AJO 230 SOUTH BROAD STREET, 20TH FLOOR | PHILADELPHIA, PA 19102-4102 | 215.546.7500/7506 FAX | AJOPARTNERS.COM

September 16, 2019

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: CBOE EDGX EXCHANGE, INC. PROPOSAL TO INTRODUCE RETAIL PRIORITY (FILE NUMBER: SR-CBOEEDGX-2019-012)

Dear Ms. Countryman:

AJO, L.P. ("AJO") appreciates the opportunity to submit this comment letter in opposition to the proposed rule change (and its amended version) by Cboe EDGX Exchange ("Cboe") to introduce order book priority for equity orders submitted on behalf of retail investors.

AJO is an independent investment adviser registered under the Investment Advisers Act of 1940. Established in 1984, AJO maintains offices in Philadelphia, Pennsylvania and Boston, Massachusetts. As of August 31, 2019, the firm managed $19 billion in value-oriented domestic and non-U.S. equity mandates. AJO offers its services to pension funds, endowments, foundations, multi-employer plans, and pooled investment clients. We view each client relationship as a partnership and pride ourselves on providing peerless client service. In this role, we take seriously our responsibility to advocate for our clients as we help them navigate today's equity marketplace and achieve their long-term investment goals.

On April 25, 2019, we submitted a comment letter in opposition to Cboe's original proposal to introduce retail priority. We expressed concern with the discriminatory nature of the proposed order type as well as the order type's inherent information leakage. Cboe amended the initial proposal in response to our comment letter and the others that were submitted. In the amended version, Cboe removed the requirement that <u>all</u> retail orders be attributed as such in the data feeds; however, in order to receive priority treatment ("jump the queue") orders must still be attributed. We view any attribution in the data feeds as information leakage, whether voluntary or required. Regarding customer discrimination, we consider any order type that permits unfair discrimination between customers to be inconsistent with the Exchange Act. We struggle to understand how Cboe's retail priority is *not* discriminatory provided that it would explicitly prioritize orders from certain customers.

As Cboe has not sufficiently addressed our concerns, we again urge the Commission to reject this proposal.

Customer Discrimination and Ordinary Investors

In their amended proposal, Cboe writes that "the proposed rule change is consistent with the requirements of Section 6(b) of the Act" and that the rule change is designed "to protect investors and the public interest and not to permit unfair discrimination between customers, issuers, brokers, or dealers."[1] We disagree with Cboe's assertion and argue quite the opposite. Retail priority, by definition, blatantly discriminates between customers. Certain retail customers (those that opt in for retail priority treatment) are prioritized to the detriment of other customer types. In an attempt to justify this discrimination, Cboe cites the "long-term interest of Main Street Investors" as the Commission's top priority for the next four years.[2] We agree with, and support, the notion of protecting the interest of Main Street Investors — in fact, this notion is the very reason we are submitting this comment letter — but, when did "Main Street Investor" become synonymous with "retail trader"? We agree that retail traders should be included under the "Main Street" umbrella; however, our collective definition of Main Street, or ordinary, investor cannot be limited to retail. In our previous comment letter we mentioned that pension funds and retirement plans make up a significant portion of the assets we manage. More specifically, public pension, corporate/ERISA pension, and other retirement plans account for a combined 85%, or roughly $16 billion, of the $19 billion we manage on behalf of our clients. We ask the Commission and Cboe alike: do you consider the individual participants that make up these plans "ordinary investors"? If so, then Cboe's retail priority must be considered discriminatory, as it would <u>not</u> apply to these ordinary investors. Even worse, approval of retail priority would serve to harm this very large segment of the ordinary investor population in the form of information leakage and longer lines to trade on the exchange.

Information Leakage

We were pleased to see that Cboe removed the requirement that all retail orders be attributed as such in the EDGX data feed. In our previous comment letter, we argued that any attribution would effectively leak critical information. Cboe seems to concede this point in their proposal, suggesting that "designating Retail Priority Orders on the EDGX Book Feed will *increase transparency by informing market participants* [emphasis added] when there is priority eligible retail investor interest available to trade on the exchange."[3] We might replace the *italicized* portion of the prior sentence with "leak information", but we otherwise agree with Cboe's statement. We also argued that professional traders — those that consume the data feeds — would be able to identify institutional orders by process of elimination. Essentially, any non-flickering quote <u>not</u>

---

[1] <u>See</u> Securities and Exchange Release No. 34-86280; File No. SR-CboeEDGX-2019-012, 19.
[2] Ibid, 17.
[3] Ibid, 15.

attributed in the EDGX Book Feed as "retail" is highly likely to represent an institutional order.

