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February 10, 2020

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

Re: PROPOSED RULE CHANGE TO ADD A NEW DISCRETIONARY LIMIT ORDER TYPE (FILE NUMBER: SR-IEX-2019-15)

Dear Ms. Countryman:

AJO, L.P. ("AJO") appreciates the opportunity to submit this comment letter in support of the proposed rule change by Investors Exchange ("IEX") to introduce a new Discretionary Limit ("D-Limit") order type.

AJO is an independent investment adviser registered under the Investment Advisers Act of 1940. Established in 1984, AJO offers its services to pension funds, endowments, foundations, multi-employer plans, and pooled investment clients. 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.

We are generally opposed to, or at least skeptical of, the introduction of new exchange order types for two basic reasons. First, we believe they introduce further complexity to an already severely fragmented U.S. equity marketplace. Second, we find that most of the order types introduced by the for-profit exchanges are created with the sole purpose of benefitting a particular type of market participant, often to the detriment of other market participants. Rarely do we come across a proposed order type or exchange mechanism that is truly accessible to *all* market participants and that aims to benefit *all* users who choose to employ it. We believe that D-Limit is unique in this regard, and we commend IEX's continued effort to create a level playing field in our equity markets.

NEED FOR SPEED

The ability to effectively implement trading ideas in our equity markets is largely predicated on speed and access to market information. The speed at which a trader is able to receive, consume, and react to information is a key factor in their ability to minimize trading costs. In a truly fair marketplace one might expect every market participant to have the same access to the same information at the same time. But that is not the case with the current US equity market. Different market participants receive and consume information at different speeds. This is not, as the exchanges might argue, by choice — surely, every market participant would prefer to trade on the most up-to-date information and at the fastest speed possible. But speed comes at a price. Recognizing the revenue opportunity that speed presents, the for-profit exchanges continue to monetize the perpetual "need for speed" through low-latency connectivity products — co-location and microwave technology for example — that provide access to order book data at faster speeds than more traditional connectivity products.[1] They sell these low-latency advantages, alongside slower (cheaper) products, to market makers and high speed trading firms at monopolistically-inflated prices that are cost-prohibitive to the vast majority of market participants.

The exchanges will argue that the prices they charge for these speed advantages are driven by market demand and that those market participants who require the fastest speeds (lowest latency) will pay up for the privilege. The reality is that all market participants require the same level of speed in order to ensure fairness in our equity markets. But the three exchange families (NYSE, Nasdaq, Cboe) have demonstrated that their motivation to maximize profits outweighs their desire to maintain fair and orderly markets. Instead of offering all market participants equal access at the same speed, the exchanges have created a multi-tiered system, effectively tilting the odds in favor of a small subset of firms that possess the resources to invest in the lowest-latency infrastructure.

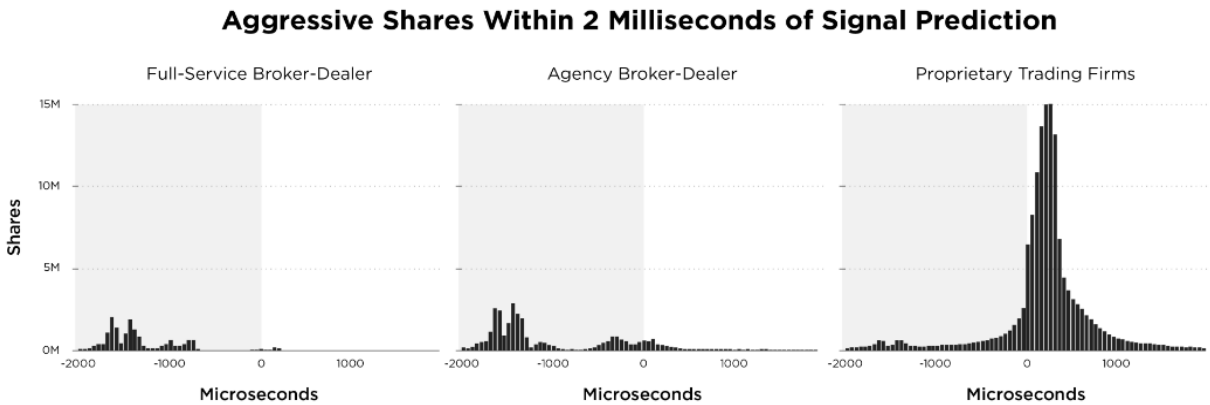
PROTECTION FOR ALL MARKET PARTICIPANTS

D-Limit aims to protect all users of the order type from adverse selection at no cost. This is a key differentiator between D-Limit and the asymmetrical speed bump proposed by EDGA, to which D-Limit has drawn comparisons.[2]

