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VIA ELECTRONIC MAIL

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

Re: Investors Exchange LLC Notice of Filing of Proposed Rule Change to Add a New Discretionary Limit Order Type (Release No. 34-87814; File No. SR-IEX-2019-15)

Dear Ms. Countryman:

Nasdaq, Inc. ("Nasdaq") writes to comment on the proposal that the Investors Exchange LLC ("IEX") has filed with the Securities and Exchange Commission ("SEC" or "Commission") to amend its rules to add a new discretionary order type, which it dubs the "Discretionary Limit" or "D-Limit."[1] Respectfully, Nasdaq requests that the Commission disapprove IEX's Proposal to adopt this new order type, as it raises serious market structure and investor confidence concerns that far outweigh its prospective benefits, which are limited largely to furthering IEX's commercial interests.

In particular, Nasdaq objects to the Proposal because: (1) D-Limit will promote phantom liquidity; (2) IEX fails to provide sufficient data for the Commission to fully assess the extent of this problem and its impacts, and thereby, to determine whether the Proposal is consistent with the Securities Exchange Act of 1934 (the "Act")[2]; (3) IEX fails to demonstrate that its Proposal is not unfairly discriminatory; (4) the Proposal is not analogous to order types on other exchanges; (5) D-Limit is not a firm and automated quotation that is subject to protection under Regulation NMS; and (6) concerns associated with D-Limit are similar to those that prompted the Commission to institute proceedings as to whether to disapprove the EDGA asymmetrical speed bump.

Additionally, as brokers evaluate this Proposal and the potential utility of D-Limit, Nasdaq believes that it is important to highlight the risks that D-Limit presents—including the risks of inaccessible liquidity, a hypo- or hyperactive crumbling quote indicator, and lost execution opportunities. These risks could be particularly acute for illiquid symbols or during times of market stress. As such, serious questions exist about whether D-Limit orders would be consistent with best execution obligations under those conditions, both for liquidity providers and liquidity takers.

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1 See Securities Exchange Act Release No. 34-87814 (December 20, 2019), 84 FR 71997 (December 30, 2019) (SR-IEX-2019-15) (the "Proposal").

2 15 U.S.C. 78a, et seq.

Background

IEX describes D-Limit as an order type that it designed to "protect liquidity providers from potential adverse selection by latency arbitrage trading strategies."[3] Specifically, IEX states that D-Limit will operate as follows:

> As proposed, if upon entry of a D-Limit buy (sell) order the CQI is on and the order has a limit price equal to or higher (lower) than the quote instability determination price level (i.e., the CQI Price), the price of the order will be automatically adjusted by the System to one (1) MPV lower (higher) than the CQI price. Similarly, when unexecuted shares of a D-Limit buy (sell) order are posted to the Order Book, if a quote instability determination is made and such shares are ranked and displayed (in the case of a displayed order) by the System at a price equal to or higher (lower) than the CQI Price, the price of the order will be automatically adjusted by the System to one (1) MPV lower (higher) than the CQI Price. A D-Limit order that is subject to an automatic adjustment will not revert to the price at which it was previously ranked and displayed (in the case of a displayed order). Once the price of a D-Limit order that has been posted to the Order Book is automatically adjusted by the System, the order will continue to be ranked and displayed (in the case of a displayed order) at the adjusted price, unless subject to another automatic adjustment, or if the order is subject to the price sliding provisions of IEX Rule 11.190(h). When the price of a D-Limit order is adjusted the order will receive a new time priority.[4]

IEX asserts that its Proposal is consistent with the Act because it will protect liquidity providers from executing at prices that proprietary trading firms and other latency arbitrageurs know to be imminently stale. IEX also asserts that the Proposal will incentivize the entry of additional resting orders, including displayed orders on IEX, thereby enhancing price discovery and exchange liquidity.[5] Finally, IEX argues that its Proposal is not unfairly discriminatory because it is narrowly-tailored, transparent, predictable, and available to all members on equal terms.[6] As explained below, Nasdaq believes that such arguments are either incorrect or lack support.

IEX will Worsen Market Quality by Creating Phantom Liquidity

IEX touts D-Limit as having the potential to improve market quality by increasing incentives for participants to submit displayed limit orders to IEX. Although an increase in displayed limit orders ordinarily would be expected to contribute to price discovery and improve market quality, this result would not occur with the addition of D-Limit liquidity. As IEX itself

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3 See Proposal, supra, 84 FR 71997.

