is specifically designed to advantage liquidity providers, and to allow them to avoid unfavorable executions, displayed quotations on IEX will be more difficult to access for liquidity takers when the market is moving in their favor. Under the Proposal, IEX has a small window of time to determine whether to reprice displayed quotes based on real-time market data, while incoming orders are delayed. This creates the economic equivalent of a “last look,” with IEX using the latest market data to determine, on behalf of the liquidity provider, whether to remain firm or reprice its displayed quote. During this process, we note that IEX will have full knowledge of the incoming orders that have been delayed by the speed bump, and could seek to leverage this information in future iterations of the “Discretionary Limit” order type.

¹⁰ See <https://www.sec.gov/comments/sr-cboeedga-2019-012/srcboeedga2019012.htm>.

In contrast, there are no specific protections for liquidity takers seeking to access displayed quotes on IEX when the market is moving against them.

In light of the above, we conclude that the Proposal impermissibly burdens market competition and unfairly advantages IEX liquidity providers, inconsistent with Sections 6(b)(5), 6(b)(8), and 11A of the Exchange Act.

III. The Proposal Inappropriately Advantages IEX Over Member Firms

The Proposal provides IEX with competitive advantages over its member firms in two key areas:

1. IEX Is Engaging in Traditional Broker-Dealer Activities While Relying On Exchange Limitations of Liability

Under the Proposal, IEX determines whether to reprice displayed quotes based on its proprietary “crumbling quote indicator” (“CQI”). The CQI uses real-time quoting data from third-party exchanges and a “proprietary mathematical calculation” to “assess the probability of an imminent change” to the NBB (or NBO, as relevant).¹¹ As such, IEX appears to be exercising a level of discretion around order pricing and execution that is typically performed by broker-dealers, rather than exchanges. While the Commission has previously concluded that IEX’s use of the CQI does not involve exercising actual discretion over the execution of an order,¹² we recommend that the Commission reconsider this analysis in light of actual experience with IEX’s use of the CQI and its proposed expansion to displayed quotes.

A critical difference between IEX’s “crumbling quote indicator” and other order types that offer discretion and/or pegging is that the CQI is not based on an objective fact (such as whether the NBBO changes). Instead, the CQI is attempting to predict when the NBBO might change before it actually does. As a result, the CQI is only as good as the algorithm written by IEX and *may be wrong*. Notably, IEX has already revised the CQI algorithm twice since its exchange launch “to enhance the accuracy of the CQI.”¹³

Therefore, although the CQI algorithm is “codified in IEX’s rulebook,”¹⁴ its predictive nature and potential for error makes it difficult to distinguish from typical broker-dealer order routing and execution algorithms (which are also codified). We urge the Commission to carefully consider the implications of permitting an exchange to exercise this level of discretion with respect to the pricing and execution of displayed quotes. These include the competitive implications vis-à-vis member firms given the materially different regulatory frameworks applicable to exchanges and broker-dealers – while the IEX algorithm will benefit from the regulatory immunity granted to

¹¹ Proposal at 71998.

¹² See IEX Approval Order at 41153.

¹³ Proposal at 71998, FN 19.

¹⁴ Proposal at 71998.

exchanges, broker-dealer algorithms are subject to a range of regulatory requirements, including best execution. In this regard, IEX should also provide data regarding the accuracy rate of the CQI, including (a) the percentage of NBBO changes that the CQI accurately predicted (as a volume-weighted average across symbols), (b) the number of times the CQI inaccurately predicted a change to the NBBO, and (c) how the accuracy rate has evolved with each update to the CQI algorithm.

2. IEX Is Bypassing Its Speed Bump to Reprice Displayed Quotes

Under the Proposal, IEX will be able to bypass its own speed bump when repricing displayed quotes that use the “Discretionary Limit” order type. This means that IEX will be able to reprice displayed quotes more quickly than any other market participant, disadvantaging liquidity providers not using the “Discretionary Limit” order type. In addition, IEX has a distinct advantage over liquidity takers seeking to access displayed quotes before they can be repriced by IEX.

In practice, IEX gains a material advantage by exempting its own activities from the speed bump that is otherwise universally applied. This is somewhat reminiscent of earlier attempts by IEX to advantage its affiliated broker-dealer by exempting outbound orders routed through it from the speed bump.¹⁵

We urge the Commission to carefully consider the implications of allowing IEX to bypass a market structure mechanism that it applies to all other market participants, particularly in a situation where IEX can be considered to be competing with other market participants to access displayed quotes. The fact that displayed quotes will be eligible to use the “Discretionary Limit” order type makes this Proposal far different than other “discretionary” order types currently offered by IEX.¹⁶

In light of the above, we conclude that the Proposal impermissibly burdens market competition for the benefit of IEX, inconsistent with Sections 6(b)(8) and 11A of the Exchange Act.

IV. Displayed Quotes Using the “Discretionary Limit” Order Type Should Not Be Protected

Although the Commission has found that IEX’s speed bump constitutes a *de minimis* delay for purposes of Rule 611,¹⁷ this does not mean that IEX has *carte blanche* to introduce new order types for displayed quotes without undergoing a separate review to assess whether the new order

¹⁵ See 81 FR 41142 (June 23, 2016) at 41157, available at: <https://www.govinfo.gov/content/pkg/FR-2016-06-23/pdf/2016-14875.pdf> (the “IEX Approval Order”).