D-Limit works in conjunction with IEX's crumbling quote indicator (CQI), "a predictive model that forecasts when the price of a stock is likely about to change."[3] The period during which the signal is turned "on" amounts to roughly 4 seconds per symbol per day; however, 24% of displayed order volume on IEX trades during this tiny window. According to IEX, in November 2019 three proprietary trading firms accounted for 55% of all lit "taking" volume while the CQI signal was "on", despite these firms accounting for only 13% of total volume on IEX.[4] The numbers suggest that these firms employ strategies that systematically anticipate quote changes and aggressively seek to pick off limit orders posted at soon-to-be stale prices. The following exhibit reinforces this suspicion. Here, IEX groups all member firms into three categories: full-service broker-dealers, agency broker-dealers, and proprietary trading firms and then plots the timing of their aggressive (liquidity-seeking) orders relative to when the CQI made its prediction (time "0"). These charts clearly indicate that the majority of orders received from broker-dealers arrive *before* the signal fires, whereas proprietary firms send a

[1] See Nasdaq, NYSE, Cboe connectivity options, https://www.nasdaqtrader.com/Trader.aspx?id=connectivityoptions,https://www.nyse.com/connectivity/documents, https://cdn.cboe.com/resources/membership/US_Equities_Options_Connectivity_Manual.pdf
[2] See https://www.sec.gov/rules/sro/cboeedga/2019/34-86168.pdf
[3] See *What is the IEX Signal*, https://iextrading.com/trading/signal/
[4] See *Leveling the Playing Field for Lit Trading*, https://medium.com/boxes-and-lines/leveling-the-playing-field-for-lit-trading-682dc723cef1

disproportionate amount of shares immediately *after* the signal fires (when IEX deems the quote is likely about to change).[5]



Data is from October 2019.

The CQI was created in response to latency arbitrageurs that seek to leverage their speed advantage by picking off limit orders posted at soon-to-be stale prices. We view latency arbitrage as a predatory trading strategy that adds zero value to the marketplace and we applaud IEX's attempt to combat it. D-Limit applies the CQI technology to posted limit orders as a layer of protection against the predatory behavior other exchanges have enabled through the sale of their speed advantages. When the CQI indicates that a price change is imminent, D-Limit orders will be re-priced one pricing unit (typically a penny) away from the soon-to-be stale quote, protecting the order from adverse selection. This layer of protection occurs natively at the exchange level, meaning it does not place the onus on market participants to proactively re-price their limit orders. All users of D-Limit, regardless of speed or technological sophistication, stand to benefit from this layer of protection.

On the contrary, the EDGA proposal seeks to protect only those firms possessing sophisticated low-latency infrastructure. EDGA's asymmetrical speed bump would delay liquidity-seeking orders by four milliseconds, allowing those firms that pay up for speed to proactively cancel or reprice their passive limit orders in response to new information they may have received in the four-millisecond window. Meanwhile, the vast majority of investors posting limit orders on EDGA — market participants that do not possess the same low-latency infrastructure — are sitting ducks. While IEX will re-price a D-Limit order on every trader's behalf, thus avoiding adverse selection for all users, EDGA's speed bump simply provides a window of opportunity for the trader to proactively re-price their order to avoid getting run over.

[5] Charts available at https://medium.com/boxes-and-lines/a-deliberate-strategy-bb8b0cff074b

Quote Fading vs Quote Protection

At least one commenter expressed concern that D-Limit will negatively impact institutional and retail investor orders seeking liquidity. The commenter wrote that "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." [6] The presumption here is that a trader seeking liquidity may have already executed a portion of a larger order across other venues. IEX will have observed these away executions in real time, triggering the CQI. As a result, any resting D-Limit orders will fade before the balance of the liquidity-seeking order has a chance to trade against them. For starters, retail orders do not trade in the manner suggested. Unlike institutional orders, large retail orders are not broken up by a smart order router and strategically routed to multiple venues. To suggest that retail traders would be adversely impacted by this proposal is unfair and misleading. On the contrary, institutional orders *are* broken up into smaller child orders and traded across multiple venues as the commenter describes, offering merit to the fade concern. But this is not a new phenomenon. We experience quote fading every day on every other exchange. Even worse, as the IEX data suggests, latency arbitragers are front-running our liquidity-seeking child orders and taking the posted liquidity we seek before our orders arrive. This unnecessary intermediation is not an example of price discovery, it is a form of predatory trading that increases investor costs! It is also the very behavior that D-Limit seeks to combat.

While we have not seen any evidence to support the argument that quote fading will increase as a result of D-Limit approval, we do acknowledge the risk. The benefit D-Limit will provide to posted limit orders, however, *is* supported by the data. We believe this well-supported benefit far outweighs the theoretical risk.

Additional Comments

Capturing "non-toxic" passive liquidity has grown increasingly difficult for investors. We are forced to compete with sophisticated trading firms that are better equipped to both establish their place at the front of the queue at optimal trading times and to remove themselves from it at suboptimal trading times. Trading from the back of the queue leads to lower fill rates during periods when the quote is stable and greater adverse selection when it is not ("last man standing" before a price change). Because of this negative experience, investors are discouraged from posting limit orders in the lit markets. If approved, D-Limit would create a better limit order experience by reducing adverse selection which, we believe, will encourage greater liquidity provision, benefitting all market participants in the process.

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[6] See https://www.sec.gov/comments/sr-iex-2019-15/sriex201915-6673725-204049.pdf

We support IEX's effort to innovate in a manner that benefits <u>all</u> investors — not a subset of market participants — and we welcome other exchanges to follow suit.

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

Sincerely,

Sean Paylor
Trader
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