4 See id. at 72000. The term "CQI" refers to IEX's "Crumbling Quote Indicator," which is an IEX formula, codified in IEX Rule 11.190(g), designed to predict whether a particular quote is unstable or ''crumbling,'' meaning that the NBB is likely about to decline or the NBO is likely about to increase.

5 See Proposal, supra, 84 FR 72001.

6 See id. at 72003.

acknowledges in the Proposal,[7] the type of displayed liquidity that IEX proposes to create will be ephemeral in nature. That is, D-Limit quotes will be subject to fading away whenever the CQI determines that prices are unstable. The prospect of quote fading would harm market quality because it would create uncertainty as to whether prices are real and reflect quotes that are or will remain accessible. Indeed, there will be no indicator in market data feeds that will inform participants as to whether an IEX quote reflects a regular limit order or a D-Limit order that is subject to fading. Without an ability to identify those orders, firms would be blind as to how to make informed routing decisions in their efforts to provide best execution on behalf of their client orders.[8] Moreover, quote fading would render filling orders more difficult and expensive for liquidity takers to accomplish. Finally, D-Limit would undo the Commission's work to largely stamp out the practice of quote fading, which was prevalent before the advent of Regulation NMS and its concepts of firm and automated quotations.

As is discussed in greater depth below, although IEX asserts that the problems that quote fading presents will be limited for many of its symbols, IEX fails to account for the possibility that these problems may be profound for symbols that are subject to routinely-high levels of price volatility, and as well as for symbols that are normally less volatile but which could exhibit significant volatility during times of market duress. Thus, D-Limit risks undermining investor confidence at times when they are most fragile and in need of stability and certainty.

Finally, IEX fails to account for the possibility that such effects would be amplified if other equities exchanges adopt order types similar to D-Limit and quotes fade at the same time across all exchanges.

IEX Data is Inadequate to Support Its Arguments that D-Limit is Consistent with the Act

IEX presents data to support its Proposal, but such data is inadequate to assess the extent to which D-Limit is likely to cause quote fading. Without such data, the Commission cannot reasonably determine that D-Limit is consistent with the Act.[9]

IEX generally asserts that any adverse impact of D-Limit arising from quote fading is likely to be limited. IEX reasons that "the CQI is only on for an extremely small percentage of the trading day," such that D-Limit will only be able to perform discretionary price adjustments during narrow windows of time.[10] Specifically, IEX asserts that for all of the approximately 8,000 symbols available for trading on IEX, the CQI is active for only "1.64 seconds per symbol

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7 See id. (acknowledging that quote fading will occur, but arguing that it will not be meaningful in comparison to the quote fading that is associated with other existing order types it identifies).

8 The Commission should also consider the question of how D-Limit would operate together with the self-help mechanism. That is, how would an exchange be able to discern whether an inability to access quotes on IEX is due to an operational problem on IEX – which would be a valid basis for declaring self-help – or whether instead it is due to quote fading arising from the normal functioning of D-Limit orders?

9 See Susquehanna Int'l Grp., LLP v. SEC, 866 F.3d 442 (D.C. Cir. 2017).

10 See Proposal, supra, 84 FR 72003.

per day," on average,[11] which it says amounts to "on average, … only 0.007% of the trading day."[12] IEX states that for "the remaining 99.993% of the trading day, D-Limit orders would be available to trade at their resting price in the same manner as any other limit order."[13] Although such statistics may appear compelling at first blush, even a cursory review reveals them to be overly-simplistic and inadequate to support IEX's positions.

The mere fact that the CQI has been active historically only for short time periods during the trading day for each of the 8,000 IEX-traded symbols, on average, is largely irrelevant. This statistic does not address whether the CQI is or can be expected to remain similarly inactive for particular symbols or for particular categories of symbols. In fact, there are good reasons to expect the CQI is and will be active for particular securities or categories of securities for far longer than the "very narrow windows of time" for which IEX states it designed D-Limit to be useful.[14] For example, Nasdaq expects that the CQI is active frequently or for extended periods of time for thinly-traded or illiquid symbols that tend to experience routinely high levels of price volatility. If this is the case, then by IEX's own admission, the D-Limit would operate outside of IEX's design parameters with respect to these securities, with an impact that IEX fails to address. In Nasdaq's view, the use of D-Limit for orders in such securities would exacerbate illiquidity and volatility. Furthermore, as Nasdaq discusses below, the use of D-Limit in such circumstances would likely limit access to resting liquidity by those other than just opportunistic latency arbitrageurs. IEX's failures to consider these impacts are fatal to the Proposal.