In reading Cboe's amended proposal, it is clear to us that the removal of the attribution requirement is irrelevant. It is Cboe's belief, as stated in the amendment, that RMO's are "comfortable attributing their orders."[4] We have no reason to believe otherwise. After all, Cboe knows better than any of us whether or not the exchange's retail broker clients will (or currently do) attribute their orders in the data feeds. So long as retail order attribution exists, required or optional, the protection of the identity of institutional investors (including those that trade on behalf of ordinary investors) is dependent on whether other market participants (in this case RMO's) choose to attribute their orders. In other words, the leakage of our orders depends on the actions of other market participants — we are at their mercy. When Cboe, or any exchange, offers incentives to certain market participants to attribute their orders in the data feeds, we fear that these market participants will accept these incentives and, as a result, the protection of our identity will be compromised.

LONG LINES

Maker-taker exchanges, or venues that offer a rebate to liquidity-providing orders (makers) and charge a fee for liquidity-taking orders (takers), have historically exhibited longer queues, or lines to trade. These longer lines are a direct result of the incentives (rebates) these venues provide to market participants hoping to capture the spread. IEX conducted a study that analyzed the effects of queue lines on execution costs. The results "demonstrate[d] a drastic difference in performance between trading at the front of the line versus the back."[5] Because of price-time priority rules prevalent on many equity exchanges, including Cboe's EDGX, it is critical that traders establish their position in the queue as early as possible. To compete for queue position, IEX suggests, "requires the ability to receive and respond to information as quickly as possible, which a market participant may attain by paying for direct feeds, co-locating their servers within an exchange's data center, or investing in more sophisticated technology."[6] The exchange operator goes on to suggest that high-frequency traders and market makers are the market participants gaining "an informational edge" through the acquisition of these sophisticated tools. "Lacking the speed advantages to respond immediately to NBBO changes, slower market participants (i.e. investors), have to wait at the back of long lines." [7] We agree with IEX and, apparently, so does Cboe. Cboe contends that "ordinary investors may not be able to compete with market

---

[4] See Securities and Exchange Release No. 34-86280; File No. SR-CboeEDGX-2019-012, 16.

[5] Stan Feldman and Elaine Wah, *Gone in Sixty Seconds: The Cost of Trading in Long Queues* (IEX: 2018), 4. https://iextrading.com/docs/Gone%20in%20Sixty%20Seconds%20-%20The%20Cost%20of%20Trading%20in%20Long%20Queues.pdf

[6] Feldman and Wah, *Gone in Sixty Seconds*, 2.

[7] Ibid.

makers and other automated liquidity providers to be the first to set a new price. Importantly, retail investors, in contrast to their professional counterparts, tend to have longer investment time horizons and are not in the business of optimizing queue placement under a time based allocation model."[8] We agree with *most* of Cboe's contention. Where do we disagree? We would lump *all* (retail and institutional) investors into the latter category of market participants with longer investment horizons and who are not in the business of optimizing queue priority. To be clear, queue optimization is the business of professional traders (high-frequency traders and market makers) — not institutional investors. Absent Cboe's proposed retail priority, all *non*-professional traders (e.g. investors) are forced to take a backseat when it comes to queue priority. Unfortunately, this is a result of the current US equity market structure we are all forced to navigate. Approving Cboe's retail priority would introduce an additional layer to an already uneven playing field. A small minority of ordinary investors (certain retail traders) would be allowed to jump to the front of the line, professional traders would follow, and all other investors (ordinary or otherwise) would be left at the back of the line. As long as prioritized retail flow exists on the order book, (non-retail) ordinary investor interest will never get the opportunity to trade.

Additional Comments

As we did in our original comment letter, we urge the Commission to reject this proposal. If approved, retail priority will harm a significant portion of the ordinary investor community. We, again, suggest that the Commission conduct a comprehensive review of existing order types on each exchange in an effort to identify those that might already be prioritizing the interests of certain market participants and harming others in the process.

On behalf of our clients, we are proud to submit this comment letter.

Sincerely,

Sean Paylor
Trader
[redacted]

[8] See Securities and Exchange Release No. 34-86280; File No. SR-CboeEDGX-2019-012, 17-18.