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October 10, 2016

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission 100 F. Street N.E.
Washington, D.C. 20549-1090

RE: Release No. 34-78908; File No. SR-NASDAQ-2016-111 - Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Amend Nasdaq Rules 4702 and 4703

Dear Mr. Fields:

Themis Trading appreciates the opportunity to comment on the above referenced proposed rule changes in which the Nasdaq Stock Market proposes to change the way in which Post Only Orders interact with resting Non-Display orders. For the reasons set forth below, Themis Trading objects to the proposal and urges the commission to instead eliminate all Post Only Order types.

Back in February 2009, Nasdaq received SEC approval for the Post-Only Order type which was described as:

> "A Post-Only Order is an order that does not remove liquidity from the System upon entry if it would lock an order on Nasdaq's system for trading cash equities (the "System"). If, at the time of entry, a Post-Only Order would lock an order on the System it will be re-priced and displayed by the System to one minimum price increment (i.e., $0.01 or $0.0001) below the current low offer (for bids) or above the current best bid (for 2 offers)."

In their 2009 filing, Nasdaq claimed that "the Post-Only Order is designed to encourage displayed liquidity and to offer Nasdaq users greater discretion and flexibility to post liquidity on Nasdaq". They also justified this order-type by saying that similar order types already existed on NYSE Arca (ALO Orders) and BATS (post only orders).

What Nasdaq failed to clearly highlight in this original filing was that in addition to displayed orders, post-only orders would also not interact with **non-displayed liquidity**. In other words, if a post-only order was entered at a price which would lock or

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cross an existing non-displayed order, **then that post only order would not trade** and instead the **price would be slid** either one tick below for buys or one tick above for sells. This is an enormous detail that has been taken advantage of for years by some market participants to give them an advantage over other market participants.

We have highlighted this order type many times since the SEC approved it in February 2009 and cited **how we thought that post-only orders were unfair since they allowed the initiator to gain valuable knowledge about hidden order flow since these orders would have their price slide from their original limit price.** Our voice fell on deaf ears and Nasdaq continued to allow their clients to use the post-only order for more than seven years. We believe that an enormous amount of information was leaked during those seven years. We also believe that many unsuspecting institutional algorithms placed non-displayed orders thinking that they were hiding their intentions but in fact were consistently being pinged by post-only orders.

On September 22, 2016, Nasdaq filed a proposal with the SEC to change the way that post-only orders interact with non-displayed liquidity. They proposed to no longer price slide post only orders when these orders interact with non-displayed liquidity. Here is how they describe the changes in the rule filing:

> "A Post-Only Order that is entered with a price equal to a resting Non-Display Order will be posted at its limit price (or its adjusted price if applicable), rather than being re-priced as it is today. This allows the Post Only Order to lock the resting Non-Display Order. Both the displayed Post Only order and the resting Non-Display order will remain available for execution at the locking price. In this way, neither order is disadvantaged; the Exchange Bid/Offer spread is tightened; **and no signal is sent to the member that entered the Post Only Order.** In this scenario, efficacy is maintained or enhanced for both the Post Only Order user and the Non- Display Order user compared to today."

Nasdaq states that under the amended post-only order protocol they will not be sending a signal about hidden order flow. We believe that they have just admitted that they have been leaking information about hidden client order flow for the past seven years. They detail this further by stating:

"In addition, the member entering the Post Only Order learns through the repricing action both that there is a Non-Display Order resting on the book and also the price

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at which the Non-Display Order is resting. The Exchange believes that this interaction is inefficient and detrimental to investors, to members, and to the market."

This is beyond astounding to us. Nasdaq is stating that one of their order types has been detrimental to investors, to members and to the market. We have a lot of questions about this admission including:

Why did they just admit this now? Why did it take seven years for them to realize this? How much information about client order flow was leaked? What damages did institutional and retail clients suffer during the last seven years? How many other Nasdaq order types are detrimental to investors and the market? What about the other exchanges that have similar order types? Will we see similar filings soon from these exchanges?

The Nasdaq Solution to the Post-Only Sliding Issue

NASDAQ intends to fix what it had created by **allowing the Post Only order to lock its own book without re-pricing.** For example, Nasdaq wants to allow member to now enter a 51 cent bid, and instead of it trading with a resting 51 cent hidden offer, allow it to simply lock said offer. NASDAQ wants to allow bids and offers at the same price, without a trade – without a clearing price.

We have a few questions about this order behavior:

1) Will allowing bids and offers at the same price without a trade help or enhanced Price Discovery? *Will the public market for stocks (bids/offers/and trades) be more or less likely to reflect equilibrium supply and demand, and true asset value*, at any point in time if bids and offers can exist at the same price and time and not trade?

2) Retail and institutional investors take for granted that at any point in time, the public market of bids/offers/trades reflect the true price of an asset. Will allowing such non-clearing-price behavior – locking behavior – make mockery of this important assumption? What is the value of a stock if bids and offers can lock and not trade? Is the value of the stock 50 cents? 51 cents? 74 cents? 23 dollars?

3) If the SEC allows such behavior, is it promoting markets with better price discovery – or worse price discovery?

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4) If the SEC allows this behavior, is it a litmus test for the removal of the ban against locked and crossed markets?

5) Is NASDAQ's solution (allowing locked hidden markets) one that will serve investors?

In addition, we believe that the following questions should be asked when an exchange proposes any new rule:

- Will the proposed rule maintain fair and orderly efficient markets?
- Will the proposed rule facilitate capital formation?
- Will the proposed rule protect and serve investors?
- Who will benefit from the proposed rule filing?