Similarly, IEX's CQI statistics do not distinguish between the behaviors of the CQI and D-Limit during normal market conditions from their behaviors during periods of substantial market stress or instability. Even if the CQI is active infrequently for many symbols during normal market conditions, this may not be the case during periods of market duress. During the latter periods, Nasdaq would expect the CQI to activate frequently or persistently for many symbols. If so, then the effects of D-Limit on a volatile market could be adverse and profound. Indeed, at the very moments when the markets clamor for liquidity and when such liquidity is

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11 Id. at 72001 (IEX notes that, "on a volume weighted basis, the CQI is on for 5.9 seconds per day per symbol, 0.025% of the time during regular market hours." It also notes that it plans to file a proposed rule change with the Commission to update its CQI calculations, which IEX asserts will result in the CQI being on 0.009% of the time during regular market hours, on average.).

12 See id. at 72003.

13 See id.

14 See id. ("As discussed above, the CQI is only on for an extremely small percentage of the trading day and is designed to protect impacted order types during these very narrow windows of time. Even if IEX enhances the CQI formula (as noted above), the nature of the CQI will remain intact— it will continue to focus on protecting impacted orders against latency arbitrage trading strategies during very narrow windows of time. Even though D-Limit orders may not be accessible to other market participants during these narrow timeframes, the Exchange does not believe that this impact is unfairly discriminatory because during the vast majority of time D-Limit quotes will be accessible.").

difficult to find, D-Limit liquidity would fade, needlessly worsening conditions. Again, IEX fails to consider this important eventuality.[15]

Even if IEX did provide data that was adequate to assess the impact of D-Limit on its own market and its market participants, this would not be sufficient. The potential implications of the introduction of D-Limit go far beyond IEX's limited purview. As one commentator has noted, IEX does not account for the possibility that "if other markets were to adopt similar order types, which also become popular trading tools, a huge chunk of the consolidated quote may fade at the same time, potentially when market liquidity is needed most." [16] The failure of IEX to consider the broader implications of its proposal on the national market system is a serious omission.[17]

Without representative data to support IEX's assertion that the CQI will only be active for a narrow window of time during the trading day, and that D-Limit will not cause a significant incidence of inaccessibility or quote fading for particular symbols or categories of symbols, or in times of market stress or instability, then the Commission cannot reasonably conclude that its approval of D-Limit would be consistent with the Act.

<u>IEX Fails to Demonstrate that D-Limit is Tailored Appropriately to the Problem it purports to Solve or that it is Predictable or Transparent</u>

Although IEX states expressly that it intends for D-Limit to protect providers of displayed liquidity from adverse selection by firms engaging in latency arbitrage, IEX argues that such discriminatory action is fair because D-Limit is "narrowly tailored, transparent, and predictable."[18]

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15 IEX is naïve, at best, or misleading, at worst, in asserting that its limited historical perspective on the behavior of the CQI provides an adequate basis for it to project that the future behaviors of the CQI and the D-Limit are likely to be benign. IEX remains a fledgling exchange that has existed for barely three-and-a-half years and only during an era of relative stability in the equity markets. Having never endured severe and protracted tumult in its market, IEX cannot speak credibly as to how the CQI will behave or what the impact of D-Limit will be in such an instance.

16 Jeff Bacidore, *The IEX D-Limit Proposal: It's Good … But What if It's Too Good?*, last updated on January 9, 2020, at https://www.bacidore.com/post/the-iex-d-limit-proposal-it-s-good-but-what-if-it-s-too-good.

17 Given the risks associated with D-Limit, both to IEX market participants and to the broader market, perhaps D-Limit is best suited to operate on a venture exchange or a similar venue that is designed to test such innovations in a cabined environment (e.g., through exemptive relief from the OPR).

