Vanessa Countryman, Secretary

Securities and Exchange Commission

100 F Street, NE

Washington, D 20549-1090

May 30th, 2021

Re: SR-IEX-2021-06

Dear Ms. Countryman:

I would like to thank the SEC for taking a longer look at SR-IEX-2021-06. As such, I think it is important that I add to my initial comments and provide some more details.

Add-ons to Previous Letter

My Initial letter can be found here:

https://www.sec.gov/comments/sr-iex-2021-06/sriex202106-8762194-237501.pdf

Market Structure Problem

One of the biggest issues today is that our Market Structure is broken. Many within the industry come up with decent rules that are "short term" fixes (ie IEX's Speed Bump rule), but I believe the Commission should focus on clawing back the rules that have broken Market Structure, and then these short term fixes wouldn't be "as" necessary. IEX's Speed Bump has been a great addition but it was only necessary because of all the other issues in the market.

Here is one of many recent examples of this type of fix: A quote from a large broker dealer advertising their proprietary mid market ALGO, which is hidden from the NBBO, that verifies the broken market structure and blames "payment for order" for their actions:

As you know there is great controversy about payment for order-flow. Brokers, who charge zero commissions, sell their orders to High Frequency Traders who execute these orders at slightly better prices than the NBBO. But these execution prices are still advantageous enough for them to be able to pay the brokers, maintain their operations, and make a profit that sums to billions. In the first quarter, nearly 50% of all stock trades were executed off the exchanges, resulting in less liquidity and wider markets for institutional traders.

Traders who do not need immediate execution, and are willing to rest mid-point pegged orders in our ATS, can effectively reduce the bid/offer spread to zero both for themselves and for the SmartRouted orders we cross with their resting order

This broker dealer is attempting to give their customers a better execution option. I don't blame the broker for this, but these types of things would be unnecessary if we could "fix" our Market Structure.

Option Retail Customer Priority

In my previous letter I wrote about how Retail Customer Priority really doesn't exist. I would like to add the following to these comments:

Number of Price Changes in Today's Market

OPRA provided me with the following data from 2020:

As of November 2020, the record number of prices sent out in one day was 101,971,763,806 on September 4th of last year (2019). The record message peak was January 28th of this year (2020) was 50,484,200 per 100 milliseconds.

A vast majority of these quotes are coming from the HFT's. These numbers actually prove that my assessment in my first letter was actually quite conservative with respect to how long an investor could gain market priority getting on the bid and ask of a particular option. For example, on Sept 4, 2019, the average option had over 85,000 price moves that day, or it would take only 106 seconds to hit 390 orders getting on the bid/ask of one option. Alternatively, during peak conditions you could post a bid/ask on all option securities for less than one microsecond (less than one millionth of a second).

Maker/Taker Rebates/Fees

I also did not mention the maker/taker issue with respect to the options market. Most Investors pay a fee for their option trades (price per contract or flat fee). Only a small percentage of retail customers have these Exchange rebates/fees passed on to them. This is important because it can result in conflicts of interest as Brokers will route orders to the Exchange that benefits them.

Some Exchanges actually only exist today because their pricing is beneficial for makers (adding liquidity) and others exist because their pricing is beneficial for takers (removing liquidity). This limits the probability of **customer-customer trades** and allows the HFT's to get a piece of virtually all retail order flow. For example, let's say an option has the following market ($10 bid $13 ask). A retail customer offers to sell one contract at $12.50. You will likely see hundreds of contracts join the offer, but it is important to note what Exchange the initial sell order is directed to. Because most brokers don't pass on these rebates/fees to customers, they will likely send the sell order to an Exchange like C2 (an exchange created by the CBOE for liquidity providers) where the rebate is high for adding liquidity (.80 per contract). Now, let's say an order to buy 1 contract at $12.50 enters the market. The executing broker is most likely to direct it to an Exchange with the lowest fee when removing liquidity because the executing broker will have to pay this fee. In this case, the Exchange with the lowest fee is NOT the C2 (where the fee for taking liquidity is high: .85 per contract). The order is most likely to go to the CBOE where there is no fee for taking liquidity. This means the retail customer who first offered at $12.50 will likely not get filled even when an "opposite" order enters the market. The maker/taker issue once again limits the possibility of a retail customer gaining priority. Remember, the Option Exchanges will tell you that they have a 390 rule because some retail customers can **game the system** by getting on Market maker bids/asks, thus getting priority.

