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February 27, 2023

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: File No.SR-NASDAQ-2022-077: Notice of Filing of Proposed Rule Change To Establish New ''Contra Midpoint Only'' and ''Contra Midpoint Only With Post-Only'' Order Types

Dear Ms. Countryman:

Investors' Exchange LLC ("IEX") is pleased to comment on the referenced rule filing by The Nasdaq Stock Market LLC ("Nasdaq") to establish a new Contra Midpoint Only and related order types ("CMO") as described in its filing ("The CMO Proposal").[1] For the reasons explained below, IEX believes that the CMO Proposal does not meet the standards for approval under the Securities Exchange Act of 1934 ("Exchange Act") because it would unfairly discriminate against investor and other orders to access liquidity on Nasdaq based solely on the price and size of those orders. Further, we believe the CMO Proposal raises questions about the potential that CMO could leak information about those liquidity-seeking orders to CMO users.

Description of the CMO Proposal

Nasdaq describes a CMO as a non-displayed order type priced at the midpoint between the national best bid and the national best offer (the "NBBO" and the midpoint of the NBBO, the "Midpoint"). Nasdaq will cancel a CMO resting on Nasdaq's order book upon entry of certain types of incoming orders. Specifically, Nasdaq will automatically cancel CMO orders if an incoming contra-side order that would otherwise execute against the CMO meets any of the following conditions:

- The incoming order is designated as a displayed order and is larger in size than the size of the CMO;
- The incoming order is priced to the "far side" of the NBBO (e.g., if a buy order, is priced at or better than the national best offer price) and is larger in size than the size of the CMO; or
- The incoming order is designated as an Intermarket Sweep Order ("ISO").

The CMO Proposal also includes certain variations of the basic CMO order type. A "Managed CMO" is a CMO that is pegged to and adjusts to changes in the NBBO. If the adjusted price would not be a permissible price, Nasdaq, after removing the CMO from its order book, would be able to resubmit a new CMO in certain circumstances. Another variation, which Nasdaq calls "CMO+PO" (for "post-only"), like other "post-only" orders, can execute on entry only when it is "economically beneficial" to the party entering the order.[2]

[1] Securities Exchange Act Release No. 96601, 88 FR 1616 (January 11, 2023) ("Rule Filing").
[2] Rule Filing, 88 FR 1617-1619.

Discussion

We think the following points are relevant to the Commission's consideration of the CMO Proposal:

First, it appears to allow a form of segmentation of orders in a way that tends to advance the interests of some market professionals, at the expense of institutional investors.

Second, it seems to raise the potential that CMO could harm institutional investors and others who send orders to take liquidity on Nasdaq by leaking information about their orders to the user of the CMO.

Third, CMO is distinct in many respects from other order types that have as an objective protecting the user from adverse selection. This includes various order types IEX has introduced as well as Nasdaq's own M-ELO order type.

CMO Would Be Unfairly Discriminatory

On the first point, it is clear that CMO is discriminatory on its face. Not all forms of discrimination are prohibited, but we believe CMO is unfairly discriminatory within the meaning of the Exchange Act.

It is important to note that CMO would provide a unique benefit to the user by *preventing* it from trading with certain orders. And the orders that would trigger the cancellation would appear to originate more frequently from institutional investors than other participants. Institutional investors trading on exchange often have urgency to access liquidity at a point in time, causing their brokers to send aggressively priced orders in size, in order to access liquidity, dark and displayed, on multiple exchanges. To help achieve this purpose, agent brokers also sometimes send orders designated ISO to multiple markets to make sure that each market can execute the order up to the order's limit price without concern about violating Rule 611.

In contrast, it seems much more likely that CMO orders would be used more often by electronic market makers. IEX believes that in the case of a standard CMO order, an institutional broker would be less well-positioned to determine how and when to submit a new order in the event the CMO order was cancelled, and it would not be in a position to react to information about incoming orders, as described below. Further, the post-only variation, like other orders of that type, seems aimed at electronic trading firms using "rebate harvesting" strategies.

It is also important to note that a liquidity-seeking participant is not in a position to evaluate whether or when it will be prevented from accessing Midpoint liquidity. Given that the CMO can be triggered based on the size of the incoming order in relation to the CMO, an investor seeking to access liquidity will have no way to assess this question.

We are not aware of any other existing order types that so clearly discriminate against orders solely based on their relative size and willingness to trade (based on their limit price). We believe the order type is unfairly discriminatory because it would disproportionately disadvantage investor orders to favor other types of participants. IEX does not object to order types that help market participants adjust their quotes in response to observed market events. CMO is very different, as it triggers cancellation of an order solely in response to discrete price and size characteristics of a contra-side order. For that reason, we

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believe it is not narrowly-tailored to incentivize participants to send resting orders without resulting in unfair discrimination.

