September 14, 2023

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington DC

Re: File No. SR-NASDAQ-2022-079, Release 34-98321; File No. SR-FINRA-2022-032, Release 34-98212; File No. S7-02-22, Release 34-94062;

Dear Ms. Countryman:

Attached is an article I'm submitting as a comment for the three above referenced matters. My scanner is a little fuzzy so I also attached a plain text transcript.

Thank you.

Sincerely,

Edgar T. Snodgrass

Exchange News Gazette

13 SEP 2023

SEC Announces Rule 3b-16 Dead at 25

By GAZETTE STAFF

WASHINGTON - Late last week the Securities and Exchange Commission announced the death of Rule 3b-16 after a brief inconvenience. It was 25.

Crafted in an earlier age of regulatory reform under SEC Chairman Arthur Levitt, Rule 3b-16 was heralded by investors at the time for codifying a long-held principle that stock exchanges stick to "established, non-discretionary methods," clear and unambiguous exchange practices which specify precisely how exchanges treat investor orders.

"Really, that just got in the way," said Milton Snifflepot, Associate Director at the SEC. He added, "Sure, it sounded cool. Like, 'legal' and stuff. Except it had to go."

Rule 3b-16 was born in 1998 as part of a suite of changes the SEC implemented in the late 1990s to reengineer how stocks trade. Several of these reforms equipped investors to keep close watch over how Wall Street handled their orders, and away from what reformers said were opaque and clubby networks of Wall Street insiders.

"I guess it meant something back then," Snifflepot admitted, "but I was in middle school."

The SEC adopted Rule 3b-16, it wrote in 1998, to draw a line between stock brokers and stock exchanges. Stock brokers could handle investor orders using their own judgment. On the other hand, stock exchanges had to handle orders with established, non-discretionary methods. This would "encourage market innovation while ensuring basic investor protections." It said the rule reflected "a more comprehensive and meaningful interpretation of what an exchange is in light of today's markets."

In perhaps the SEC's most detailed examination of Rule 3b-16 since 1998, the SEC reviewed a new stock exchange application from a small startup called IEX in 2016. At the time some Wall Street firms objected to a feature IEX proposed to protect investors from high frequency traders, complaining the feature was not an established, non-discretionary method.

The SEC carefully tested IEX against Rule 3b-16. Since IEX defined the "totality" of the feature, the SEC said, the feature did not violate the rule. IEX had noted the "specific conditions" under which the feature operated and gave investors certainty. The SEC said investors would know exactly what it did and why, and so IEX could become a registered stock exchange with the feature in place. As the most practical exercise of Rule 3b-16 in recent memory, the SEC's decision seemed to further clarify what established, non-discretionary methods meant and how exchanges should conform.

But the SEC apparently thought better of Rule 3b-16 when the agency approved a new proposal this month from a much larger and more dominant exchange than IEX. Its proposal was for a kind of order that would, for the first time at an exchange, use a particular kind of artificial intelligence technology.

This technology, however, is well-known to be unpredictable and even indecipherable. Shortly before joining the SEC in 2021, SEC Chairman Gary Gensler co-authored a paper about AI. He wrote that a developer using this type of AI "does not know what they are going to get" and that the technology could construct "a different set of parameters, thus a different algorithm, each time" the technology reconfigured itself. He wrote "decisions and outcomes are often unexplainable" and that market transparency, which is the ability of investors to see and understand what happens in the markets, "is likely to decrease." He also warned that sophisticated groups of high frequency traders might figure out how to game the technology.

Seizing on this, opponents of the proposal argued the technology conflicted with Rule 3b-16 and how the SEC had regulated exchanges for the past quarter century, including in its appraisal of IEX. It was impossible for exchanges to completely describe how the AI feature would behave, opponents said, and the technology's unpredictability made it impossible for investors to know what the exchange would do with their orders and why. They also complained that, if allowed, it would be the first time the SEC had ever approved a stock exchange feature that reversed market transparency and certainty.

"Well, tomato/tomahto," Snifflepot said. "An exchange can do whatever we let it do, right?" Another SEC official, speaking without attribution because they were not authorized to talk about it, said "Everybody wants to brag they did the world's first artificial intelligence order type on their LinkedIn. We had to ditch 3b-16 to do it."

Rule 3b-16 is survived by a replacement SEC directive that permits exchanges "an unavoidable degree of uncertainty with respect to the use of these order types." Commenting on the new standard, Snifflepot said "Wrap a computer around it and we'll approve it." Was he worried high frequency traders could game AI? "Shut up," he explained.

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*For the avoidance of doubt, this includes obvious burlesques.