18 <u>See</u> Proposal, <u>supra</u>, 84 FR 72003 ("The Exchange believes that it is similarly not unfairly discriminatory to use a narrowly tailored means to provide protection to and encourage the placing of displayed limit orders on IEX by investors and market makers by providing them with a measure of protection from the trading strategies documented above. The Exchange further believes that the proposed rule change is consistent with

IEX asserts that D-Limit is narrowly-tailored because the CQI would only be active, and D-Limit would only re-price limit orders, during periods in which proprietary firms are most likely to actively engage in adverse selection. In support of this assertion, IEX cites daily average data from September 2019 involving its D-Peg and P-Peg order types. Specifically, IEX asserts that "[w]ithin the two millisecond periods following CQI determinations, proprietary trading firms submit 6.8 times as many marketable-to-mid shares (i.e., shares priced at least as aggressively as the midpoint and eligible to trade) compared to full-service and agency firms; while outside of those two millisecond periods, the situation is reversed, with full-service and agency firms submitting 3.4 times as many marketable-to-mid shares compared to proprietary trading firms."[19] Once again, however, IEX's data is overly-simplistic and fails to prove its point.

IEX provides no indication as to whether its statistics, which it derived from only a one-month sample, are representative of other time periods or of different market environments. IEX also provides no indication as to whether its figures hold true for all categories of symbols, including those which are subject to frequent or routinely-high levels of volatility.

In fact, as noted above, in circumstances where a symbol is largely illiquid and where trading is frequently or routinely volatile, as well as during times of extraordinary market instability, the market is likely to be populated by more than just aggressive arbitrageurs looking to profit from adverse selection. In these circumstances, the market also will likely include ordinary liquidity-seekers, such as institutional investors and market makers. IEX itself acknowledges as much:

> To reiterate, not all proprietary trading firms are running these [latency arbitrage] strategies. In fact, many of the leading proprietary trading firms are bona fide market makers whose liquidity is critical to pre-trade price discovery. Ironically, as much technical and financial sophistication as it takes to compete as a market maker, they still end up adding while the [CQI] Signal is "on," and their average execution quality suffers from these trades.[20]

Such participants, and their orders, will become collateral damage if D-Limit liquidity vanishes, like a cruel mirage, during volatile periods. Such harm would occur in service of no discernible higher purpose.

Additionally, IEX argues that the circumstances are "predictable" in which the CQI will be active, and D-Limit quotes will be subject to re-pricing.[21] However, it discloses no data in the Proposal to support the accuracy of the CQI. To the contrary, IEX suggests in the Proposal that

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the protection of investors and the public interest because the circumstances under which a D-Limit order will be adjusted are narrowly tailored, transparent, and predictable").

19 See id. at 72002.

20 See Eric Stockland, *A Deliberate Strategy*, Medium, December 17, 2019, at https://medium.com/boxes-and-lines/a-deliberate-strategy-bb8b0cff074b.

21 See Proposal, supra, 84 FR 72003.

the CQI, as currently formulated, does not activate in at least 20 percent of the circumstances where it should do so.[22] This suggests that D-Limit is not predictable and may fail to provide promised protections to liquidity providers. Moreover, IEX provides no data to indicate whether, or to what extent, the CQI activates mistakenly in circumstances where it should not do so. Such data is crucial to assess whether D-Limit, in fact, will cause needless missed executions for liquidity takers.

Meanwhile, IEX's argument that D-Limit is fair because it is "transparent" misses the point. Although IEX is indeed transparent about the mechanics of the CQI, the conditions under which it would activate, and how D-Limit would behave once CQI is activated, market participants would have no means available to them to determine when a resting limit order on the IEX book is a normal limit order, which would be accessible at its displayed price, or whether instead it is a D-Limit Order, which might not be accessible. Without this information, liquidity seekers would have no means of avoiding potentially fruitless interactions with D-Limit liquidity, even as D-Limit provides a means for liquidity providers to avoid interacting with orders from high-speed trading algorithms.

Finally, the Commission should consider whether the discriminatory nature of the actions that IEX proposes to employ, along with aforementioned risks associated with those actions, are commensurate with the scope of the problem that IEX identifies. In a blog post that preceded the filing of the Proposal, IEX's Chief Strategy Officer acknowledged that "[i]n November 2019, just 3 member firms at IEX were responsible for 55% of all the lit taking volume while the [CQI] Signal was 'on,' even though those firms accounted for only 13% of the total volume on IEX."[23] Based upon such statistics, the Commission should consider whether latency arbitrage on IEX is actually the serious and widespread problem that IEX asserts it to be. Likewise, the Commission should consider whether it would be fair for IEX to discriminate against 45% of its lit taking volume to address a perceived problem with only three firms.

