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September 17, 2019

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

Re: Release No. 34-86626; File No. SR-IEX-2019-07

Dear Ms. Countryman:

Investors Exchange LLC ("IEX") is writing to respond to written comments by the Nasdaq Stock Market LLC ("Nasdaq")[1] directed to IEX's proposal to charge certain fees for logical entry port connections in excess of five connections per member.[2] In brief, the Port Fee Proposal proposes to charge a fee of $100 per month per logical "port" that is used by members to access IEX's systems, subject to an exclusion for the first five ports, *i.e.*, the first five ports are free for each member.

In its letter, Nasdaq states that it has no objection to the fee itself, but it uses the letter to make certain assertions about the state of competition for proprietary market data and connectivity products and characterizes IEX's approach in providing detailed justification for the proposed fee as "ratemaking." We write to rebut Nasdaq's statements about competition for these products, which is a topic of significant public interest, and to correct its mischaracterization of IEX's purpose in providing heightened transparency in support of the Port Fee Proposal.

Exchange Fees Should Not Avoid Scrutiny Based on Theoretical Arguments About Competition

In its filing with the Securities and Exchange Commission (the "Commission"), IEX explicitly declined to try to support its Port Fee Proposal based on the premise that exchanges compete in selling their own market data and connectivity products, because we believe this is a false premise that exchanges have used for years as a fig leaf to avoid further scrutiny or need for justification of their fee increases. Instead, IEX provided detailed analysis and data concerning its own cost to offer logical ports, the amount of revenue that will be generated, and how different types of member firms are likely to be impacted, as well as an explanation, supported by data, of

[1] Letter from Tal Cohen, Executive Vice President, Nasdaq, to Vanessa Countryman, Secretary, SEC, dated September 5, 2019 ("Nasdaq Letter").
[2] Securities Exchange Act Release No. 86626 (August 9, 2019), 84 FR 41793 (August 15, 2019) ("Port Fee Proposal").

how the fee was structured so as not to create a barrier to trading on IEX or impose a material new cost of trading for any group of members.

Nasdaq objects especially to our statement that exchanges have a natural monopoly over their own market data and access to their own markets, and it repeats other recent statements it has made likening exchange fees to those imposed by health clubs (which may control and charge for lockers and parking but do not control access to health club facilities in general). Nasdaq also recycles its latest theory as to why its market data fees are constrained by competition – that exchanges compete based on a hypothetical "all-in cost to trade", *i.e.,* an average price per share after considering all exchange fees charged (or rebated) to all participants.

The statement that exchanges have a monopoly over direct access to their own markets and their own market data is a simple statement of fact. No firm can connect to Nasdaq's exchange systems or receive its market data directly except on terms set by Nasdaq. Firms can connect or receive data indirectly, but the fees Nasdaq imposes on direct subscribers affect other users indirectly, and that option is impractical for trading firms and many agency brokers who need direct access and the fastest and most complete data to be competitive with their peers.

Theoretical arguments aside, in order to demonstrate that market competition constrains market data fees, Nasdaq would need to be able to show in practice that cheaper market data leads to increased order flow, or that raising data fees reduces order flow, or that one exchange's market data can readily substitute for that of another exchange. But it was precisely the failure to provide credible evidence to support any of those hypotheses which led a federal court in the *Netcoalition* decision to find that Nasdaq and NYSE Arca's assertions about competition were unsupported.[3] Nine years later, the world is still waiting for proof. Nasdaq's latest arguments are just dressed-up versions of the old, discredited arguments.

The reasons the theory, whatever label is given, doesn't work are many of the same reasons why exchanges are nothing like health clubs. Exchanges are highly-regulated companies holding exclusive federal licenses. Those licenses come with both obligations and privileges, including public dissemination of quotes, limitations on the ability of participants to bypass those quotes, and regulatory best execution obligations that require agency brokers to be able to quickly access the best prices available on all exchanges. As a result of these factors and the importance of speed to contemporary traders, the participants that account for the bulk of equity trading in the market need direct physical access and proprietary market data from all the large exchange groups, regardless of how those participants allocate their order flow among individual exchanges over time, in response to transient changes in transaction costs and other factors. This means that exchanges have extraordinary leverage in setting subscription fees for their own data and connectivity products, but not in setting their transaction fees. These obvious distinctions make comparisons to health club facilities inapposite, if not a bit absurd.