¹⁶ The Commission made this specific distinction when approving IEX as an exchange, stating “investors routing to displayed liquidity on IEX will not ‘compete’ against IEX in the sense of racing to access a resting order before IEX can reprice it—because IEX will not reprice displayed orders, there is no such race.” IEX Approval Order at 41156, FN 215.

¹⁷ IEX Approval Order at 41162.

type, combined with the existing speed bump, impairs fair and efficient access to IEX's displayed quotations.¹⁸

When considered specifically in combination with the "Discretionary Limit" order type, the IEX speed bump impairs fair and efficient access to IEX displayed quotes in violation of Rule 611. This is because the "Discretionary Limit" order type fundamentally changes the operation of the IEX speed bump, causing it to resemble an asymmetric speed bump from the perspective of a liquidity taker. While incoming orders are delayed, IEX can now bypass the speed bump to reprice displayed quotes from liquidity providers more quickly than they can be accessed. This alters the Commission's prior analysis of the IEX speed bump under Rule 611, as it specifically noted in its Automated Quotations Interpretive Guidance that "[g]enerally, the Commission would be concerned about access delays that were imposed only on certain market participants."¹⁹

IEX specifically acknowledges that "D-Limit orders **may not be accessible** to other market participants" when the CQI signal is on (emphasis added).²⁰ Unlike discretionary and/or pegged order types offered by other exchanges, the "Discretionary Limit" order type is specifically designed to prevent execution when the CQI signal is on by repricing the order to be less aggressive than the NBBO. An analysis of existing IEX order types using the CQI signal for non-displayed orders shows that almost no volume is executed when the CQI signal is on, meaning the associated quotes are almost completely inaccessible in practice.²¹

IEX seeks to mitigate these quote accessibility concerns by arguing that the CQI signal is only on for a small percentage of the trading day. However, IEX data shows that 33.7% of marketable orders are received, and 24% of displayed volume is executed, when the CQI signal is on, meaning that a material percentage of overall trading activity will be impacted, and unable to access displayed quotes that use the "Discretionary Limit" order type.²²

As a result, it is clear that the combination of the "Discretionary Limit" order type and the IEX speed bump will impair fair and efficient access to IEX displayed quotes, meaning that the intentional access delay can no longer be considered *de minimis* under the Commission's

¹⁸ The Commission made exactly this point when approving IEX as an exchange, stating "The Commission notes that IEX will only reprice pegged orders, which are non-displayed. Non-displayed orders are not reflected in an exchange's quotations, and Rule 611 applies order protection to publicly displayed quotes only. Accordingly, an access delay that does not allow the repricing of displayed orders does not impact an exchange's displayed quotation, and cannot be said to lead to "maybe" quotations." IEX Approval Order at 41156, FN 216.

¹⁹ 81 Fed. Reg. 40785 (June 23, 2016) at 40792, FN 75, available at: <https://www.gpo.gov/fdsys/pkg/FR-2016-06-23/pdf/2016-14876.pdf>.

²⁰ Proposal at 72003.

²¹ For orders using the D-Peg and P-Peg order types, only .17% of volume occurs when the CQI signal is on. See "Leveling the Playing Field for Lit Trading" (Dec. 17, 2019), available at: <https://medium.com/boxes-and-lines/leveling-the-playing-field-for-lit-trading-682dc723cef1>.

²² Proposal at 71999, 72001.

Automated Quotations Interpretive Guidance in the context of this specific order type.²³ Therefore, displayed quotes using the “Discretionary Limit” order type will not qualify as “automated quotations” for purposes of Rule 611.

Market participants rely on the displayed NBBO to provide a reliable, transparent, and objective standard against which investors can measure execution quality and hold their broker-dealers accountable. Permitting an order type that allows systematic quote fading undermines these benefits and raises fundamental concerns around market transparency, competition, and fairness. We urge the Commission to disapprove this Proposal.

If you have any questions about these comments, or if we can provide further information, please contact Joanna Mallers (jmallers@fia.org).

Respectfully,

FIA Principal Traders Group



Joanna Mallers
Secretary

cc: Walter J. Clayton, Chairman
Robert J. Jackson, Jr., Commissioner
Hester M. Peirce, Commissioner
Elad L. Roisman, Commissioner
Allison H. Lee, Commissioner
Brett W. Redfearn, Director of the Division of Trading and Markets

²³ We note that Staff may consider updating its associated guidance on automated quotations to reflect subsequent market experience with intentional access delay proposals, including additional considerations that may be relevant in assessing whether an intentional access delay impairs fair and efficient access to displayed quotations, such as (a) whether the delay is symmetric or asymmetric, and (b) whether the delay is coupled with a new order type that can also impact access to displayed quotes. (Staff Guidance on Automated Quotations under Regulation NMS (June 17, 2016), available at: <https://www.sec.gov/divisions/marketreg/automated-quotations-under-regulation-nms.htm>)