D-Limit is not Analogous to Order Types that Other Exchanges Presently Employ

In an attempt to parry concerns that D-Limit is problematic because it will cause fading quotes, IEX argues that such concerns are of no import because D-Limit will cause no more quote fading than do other Commission-approved discretionary order types. In support of its argument, IEX claims that D-Limit is substantially similar to Cboe EDGA's and Cboe EDGX's MidPoint Discretionary Order, which IEX asserts explicitly provide for quote fading.[24] IEX also

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22 See id. at 72001, n.56 (stating that IEX plans to file a proposed rule change with the Commission to "incrementally optimize and enhance the effectiveness of the quote instability calculation in determining whether the CQI is on," with the result that these changes will "increase the expected number of CQI determinations by approximately 20%.").

23 See Stockland, supra.

24 See Proposal, supra, 84 FR 72003.

cites to a Nasdaq "discretionary order type for which the display price can be pegged to a floating price range" as well as to primary pegged order types that NYSE, and NYSE Arca offer.[25]

IEX's analogies to these order types fail because they gloss over the important distinction that the EDGA, EDGX, Nasdaq, NYSE, and NYSE Arca order types are pegged to the NBBO, and their prices change as a reaction to changes in the NBBO that have already occurred, rather than in anticipation of changes that are yet to occur. Thus, for these order types, shifts in their prices do not constitute quote fading because those shifts are affected by, but do not themselves affect, the NBBO.[26] By contrast, D-Limit Orders may be alone at the top of the IEX book and re-pricing those orders could cause the NBBO to shift.

D-Limit Orders Are Not Automated Quotations and are not Subject to Protection under Regulation NMS Rule 611

In the Proposal, IEX states that it does not propose changes to its rules which specify that it operates as an "automated market center" and displays "automated quotations," as those terms are defined in Regulation NMS.[27] [28] It states that "displayed D-Limit orders will qualify as automated quotations within the meaning of Regulation NMS (except in the event that a systems malfunction renders the System incapable of displaying automated quotations)."[29] Finally, to the

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25 See id. at 72003-04 (citing Nasdaq Rule 4703(g), NYSE Arca Rule 7.31-E(h)(2), and NYSE Rule 7.31(h)(2)).

Nasdaq notes that IEX argues that in 2015, the Commission approved a displayed discretionary order type for Nasdaq without a discussion of quote fading. See Proposal, supra, 84 FR 72004 (citing Securities Exchange Act Release No. 75252 (June 22, 2015), 80 FR 36865 (June 26, 2015) (SR-NASDAQ-2015-024)). However, IEX's argument is misleading, because this Nasdaq filing was merely a restatement of existing order types, and did not make substantive changes to the rule text.

26 See Securities Exchange Act Release No. 34-67226 (June 20, 2012), 77 FR 38113, 38114 (June 26, 2012) (SR-EDGA-2012-22) ("The displayed prices of MDOs would move in tandem with changes in the NBB (for buy orders) or the NBO (for sell orders). Moreover, MDOs would not independently establish or maintain an NBB or NBO; rather, the displayed prices of MDOs would be derived from the then current NBB or NBO."); Securities Exchange Act Release No. 84327 (October 1, 2018), 83 FR 50416, 50417 (October 5, 2018) (SR–CboeEDGX–2018–041) (same).

27 See 17 CFR 242.600(b)(4) (defining an "automated quotation" as one that permits an incoming order to be marked as immediate-or-cancel (''IOC'') and that ''immediately and automatically'' executes an IOC order against the displayed quotation up to its full size, cancels any unexecuted portion, transmits to the sender a message indicating the action taken, and updates the quotation to reflect a change to its material terms.); id. 600(b)(5) (defining an "automated trading center" as a trading center that, among other things, is capable of displaying automated quotations).

28 See Proposal, supra, 84 FR 72001.

29 See id.

extent that D-Limit quotes qualify as automated quotations, IEX argues that they would also qualify as "protected quotations" under Rule 611 of Regulation NMS. [30]

IEX makes two arguments in support of its assertion that D-Limit quotes will be automated and protected. First, IEX argues that "[a]ccess to D-Limit quotes will not be subject to any delay beyond that to which all [of] IEX's orders, displayed and non-displayed, are now subject" – (its "de minimis" 350 microsecond speed bump) – such that D-Limit will remain "immediately accessible under Regulation NMS."[31] Second, IEX argues that "based on precedent, the fact that D-Limit displayed orders are subject to automatic repricing based on changes in market prices does not affect their status as protected quotations."[32] Both of these arguments fail.

