

August 3, 2020

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

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

Dear Ms. Countryman:

Thank you for the chance to comment on the Filing. Back in February, as I was digging my bunker under Pilgrim Hill, the Filing seemed pretty straightforward to me. It looked like an easy extension of one of IEX's popular undisplayed order types, an order type that's proved to be an effective counter to latency arbitrage strategies. Cboe EDGEA had its own active filing at the time with a different idea to defeat latency arbitrage strategies. The contrast between IEX's proposal and what Cboe EDGEA was then trying to do, to my mind, couldn't have been more vivid. IEX's new order is a peg, I thought, and anybody can use it. On the other hand, as I argued at length in the matter, Cboe EDGEA's discriminatory speed bump might have added up to a billion dollar subsidy lavished on an elite group of traders.

Sure, IEX's peg is different from other pegs. Instead of pegging to one piece of market data the order is pegged to several pieces of data run through a clearly documented formula. So what? Same inputs, same outputs, every time, unless they file a rule change. The quote instability formula behind the peg is something anyone with a little arithmetic can figure out if they want to. IEX's model might be overfitted and it might not. But there's no discretion to it and no structural or practical discrimination in who can use it. It seems to work pretty well. And as I said it seems to be popular.

Critics try to use that popularity against it. IEX critics like to point out that a large percentage of IEX's volume is dark, that is, against those very undisplayed order types. The logic of that reminds me of what Yogi Berra once complained about a restaurant, "No one goes there anymore. It's too crowded." If the biggest complaint against IEX's undisplayed peg reduces to that a wide range of IEX's customers like it, those critics need to move on.

The discussion has since tumbled into a snarl about what is and isn't a peg. Some commenters insist that because the quote instability calculation attempts to predict an event, IEX's peg is materially different from the many pegs already out there. Those pegs reflect what is, they say, while IEX's peg anticipates what will be.

At one point in my life I was offered excellent university training in ontology. Unfortunately I experimented with too many psychedelics at the time to nail it all down. Still, I was clear-eyed once in a while, enough to grasp that no one can time travel to the future, and so no matter how you might frame your hopes and dreams, if you're using data from right now to do it all you're ever talking about is what things look like right now. IEX's quote instability formula uses data from right now, just like every other peg, and not from some future state only IEX knows. This isn't a hard question.

The critics point to IEX's speed bump to say that IEX is, in fact, time traveling. We've been through all this before. Their arguments here would deny IEX any kind of pegged order type, displayed or undisplayed. The argument over undisplayed pegs was settled years ago. We also crossed the threshold for displayed pegs long ago. I don't know who appreciates it but IEX has been operating with displayed pegs since launch, though it doesn't call them pegs, and if that's corrupted the republic no one's said so - take a look at IEX's "display-price sliding" feature or its "short sale price sliding" feature or its "limit up-limit down price constraint" features. In plain sight IEX has been pegging the bananas out of displayed, protected orders for years and no one has noticed or cared.

With all that, gasps over quote fade are pretty funny, especially since some of the pearl clutchers spend millions every year perfecting quote fade. Being lectured about quote fade by the FIA or Nasdaq is like being lectured about cocaine by Charlie Sheen. They don't call what they do or enable "quote fade." No, they might call it "reacting to market prices" or "high-speed price discovery" or "impounding information into prices" or some other kind of bloated rah-rah, but when you have cancel-to-trade rates as much as 100:1 or hawk nanoseconds you likely know very well what's going on.

Tough luck

I don't usually praise Citadel and, to say the least, no one there is waiting breathlessly for my opinion, but the firm has an interesting point. Not all the activity that will trigger IEX's repricing will come from latency arbitrageurs. We can argue about how much of that activity will come from retail, institutions, or hedgers instead of predatory traders. Of course some of it does but that doesn't disqualify the Filing. Whether IEX discriminates against a wide variety of liquidity takers isn't the point. It certainly will discriminate broadly against liquidity takers, as Citadel and others have helpfully pointed out. The question of course is whether the discrimination is unfair. (It's also doubtful whether by discriminating against liquidity takers broadly there is any discrimination at all here "between customers, issuers, brokers, or dealers" under 6(b)(5).)

Any participant can take liquidity and move a market. The analysis doesn't stop there. How well equipped are other participants to recognize the market's moving? Some participants have invested millions, tens of millions, and even hundreds of millions to do just that on microsecond timeframes. For many other participants all this is forever out of reach, so that when the market moves on microsecond timeframes they are at a distinct information and resource disadvantage

to (a) participants moving the market and, more important, (b) participants with the resources to detect when the market is moving and react first on microsecond time scales. The disadvantage costs them money. There's no real argument about that. The question before the SEC is whether that disadvantage is just tough luck. I've argued it is tough luck when the firms being picked off are market maker firms. That's because they are given valuable regulatory subsidies to compensate them for being adversely selected, so, you know, tough luck if they're adversely selected. I believe this strongly enough that a useful improvement to the Filing would be to exclude market maker firms from using the order type, but that's me.

Anyway, as in so many dilemmas, we can turn to Canada for an insight. I was struck by a distinction Professor Marius Zoican of the University of Toronto made (go Blues), "The D-Limit order allows traders to separate high-frequency trading strategies from high-frequency infrastructure." This is the goal of IEX's liquidity taker discrimination, to give all liquidity providers, when they are vulnerable, otherwise unobtainable infrastructure to react to market information on microsecond time scales just like, for example, members of the FIA PTG can. That's fair. Please say yes.

Sincerely,

R. T. Leuchtkafer