How Do Other Exchanges Treat Post-Only Order Types

When Nasdaq originally filed for their post-only order in February 2009, they noted that BATS and NYSE ARCA already had similar order types:

"*Nasdaq believes that the Post-Only Order is designed* ***to compete with orders already approved*** *and in use at other national securities exchanges, thereby enhancing competition between the exchanges.*"

We looked at how BATS and ARCA each operate when a post-only order matches up with a hidden order and found their methods to be different than Nasdaq's current and proposed new method.

BATS

We obtained information from the BATS Order Type Guide and concluded that BATS will accept a Post-Only order that locks an existing hidden order. **But rather than sliding the price of post only order away from the hidden order, BATS will slide the price of the hidden order.** For example:

BATS has a hidden sell order at .10 and they then receive a Post-Only Displayed buy order for .10. Since the order is post-only, it will not trade with the hidden sell order because the

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buyer doesn't want to pay an access fee. Instead, the hidden sell order will be slid to .11 in order to prevent a locking situation.

We think there are a few important things to note here:

- No information leakage occurs since the post-only buy order did not get price slid.

- Displayed liquidity does not suffer since the buy order is allowed to post

- The original non-displayed seller at .10, however, has their price moved away because the post only order would have locked the hidden order.

- Does this price sliding of an existing hidden order hurt the price discovery process since the buyer and seller would have traded if it were not for the avoidance of access fees?

- Do the market participants who entered the hidden orders even know that their price was slid?

- In September 2016 , **39% of BATS orders were entered as non-displayed and 32% were entered as post-only displayed orders**. That's a lot of potential trades that might not be occurring due to price sliding.

ARCA

Based on a NYSE ARCA Order Type document , we concluded that ARCA treats post only orders differently than Nasdaq and BATS (note: post only orders on ARCA are known as ALO orders - add-liquidity only). Similar to the new Nasdaq proposal, ALO orders that lock a non-displayed order will not trade. Instead, the order will be accepted and the ARCA market will remain locked. ALO orders that cross a non-displayed ARCA order will trade with hidden orders. This is a relatively new treatment of ALO orders that was rolled out when NYSE went live with their Pillar system.

Prior to the Pillar system change, ARCA was also apparently leaking hidden order type information. If an ALO order was marketable on entry, rather than trade, it was rejected. This rejection informed the initiator of the ALO order that there was contraside liquidity available at the ALO price. How long was ARCA rejecting these marketable ALO orders? How much information was leaked about hidden order flow?

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What is the SEC's position on Post-Only Order type behavior?

For the past seven years, Nasdaq has been price sliding post-only orders and now has proposed that they cease this behavior because it's harmful to investors. Since the SEC approved the Nasdaq post-only order type in 2009, we can only assume that the SEC approved of the way that Nasdaq has handled these orders for the past seven years. Was the SEC aware of the harm that these orders were causing? Did the SEC realize that Nasdaq was actually leaking client information. We have a few questions for the Commission:

- Based on Nasdaq's admission that they have been harming the market, can the SEC punish Nasdaq for an order type that the Commission approved?
- Did the SEC understand this behavior from day one seven years ago, when the order type was approved?
- Where was NASDAQ surveillance for the past seven years? In their rule filing from September 22nd 2016, they acknowledge that "**this interaction is inefficient and detrimental to investors, to members, and to the market."**
- Did NASDAQ come up with this order type at the bequest of one of their high volume clients? Did they know it was going to be possibly used nefariously?

Conclusion

There does not seem to be uniformity in how exchanges deal with the interaction between post-only orders and hidden orders. Some exchanges lock the market, some price slide the initiator of the post only order and some price slide the hidden order. Some exchanges leak information on hidden order and others allow them to trade. This type of behavior is what apparently exchanges refer to as competition. When they submit rule proposals, they will often cite this competition as a reason why the SEC should approve the proposal.

The competition that exchanges speak of is the competition amongst themselves to attract as much order flow as possible so they can enhance the value of their market data products. We think that this competition does not always help traditional investors and in many cases ends up hurting investors.

For-profit exchanges have lost sight of their original purpose and instead have continued to invent new ways to attract their highest volume customers. Their goal is not to always help traditional investors but to figure out ways to make their own market data products more valuable. Proprietary data feeds are valuable not only because of their speed but also because of their content (revealing information about hidden orders is very valuable).

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We find it troubling that the SEC allowed this behavior to go on for seven years. Maybe this is because of the lack of comments by the industry or maybe this is because regulators did not fully understand the order type? Either way, how can we have confidence in our market structure if exchanges are continuing to disadvantage traditional investors and regulators continue to allow this behavior?

Our markets today have morphed so that technology is leveraged to bring the maximum amount of intermediation between natural investors. The time has come for the SEC to acknowledge this, and reverse it. The Commission can begin by not approving Nasdaq's proposal to change how they handle post-only orders. **Rather than approve the proposal, we think that the Commission should eliminate all post-only order types, instead of allowing them to continue to wreak havoc on the simple price discovery mechanism.**

We would like to close this letter by reiterating what Nasdaq said in their post-only order change proposal:

"The Exchange believes that this interaction is inefficient and detrimental to investors, to members, and to the market."

We think that statement says it all.

Sincerely,

Joseph Saluzzi and Sal Arnuk

Partners, Themis Trading LLC