As to IEX's first argument, it is irrelevant that the design of D-Limit would not permit a temporal delay in accessing quotes that is longer than IEX's Commission-approved 350 microsecond speed bump. The potential inaccessibility of D-Limit quotes is not a function of temporal factors; instead, it is a function of the fact that a quote may <u>never</u> be accessible at the originally-displayed price, immediately or at any time thereafter, after a re-pricing occurs.[33]

IEX's second argument fails for similar reasons. Although it is true that discretionary pegged orders at other exchanges are considered to be automated quotations notwithstanding the fact that they, like D-Limit, are subject to automatic repricing, pegged orders are accessible at displayed prices at any given time, whereas D-Limit quotes may never be accessible at such prices, either immediately or at all.

Not only would D-Limit quotes be manual, but they also would be non-firm in many cases, pursuant to Regulation NMS Rule 602(b).[34] IEX asserts otherwise, stating that, "[n]otwithstanding that D-Limit orders will be subject to price adjustment when the CQI is on, IEX believes that this functionality is consistent with the 'firm quote' requirements of Regulation NMS Rule 602(b) in that it will not result in a meaningful amount of quote 'fading' compared to the quote fading, both explicit and implicit, that exists and is permitted today."[35] As discussed above, IEX fails to support this argument with representative data which demonstrates the extent to which D-Limit will cause quote fading for particular categories of symbols and in various market environments. Nasdaq expects that for certain categories of high-volatility symbols and in times of market duress, the extent of quote fading that D-Limit will produce will, in fact, be

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30 <u>See</u> 17 CFR 242.611; <u>id</u>. at 242.600(b)(61)(iii) (defining a "protected" bid or offer, in part, as an "automated quotation that is the best bid or best offer of a national securities exchange").

31 <u>See</u> Proposal, <u>supra</u>, 84 FR 72005.

32 <u>See</u> <u>id</u>.

33 <u>See</u> <u>id</u>. at 72000 ("A D-Limit order that is subject to an automatic adjustment will not revert to the price at which it was previously ranked and displayed (in the case of a displayed order)").

34 <u>See</u> 17 CFR 242.602(b).

35 <u>See</u> Proposal, <u>supra</u>, 84 FR 72003.

meaningful.[36] Moreover, it is antithetical to the concept of a "firm quote" that a quote can be firm in some circumstances, but then be non-firm in other circumstances.

D-Limit May Fail to Satisfy Brokers' Duty of Best Execution

IEX argues that the Proposal is consistent with the protection of investors and the public interest because it is "designed to assist Members in obtaining best execution for their customers by providing an opportunity to execute at the NBBO, but limiting executions at the NBBO when the NBBO appears to be unstable, thereby reducing the potential to execute at an imminently stale price."[37] Even if D-Limit provides improved execution opportunities for liquidity providers in many cases, a substantial risk also exists that this liquidity may prove to be inaccessible to liquidity takers. Brokers would need to account for this risk, along with the risk of missed executions, in determining whether it would be consistent with the broker's best execution obligations under FINRA Rule 5310 (requiring FINRA members to consider the accessibility of quotations) to send customer orders to IEX, particularly when D-Limit quotes would not be discernible from regular displayed limit orders. In many cases, Nasdaq believes that routing to IEX would be inconsistent with this obligation insofar as other venues would offer more reliably accessible quotations.

To the extent that best execution concerns cause market participants to avoid sending liquidity seeking orders to IEX, then in turn, the execution quality of IEX for liquidity providers would suffer as well. Moreover, to the extent that the CQI proves to be imprecise in its behavior and causes D-Limit orders to either miss valid execution opportunities or fail to provide promised protections against adverse selection, then the ability of D-Limit to provide best executions will be in further doubt.