[3] *NetCoalition v. SEC,* 615 F.3d 526, 537-540 (D.C. Cir. 2010) ("NetCoalition Decision").

In filing its Port Fee Proposal, IEX refused to follow the pattern of other exchange fee filings in making unsupported assertions about competition and its effect on market data fees. More generally, IEX believes that no exchange should be able to avoid providing hard data and analysis to support its market data fees in favor of reciting theoretical arguments that are not rooted in the realities of U.S. equity market structure and the exchange business.

Exchanges Should be Expected to Justify Their Market Data Fees Based on Disclosure of All Relevant Factors, Including Cost

IEX included data and analysis concerning its costs to provide logical connectivity ports as one factor supporting its Port Fee Proposal. We provided our estimate of the annual cost to produce order entry ports of approximately $1.5 million and described in detail the specific cost items that were included in that estimate and how it was determined. We also contrasted that figure with the total amount of fee revenue expected to result from the Port Fee Proposal.[4] Nasdaq objects to the inclusion of this cost information as an "ultimately misleading foray into public utility-style ratemaking."[5]

Nasdaq fundamentally misunderstands the point of the discussion of IEX's costs in its rule filing. The point is not to tie the amount of fees that IEX *could* permissibly charge for order entry ports to a specific estimate of related costs. We included our cost estimates because we believe these direct costs are one relevant factor in showing what we *actually* proposed to charge is fair and reasonable and meets the other standards for approval of exchange rules under the law. Our filing contains extensive disclosure of factors other than cost, including data and analysis about the total amount of fee revenue IEX expects to receive, the percentage of reserved ports that are unused, the number of members who will pay no fee (103), and how much other members, segmented in groups by their port fee usage and other factors, may be expected to pay. IEX also provided extensive analysis of the objectives it sought to achieve, including a more efficient system for allocating available ports, ensuring the fee will not hinder participation on IEX and will not have a material impact on any firm, and partial recovery of our costs.

But Nasdaq appears to object to *any* consideration of cost, based on the premise that all of an exchange's operational costs are inextricably linked to all the others, and that therefore any allocation of costs to particular aspects of its business is arbitrary. We believe that position flies in the face of common business practice and, no less, common sense. It also contradicts the statements of the D.C. Circuit Court of Appeals, which in its 2010 decision explicitly rejected the idea that a market-based approach to review of data fees makes cost considerations irrelevant: "On the contrary, in a competitive market, the price of a product is supposed to approach its marginal cost, *i.e.*, the seller's cost of producing one additional unit….Thus, the costs of

[4] Port Fee Proposal, 84 FR at 41795. *See* "The Cost of Exchange Services – Disclosing the Cost of Offering Market Data and Connectivity as a National Securities Exchange" (January 2019), avail. at https://iextrading.com/docs/The%20Cost%20of%20Exchange%20Services.pdf ("Cost Study").
[5] Nasdaq Letter, at 2.

collecting and distributing market data can indicate whether an exchange is taking "excessive profits" or subsidizing its service with another source of revenue."[6]

We believe we sufficiently documented the methodology in our Cost Study to demonstrate that it is entirely feasible to identify the cost elements that are directly relevant to providing physical and logical connectivity and to producing and providing market data. Nasdaq or other exchanges, when they propose to charge new or increased fees, are free to argue that other, less direct costs should also be considered, if they identify those other costs and explain their relevance. But there is no reason exchanges should be entitled to skirt the question of cost altogether.

Nasdaq goes so far as to suggest that the Commission believes "for-profit" is a "dirty word."[7] It seems clear to us that Nasdaq's real objection and source of frustration is with the Commission's insistence on full transparency by exchanges seeking to increase their market data and connectivity fees. The question is not whether exchanges should be able to make a profit, but whether in doing so they are held to the legal standards that apply to them as exchanges. In its own filing, IEX has made a sincere effort to meet those standards, and we believe that the Commission has both the right and obligation to insist that all other exchanges do likewise.

Sincerely,

John Ramsay
Chief Market Policy Officer

cc: The Hon. Jay Clayton, Chairman
The Hon. Robert J. Jackson, Jr., Commissioner
The Hon. Hester M. Peirce, Commissioner
The Hon. Elad L. Roisman, Commissioner
The Hon. Allison Herren Lee, Commissioner

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[6] NetCoalition Decision, 615 F.3d at 537.

[7] Nasdaq Letter, at 4.