Prohibition against Market-Making

Additionally, most of these Option Exchanges, including all the CBOE Exchanges, won't even allow you to post continuous markets.[1] According to them, they won't allow it because of Customer priority.[2] Why does the option industry need a 390 rule when they already have a rule which prevents Retail Market Making?

The bottom line is that retail customer priority exists in "name only" as there is virtually ZERO customer to customer trading (where there was a priority advantage on one side) in today's Option Market.

Previous Comment Letters That were Ignored

1) I'm not the only one who has warned the Commission as to why these Exchanges and HFT's really want customers designated into two different categories. See this Themis Trading comment letter for SR-CBOE-EDGX-2019-012 dated May 8, 2019:
   https://www.sec.gov/comments/sr-cboeedgx-2019-012/srcboeedgx2019012-5475062-185048.pdf

   In Particular:

   Identification of retail orders in the exchange proprietary data feed will result in ***information leakage****. In their proposal, Cboe EDGX states: "A Retail Member Organization on EDGX has the option of designating Retail Orders to be identified as such on the EDGX Book Feed, which may increase potential execution opportunities for that order."*

   The decision to mark the order as retail rests with Retail Member Organization (RMO). If an RMO wants to participate in the retail priority program, they must agree to mark ALL of their orders as "retail". We suspect that EDGX will be offering these RMOs an enhanced liquidity rebate ***to entice them to sacrifice the anonymity of their clients****.*

   The value added in this proposal is for the ***high speed traders that consume the EDGX direct feed and now get to identify all the retail orders on the EDGX book****. Another value added is for the Cboe themselves since they are protecting the value of their data feed and can continue to charge exorbitant fees for access to their data.*

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[1] Rule 8.20. Prohibition Against Customers Functioning as Market-Makers

(a) TPH organizations may neither enter nor permit the entry of priority customer orders into the System if (1) the orders are limit orders for the account or accounts of the same beneficial owner(s) and (2) the limit orders are entered in such a manner that the beneficial owner(s) effectively is operating as a Market-Maker by holding itself out as willing to buy and sell such securities on a regular or continuous basis.
(b) In determining whether a beneficial owner effectively is operating as a Market-Maker, the Exchange will consider, among other things, the simultaneous or near simultaneous entry of limit orders to buy and sell the same security and the entry of multiple limit orders at different prices in the same security.

[2] From their latest revision of the rule (CBOE-2009-009): The Exchange noted that it is retaining the restriction (market making) for customers who are not Voluntary Professionals because such customers have **priority** at any price over the bids and offers of market makers, other broker-dealers, and Voluntary Professionals.

2) See the following comment letter dated March 4th, 2008 by Charles B. Cox with respect to the ISE introducing a 390-order rule. Although this comment letter is **13 years old**, it is relevant because Mr. Cox is accurate in his analysis as to what will likely happen if the rule is approved: https://www.sec.gov/comments/sr-ise-2006-26/ise200626-6.htm

   In Particular:

   *The mission of the ISE is to protect the competitive advantage of our Specialists. Therefore, we welcome **all unsophisticated retail trades** which will afford our specialists the opportunity to profit from your **rudimentary pricing** capability. If however, you become a frequent trader who employs sophisticated pricing techniques then, with the approval of the SEC, you may be subject to being categorized by the ISE (the formula for this categorization is subject to change at the sole discretion of the ISE) as a "professional account holder." If you become a "professional account holder" then under this new designation you can expect to **receive inferior fills and pay increased fees** for trading. Additionally, with the approval of the SEC, the ISE can compel your broker to provide us (The ISE) with your trading information from other options exchanges. **The SEC has found that your rights to privacy and anonymity are superseded by the ISE's need to protect their specialists from undue competition.***

   Other sources of liquidity are deemed inferior by the ISE even if they result in tighter pricing for all participants.

   Sound familiar?