Concerns Associated with D-Limit Are Similar to those that Prompted the Commission to Institute Proceedings as to whether to Disapprove the EDGA Asymmetrical Speed Bump, and should Prompt Similar Commission Action Here

It is worth noting that although IEX asserts that it intends for its Proposal to protect against adverse selection in a manner that avoids "concerns around … disparate treatment, and fair access by institutional investors to displayed quotations that have been voiced with regard to the EDGA asymmetrical speed bump proposal [(the 'Liquidity Provider Protection Mechanism' or 'LP^2')],"[38] many of the objections that have been raised to LP^2 are equally applicable here.

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36 To the extent that D-Limit orders are non-firm, manual, and non-protected under Regulation NMS, then their submission to the SIP will not result in the payment of credits. The SIP's revenue allocation formula rewards quotes that contribute to price discovery. Quotations that are subject to fading do not do so, and thus are excluded. See Final Rule, Regulation NMS, Securities Exchange Act Release No. 34-51808, 70 FR 37496, 37503 (June 29, 2005) ("the new [revenue allocation] formula eliminates any allocation of revenues for manual quotations. It therefore will promote an allocation of revenues to the various SROs that more closely reflects the usefulness to investors of each SRO's market information.").

37 See Proposal, supra, 84 FR 72006.

38 See id. at 71998.

EDGA's LP^2 proposal,[39] which would seek to protect liquidity providers from latency arbitrage by delaying all incoming executable orders for up to four milliseconds, is subject to a pending proceeding to determine whether to approve or disapprove it.[40] The concerns that commentators and the Commission raise about the LP^2 proposal[41] are similar to those discussed above, including: (1) whether the proposal would lead to quote fading[42]; (2) whether it would create illusory liquidity and whether such liquidity would be a significant portion of the exchange's overall liquidity[43]; (3) whether the proposal is unfairly discriminatory[44]; (4) whether the proposal is appropriately tailored such that its potential benefits outweigh its potential or likely harms or unintended consequences to the national market system; and (5) the potential impact on market quality and investor protection if other exchanges adopt similar proposals.[45] Additionally, the Commission noted that numerous commenters on the LP^2 proposal expressed concern that the

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39 See Securities Exchange Act Release No. 86168 (June 20, 2019), 84 FR 30282 (June 26, 2019) (SR-CboeEDGA-2019-012).

40 See Securities Exchange Act Release No. 87096 (September 24, 2019), 84 FR 51657 (September 30, 2019) (longer period of time for Commission action granted pursuant to Securities Exchange Act Release No. 34-87757 (December 16, 2019), 84 FR 70231 (December 20, 2019)).

41 See Securities Exchange Act Release No. 87096, supra, 84 FR 51667.

42 See, e.g., Comment of Tabb Group Re: File No. SR-CboeEDGA-2019-012 (July 16, 2019) ("Lastly, before the SEC approves or turns down the Cboe proposal, the SEC should look at quote and execution traffic to estimate the proportion of fading that will occur if market makers could move their quote within 4 milliseconds of a price movement. Not that I know the appropriate level of beneficial fading, but analysis is need[ed] to ascertain the appropriate proportion of price improvement that will be gained from more aggressive but [sic] quotes, versus the value of trades that will not be executed or executed at worse prices given a market maker's propensity to fade as the pricing of other markets fade.").

43 See, e.g., Comment of BlackRock Re: File No. SR-CboeEDGA-2019-012 (August 2, 2019) (arguing that the proposal "has the potential to open a Pandora's box of illusory quotes and phantom liquidity").

44 See, e.g., Recommendation of the Investor Advocate Re: File No. SR-CboeEDGA-2019-012 (December 13, 2019) (objecting that EDGA's proposal "intentionally discriminates in favor of one category of liquidity providers" without demonstrating that such discrimination is justifiable).

45 See, e.g., Comment of Hudson River Trading LLC Re: File No. SR-CboeEDGA-2019-012 (July 17, 2019) ("Given that approval of proposals like the asymmetric delay proposed by EDGA would effectively permit any substantially similar proposal by competing exchanges, the Commission should consider the impact on market quality and investor protection that would be caused if such a proposal was adopted by all or a substantial portion of the U.S. Equities market.").

proposal did not provide data to support key assertions within it, including the benefits and impacts of the proposal. [46]

To the extent that such concerns and unanswered questions led the Commission to institute proceedings for the LP^2 proposal, it should do the same for the D-Limit proposal.[47]

Despite the Bravado, D-Limit is Nothing More than a Self-Serving Commercial Ploy

True to form, IEX spins its Proposal in self-righteous and idealistic terms, by claiming that it seeks to "protect" liquidity providers from predatory trading strategies and create a "transparent and level playing field where both investors and market professionals can participate and have confidence in the fairness of the system."[48] But this yarn, like many others that IEX spins, frays quickly upon close examination.