Enabling Information Leakage

Another concern is that CMO could provide a "signal" to the user about the presence of a large, ISO and/or aggressively priced order before that information is known to other participants. The act of Nasdaq sending a cancellation necessarily conveys the existence of such an order to the CMO user. An order with those characteristics is often sent to access liquidity on multiple exchanges (an order marked ISO by definition is seeking to access quotes on multiple markets). We believe there is a risk that a CMO user receiving a cancellation could be able to react to information about the presence of such an order by changing its activity on other markets before the order results in executions on those other markets, or in the case of a displayed order, before it is displayed on other markets. In those circumstances, a user could be able to react to information not available to other market participants, potentially to the disadvantage of the order sender.

Comparison to Other Order Types

Finally, it is important to consider the distinctions between CMO and other order types with the purpose of protecting users from adverse selection. IEX has introduced various order types designed to protect users from adverse selection resulting from trading strategies that seek to execute against resting orders at imminently "stale" prices. These trading strategies often work to the disadvantage of institutional investors and the agent brokers that trade on their behalf.

These order types all work in conjunction with a transparent algorithm called a Crumbling Quote Indicator ("CQI"), which uses real-time market data to determine whether there is likely an imminent change to the NBBO in a direction adverse to the resting order. For example, IEX's Discretionary Peg ("D-Peg") is a non-displayed order that generally rests in the IEX order book at a price less aggressive than the NBB or NBO, as applicable, but can exercise discretion to trade at prices up to (in the case of a buy order) or down to (in the case of a sell order) the Midpoint, except in discrete moments when the CQI determines that the NBBO is unstable. During those moments, D-Peg remains at the less-aggressive price.[3] As another example, D-Limit is an order type that can be either displayed or non-displayed and generally rests at the order's designated limit price, except that it may be repriced to a less aggressive price in moments when the CQI determines the quote is unstable.[4]

These and similar order types draw on real-time market data from public sources to provide protection from speed-based trading strategies that seek to execute against resting orders in the milliseconds when the NBBO is in transition. The CQI, as it has changed over time, is fully disclosed in SEC rule filings.

These order types are distinct from CMO in the following ways:

First, these order types are designed and calculated to be most useful to institutional investors and other participants who are least able to defend themselves from speed-based strategies. CMO is meant to

[3] See Securities Exchange Act Release No. 96014, 87 FR 62903-4 (October 17, 2022).
[4] See Securities Exchange Act Release No. 96611, 88 FR 2379-2380 (January 13, 2023).

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protect a user not from the effects of superior speed-based technology but from the potential effects of trading with an order that is seeking to trade in a certain size and/or is willing to submit a more aggressive limit price than others.

Second, they make use of public market data that is available to all participants and rely on a signal that is fully transparent, so that all market participants can determine precisely how they work and in what circumstances they may provide protection. The cancellation of a CMO order is triggered by certain specific order characteristics of contra-side orders seeking to trade, not by market conditions.

Third, users of the IEX orders do not receive any special information about other orders seeking to trade with them. The price at which their orders execute may tell them that IEX determined the NBBO was or was not likely to imminently change when their orders traded. But that is information any other participants can see equally as well.

Nasdaq relies on the precedent of its M-ELO order type and suggests that CMO is a simply a natural evolution of that order type. We disagree. M-ELO matches orders that both meet a specified minimum resting time in the Nasdaq system. Nasdaq describes M-ELO as an order type designed to appeal to "like-minded participants" that allows "matching longer-term investors on a broker-neutral exchange."[5]. CMO is something else. There is nothing necessarily "like-minded" about CMO users and other participants they may eventually trade with. The CMO order seeks simply to avoid matching with orders that have certain characteristics, not to find other participants with similar trading objectives. Further, in offering CMO, Nasdaq would not seem to be acting in a way that is "broker-neutral", according to our understanding of that term.

Conclusion

CMO represents a certain type of "segmentation" of order flow that is a characteristic of alternative trading systems. But those systems do not need to seek approval for their order types or show that they pass scrutiny under the Exchange Act. IEX believes it is not enough to show that an order type helps users avoid "certain execution scenarios they may deem unfavorable," the justification Nasdaq relies on. It also matters – a lot – how it seeks to do so, and who is likely to benefit, or not, from the ability to discriminate. We think the CMO Proposal fails to give satisfactory answers to those questions and the Commission should reject it.

Sincerely,

John Ramsay
Chief Market Policy Officer

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[5] See https://www.nasdaq.com/solutions/midpoint-extended-life-order-m-elo.

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