Zero Commission Customers affected by the 390 Rule

Investors who use zero commission brokers are also now sending more than 390 option orders per day and are being designated as “professionals”. This is important because these brokers want to sell “unsophisticated” order flow **only** as they don’t even have pricing models for “professional” customers so these brokers are often banning these active traders for 90 days (until they revert back to regular customers again).[3] Other more mainstream brokers also won’t “support professional traders that fall under the 390 rule”[4]. No one would ever be banned or not supported like this if this rule didn’t exist. This is an example of how this rule **directly** limits competition. It is also important to note that virtually all retail brokers now offer warnings to retail customers when they are getting close to the 390-threshold. Why would they do this? Well, because they and their customers know the **consequences of becoming a “professional**”. It is clear that most customers who receive this warning will reduce the number of orders they subsequently send. Does this sound like a competitive market?

Does anyone actually believe that zero commission customers using a phone can gain priority advantages over option market makers?[5]

[3] From a Robinhood email to a Professional customer: At this time Robinhood does not support professional traders, so your account will be set to Position Closing Only for options for the following quarter. You can still trade equities.

[4] From tastyworks website: https://support.tastyworks.com/support/solutions/articles/43000435379-what-is-the-390-professional-orders-rule-390-rule-

[5] I’d rather not post anything from reddit but one can do their own due diligence searching this site and you will find multiple posts on the “professional customer” topic and how it is affecting the reddit crowd.

Enforcement of the 390 Rule

The Option Exchanges have attempted to provide clarifications on how the Broker Dealers should actually count the option orders. The latest was a circular the CBOE sent out in 2016:

https://cdn.cboe.com/resources/regulation/circulars/regulatory/RG16-064.pdf

However, there doesn't seem to be a way to effectively enforce this rule in the Options market. For example, many on Reddit believe that they can simply open accounts at multiple brokerage accounts (i.e. sending 200 + orders with three separate brokers). Clearly this would be an attempt to evade the rule, but the actual issue is that many have successfully been able to do so using various methods, and this clearly isn't right, especially for those who are abiding by it.

I have been proactive in trying to seek even more clarification. For example, Question 21 and 23 in the above circular:

Question 21: If a non-broker-dealer person or entity places orders for multiple accounts, do the orders need to be aggregated?

Answer: Yes. All orders for accounts controlled by the same person or entity must be aggregated when determining whether or not the 390 average daily order threshold has been exceeded by that person or entity.

Question 23: If accounts have different Taxpayer Identification Numbers, is it okay to not aggregate them?

Answer: Not necessarily. TPHs need to recognize and aggregate orders from accounts that are obviously related to each other whether or not they have different taxpayer identification numbers. For example, if two accounts are named XYZ-I and XYZ-II and executions are regularly allocated between them, CBOE would expect a TPHs to aggregate orders placed for these accounts even though they might have different Taxpayer Identification Number.

This implies that if you are entering orders for your personal account and a corporate account or multiple corporate accounts, then you must cumulate the orders from all accounts. However, it becomes unclear when it comes to people you may be related to (spouse, children, siblings, parents etc). For example, if you are entering orders for your spouse's account, then you would cumulate them with yours, but what if you are not? The rule implies that related accounts (spousal, children etc) should **NOT be cumulated** if they have with a separate tax Identification numbers and each owner of these accounts also enters their own orders. How can a broker dealer be expected to police this? It would be impossible for them to tell who actually "clicked" the mouse (entered the order). In fact, I spoke to one broker dealer who told me that they do NOT cumulate spousal accounts, but I know other brokers that do. This inconsistency should not take place in the market.

In 2018, I questioned my broker about "related" accounts, and if they enter their own option orders, would they be counted as "mine". Their Compliance Department said they likely would because we are "related". Frustrated by this, I contacted an Option Exchange's Chief Regulatory Advisor and asked her for clarification on the rule with respect to "related" accounts. This was her response on February 13, 2018:

Thanks for your question. We are looking into this, but wanted to acknowledge receipt of your email in the interim.

I followed up with subsequent emails many months later and to this day have not received a clarification. I expect that the reason for the lack of clarity is that they likely feel I'm just trying to evade the rule, but this sincerely isn't the case.

The questions here truly are never ending. For example, if you tell your spouse to buy the XYZ March $8 calls, should that be considered your order if your spouse enters the order? How about a child or sibling? How about a friend?

I find it interesting that some Option Exchanges use the terminology that brokers should enforce the rule on a "best efforts basis". In my opinion, all rules approved by the Commission should be **fully clarified** if required and **fully enforceable**, or the rule itself should be re-written or disapproved. Otherwise, there clearly is an incentive to evade the rule.