At its core, this Proposal is nothing more than a thinly-veiled attempt by IEX to bolster its dismal market quality for displayed orders. Any argument to the contrary is belied by IEX's own prior statements attacking the very practices in which it now proposes to engage. In a 2016 interview, IEX founder and Chief Executive Officer Brad Katsuyama dismissed the prospect of creating a displayed version of its D-Peg order type due to the fact that such an order type would permit quote fading—a practice which he suggested would contravene the mission of IEX to promote a more fair and equitable marketplace:

> … within the context of displayed liquidity—seeing something and having it fade on you—we've been very cognizant that's what started this whole journey for us. We don't want to contribute to that.[49]

In an earlier interview, Mr. Katsuyama similarly railed against trading practices that he said created illusory quotes:

> Once you realize those screens are kind of an illusion of what you can buy and sell, it does kind of undermine your confidence that the markets are operating the way that they should.[50]

Of course, nothing precludes IEX from changing its position on this issue and pursuing its own commercial interests. In doing so, however, IEX should, at the very least, reconcile why

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46 See Securities Exchange Act Release No. 87096, supra, 84 FR 51663-64.

47 Nasdaq notes that in EDGA's speedbump proposal, EDGA conceded that orders which would be subject to the speedbump would not be protected, whereas IEX makes no such concession.

48 See Proposal, supra, 84 FR 71998.

49 See Matt Levine, *Beyond 'Flash Boys: Matt Levine Interviews IEX's Brad Katsuyama*, Bloomberg, October 12, 2016, at https://www.bloomberg.com/news/articles/2016-10-12/beyond-flash-boys-matt-levine-interviews-iex-s-brad-katsuyama.

50 See *Brad Katsuyama Says His Aim is to Make Trading Fair*, CBC News, April 4, 2014, at https://www.cbc.ca/news/business/brad-katsuyama-says-his-aim-is-to-make-trading-fair-1.2597414.

something that it previously attacked as being sinful when others did it is suddenly virtuous now that IEX proposes to do it – especially when the quote fading that IEX now proposes to engage in now would be deliberate, and thereby arguably worse than what occurred in years past. To Nasdaq and others, the true explanation for IEX's hypocrisy seems obvious: strict adherence to its supposed principles proved to be an obstacle to its pursuit of a viable and profitable exchange business. In future proposals, IEX should be more forthright with the Commission and with the public in explaining the pragmatic business motivations for its actions, rather than by falsely couching its proposals in sanctimonious terms. Likewise, IEX should perhaps refrain from demonizing its competitors and other participants in the market – including by propagating falsehoods and mischaracterizations about their intentions and practices.[51] Such actions are counterproductive, reduce industry collaboration, and ultimately will come back to haunt IEX as its resemblance to other exchanges becomes more stark.

Conclusion

In Nasdaq's view, the Commission cannot reasonably determine that approval of D-Limit is consistent with the Act. Numerous significant questions remain unanswered about its likely behavior and its potential impact on liquidity takers, the IEX market, and the national market system as a whole. Respectfully, Nasdaq requests that the Commission disapprove the Proposal.

Sincerely,

Joan Conley
Senior Vice President & Corporate
Secretary

Cc: The Honorable Jay Clayton, Chairman, SEC
The Honorable Robert J. Jackson, Jr. Commissioner, SEC
The Honorable Hester M. Peirce, Commissioner, SEC
The Honorable Elad L. Roisman, Commissioner, SEC
The Honorable Allison H. Lee, Commissioner, SEC
Director Brett Redfearn, Division of Trading and Markets

51 For example, IEX mischaracterizes "maker-taker" exchanges as providing rebate payments to participants to induce them to post quotes and other resting orders notwithstanding participants' misgivings about doing so in the face of adverse selection by proprietary trading firms. See Proposal, supra, at 84 FR 71999. In fact, the exchanges like Nasdaq provide rebates to incentivize market-improving behavior to the benefit of all participants. By subsidizing liquidity provision, the maker-taker model helps to narrow spreads and deepens the NBBO.