These exact enforceability issues within the Options market exist in the IEX proposed rule for Equities.

Additionally, one of the biggest differences in the Equities Market is that so much of the equity trading has shifted to Dark Venues. Recent statistics indicate that on some days more than half of all trades in the U.S. are traded outside public stock exchanges. This clearly is a major issue and it is important because we still don't know exactly how this IEX proposed rule will count equity orders. Will it include orders sent to Dark Pools or Alternative Trading Systems (ATS)? If not, then there clearly would be an incentive to send more orders to these off Exchange venues just to keep order counts low.

Questions the Commission should be asking the Option Exchanges

1) **Why do you have a 390 rule today?**
2) **What percentage of retail trades are done with a HFT on the other side?**
3) **How can a retail customer go about getting best execution (including finding the hidden liquidity) when they are limited to the number of orders they can send (390) and the typical option often averages around 250+ price points between the bid and ask?**
4) **How can you have a 390 rule when you won't fully clarify the rule and brokers can't properly enforce it?**

IEX Proposal

I spent a great deal of time from 1999-2004 writing to the SEC, Exchanges, and my Broker with respect to the anti-competitive rules that were being adopted in the marketplace. I recall speaking to someone at the SEC who told me that it is the Commissions' belief that **in the long run**, markets/investors will dictate what rules/policies are in the best interest of investors, and this will self correct market structure issues. For example, if Payment for Order flow is such a "bad policy", then a majority of investors will choose a broker that doesn't accept these payments, and this practice will eventually cease to exist. Unfortunately, this has not happened. In fact, some might say this is exactly why the problem is getting worse and why **regulation is so important**. Given this, it is not surprising to see the Exchanges/Brokers that try it the "honest" way, eventually cave because they are in the minority and will eventually "accept" what our industry deems as standard practice[6]

Looking at the IEX's relatively stagnant market share (1-3%) since 2016, it really shouldn't surprise anyone that they would be looking at ways to increase market share, and really the only way to do this would be to get the HFT's (RLP's) to actively send orders to their Exchange.

[6] In September of 2019, Interactive Brokers reluctantly introduced IBKR Lite, a commission free platform using the payment for order flow model that many competitors use. The original platform is now called IBKR Pro where there is no payment for order flow. Interestingly enough this Pro model is what a vast majority of their customer use today. This is actually a testament to what is better for retail investors (when both models are made available).

Here is what the President of the IEX, Ronan Ryan wrote on May 6th 2021:

IEX's Retail Program was introduced in 2019 to bring that high-performance dynamic to a different subset of the trading ecosystem: the retail community. ***.*** *Since then, we've scrutinized the performance of the program and* ***asked participants what worked and what didn't. The feedback we received encouraged us to propose*** *enhancements that are designed to give retail investors and the brokers who serve them more opportunity to receive midpoint price improvement on IEX Exchange.*

Firms like Citadel have expressed the desire to only trade against unsophisticated order flow. This is their **feedback,** and it can be viewed by reading the text of this rule and their own previous comment letters to the Commission. Remove the more sophisticated customers, and we will participate in your mid-market auctions. It appears that Citadel threw out the bait and the IEX took it - hook, line, and sinker.

Final Thoughts

The evidence is clear that bid-ask spreads have increased in the options market, and from personal experience I can guarantee you that one of the main reasons is the 390-order rule. Adding this type of rule to the Equities Marketplace will also decrease overall competition within the market, which can only hurt secondary liquidity and thus will also increase bid-ask spreads.

This bid-ask spread is the number one cost to long term investors (not commissions), and as such **any rule that will increase this spread should be disapproved**.

In the equity market today, a large company like Berkshire Hathaway enjoys the anonymity when making purchase/sales in the marketplace. However, every quarter they file a 13F, and that information, if material, can move individual equity prices substantially. Rules similar to SR-CBOE-EDGX-2019-012 in the equity market will allow information leakage to the extent where HFT's can determine what orders are coming from sophisticated investors in "real time". Can the Commission be certain that these large equity investors will continue to enjoy this anonymity if they are deemed professional customers? It would seem rather foolish to believe that they will continue to receive the same fill rates on their investments if deemed a Professional.

Finally, most of the market structure related rules that have been passed in the last 15 years have benefited the HFT firms. Each year these rules reduce competition a little more and put more of the trading business in the hands of fewer firms.[7] Specifically, previously large market makers in the Options business have left the business because virtually all the unsophisticated order flow ends up in the hands of the major HFT's.[8]

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[7] Citadel's automated equities platform trades approximately 26% of U.S. equities volume across more than 8,900 U.S.-listed securities and trades over 16,000 OTC securities. They execute approximately 47% of all U.S.-listed retail volume. Virtu Financial claims to handle over 30% of all retail volume. Therefore, two firms handle close to 80% of all retail volume.

[8] Quote from Timberhill on why they are leaving the Options business (2017): Having initiated the first automated option market making operation in the mid '80s, which grew into the largest such business on a global scale over the next 25 years, it's been painful for me to see it deteriorating in the last few years. But we do not have a choice in this matter. Today retail order-flow is purchased by large order internalizers and joining them would represent a conflict we do not wish to have. On the other hand, providing liquidity to sophisticated, professional synthesizers of short-term fundamental, technical and big data is not a profitable activity.

This proposed rule will add to this issue as more unsophisticated order flow will be made available to HFT's, which could potentially lead to a **major systematic shock** in the US market/economy at some point in the future. No doubt the Commission has heard many retail customers complain about the delays in their respective orders and fills in the last few years. These customers can often wait 10 minutes to get a fill on a marketable order. These delays often take place when the markets get a little busier and the HFT's have their own technical issues handling all the retail order flow. This issue is not specific to the "meme stocks" of 2021 (GME, AMC etc) and as such could be the **warning** of a future problem. For example, if the market were to have a major meltdown, is the Commission confident that 75%+ of all retail orders will be in good hands with **two** HFT firms? Many of these zero commission brokers have no "back ups" with respect to order execution and in many cases are not even members of the major Exchanges. An issue with one of these HFT firms would cause havoc for many small investors. This systemic risk can be reduced with greater competition in the marketplace**. Specifically, more competition for this type of order flow should be a mandate for this Commission**. This competition can come from other large institutions or even other retail traders. We should not be counting anyone's orders and then punishing them when they hit thresholds. Counting orders can only result in less overall competition, resulting in what we see in the Options market, virtually zero **customer to customer trades**.

REG NMS was introduced in 2005 with the main component being the "Order Protection Rule", which should ensure "best price execution" by eliminating trade-throughs. I would argue that this regulation is moot today given that a vast majority of orders are trading through the "real" NBBO, as many levels of competition have been driven from the market due to other rules introduced by Exchanges and subsequently approved by the Commission. In fact, the IEX recently acknowledged the "shrinking pool of Competitors" in the marketplace[9]. The "real" NBBO in today's market would encompass all orders (including the hidden ones) and **allow an unlimited number of competitive orders by all market participants with no consequences.**

I view today's market structure as "death by a thousand paper cuts". No one rule (paper cut) is the exact cause for the problems we see today, but it is the cumulative effect of all the rules introduced. These rules then create incentives for others to establish things like off Exchange trading, which makes things worse for everyone. I believe the Commission should focus on rules that provide incentives for investors to post liquidity in "lit" markets. Anti-competitive rules are ones that do the opposite as they provide incentives for Investors to post less "lit" liquidity. Rules such as Payment for Order Flow, Maker/Taker fees, Retail Customer designations (like this one), Price Improvement, and colocation data feeds should be reviewed by this Commission and disapproved or eliminated if they are deemed to be anti-competitive.

I'm not sure if my comments will make a material difference with respect to your final decision on SR-IEX-2021-06, but I do feel that it is very important to at least get them on record.

Please feel free to contact me if you have any questions,

Sincerely,

Mike Ianni

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[9] See article on June 8th, 2021 from John Ramsay, Chief Market Policy Officer at the IEX: https://medium.com/boxes-and-lines/the-rising-tide-of-broker-costs-and-the-shrinking-pool-of-competitors-40d4d389e59a
They suggest that a lack of competition in the market is a problem ("Competition is a linchpin of successful free market economies"), going as far as linking a WSJ article saying that Citadel controls over 50% of trading on the NYSE. Yet, the IEX quotes Citadel in ***this proposed rule,*** as a reason for requesting such rule which would likely result, if approved, in a higher overall market share for Citadel.