IEX Group, Inc.

3 World Trade Center
58th Floor
New York, NY 10007

t. 1 646 343 2000
f. 1 646 365 6862
iextrading.com

March 18, 2020

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

Re: File No. S7-18-19; Commission Statement on Market Structure Innovation for Thinly Traded Securities

Investors Exchange LLC ("IEX") appreciates the opportunity to comment on the Commission Statement on Market Structure Innovation for Thinly Traded Securities ("Commission Statement"), and in particular on whether consideration should be given to potential suspension or termination of unlisted trading privileges ("UTP") for thinly traded securities.[1] IEX welcomes innovation in the U.S. equities market—in general and in this specific area. IEX and other market participants have repeatedly demonstrated that the current regulatory framework leaves ample room for innovation. The proposal for UTP suspension would reintroduce known risks into the equities market, kill incentives for innovation and go against the SEC's mission of promoting competition.

The current regulatory framework leaves ample room for innovation

Dozens of trading venues innovate on a routine basis, in areas ranging from order types and order book logic to technology offerings, among others. The current regulatory framework leaves ample room for innovations, including those that are designed to provide new choices that can benefit investors. For example, the Nasdaq M-ELO order type[2] makes orders eligible to trade only after they have rested on the order book for half a second. PDQ's CODA Markets runs on-demand auctions[3] in an effort to tackle the temporal aspect of liquidity fragmentation. Cboe's Lead Market Maker program[4] is an economic incentive program specifically targeted to support market quality in exchange-traded products. IEX's own speed bump[5] is designed to allow pegged order types to be priced to current market prices.

---

[1] See Securities and Exchange Act Release No. 87327; File No. S7-18-19.
[2] Introduced 2018, https://www.nasdaq.com/docs/ELO%20Infographic%20Update%20January%202018.PDF
[3] https://www.sec.gov/comments/265-31/26531-3619683-162360.pdf
[4] Introduced 2019, http://ir.cboe.com/~/media/Files/C/CBOE-IR-V2/press-release/2019/cboe-introduces-new-lmm-program-final-06-13-19.pdf
[5] Filed in 2015, https://www.sec.gov/comments/10-222/10-222.shtml

IEX Group, Inc.

3 World Trade Center
58th Floor
New York, NY 10007

t. 1 646 343 2000
f. 1 646 365 6862
iextrading.com

IEX welcomes the Commission Statement's call for "market structure innovations that may provide benefits to thinly traded securities" specifically. The Commission Statement already identifies several ideas that may improve market quality for thinly traded securities, including tailored market making incentive programs, periodic intraday auctions and some forms of non-automated markets for thinly traded securities. Implementation of these ideas does not require significant regulatory intervention. The same is true of many other ideas that could potentially improve market structure for thinly traded securities, some already known and others yet to be discovered. As recent market structure history has repeatedly demonstrated, innovation does not require significant regulatory intervention and in fact is best encouraged by competition between trading venues.

Suspending UTP would impose known costs to the market by limiting competition

One specific regulatory intervention mentioned in the Commission Statement refers to the proposal by one exchange group to suspend UTP.

UTP have been a cornerstone of the U.S. equities market since the adoption of the Securities Exchange Act of 1934. The Unlisted Trading Privileges Act of 1994 further facilitated UTP by replacing a cumbersome administrative process whereby the SEC used to review and systematically approve exchanges' UTP applications:

> *This bill eliminates an anachronistic provision of the Securities Exchange Act of 1934 which requires regional stock exchanges, such as the Boston Stock Exchange, to receive Securities Exchange Commission approval before they can trade stocks listed on the New York or the American Stock Exchange. The Securities and Exchange Commission routinely approves all requests by the regional exchanges for unlisted trading privileges. Last year, for example, the Commission reported that it approved over 1,600 exchange requests for UTP. No UTP requests have actually been denied since 1934, and during the last 10 years, virtually no comments have been submitted to the SEC on a UTP application.*[6]

UTP trading is a cornerstone of the U.S. equities market because competition among trading venues for order flow is a cornerstone of the U.S. equities market.[7] As the Commission said when it approved

[6] Statement of Rep. Markey cosponsoring the bill on Aug. 1, 1994, 140 Cong. Rec. H6508, cited in *A New Approach to the Regulation of Trading Across Securities Markets*, Amihud and Mendelson, New York University Law Review, December 1996, also available at https://www.c-span.org/congress/bills/billAction/?print/1552564/597367955
[7] See for example: *Competition: The Forgotten Fourth Pillar of the SEC's Mission*, Speech, Commissioner Robert Jackson, October 11, 2018, available at https://www.sec.gov/news/speech/speech-jackson-101118

IEX Group, Inc.

3 World Trade Center
58th Floor
New York, NY 10007

t. 1 646 343 2000
f. 1 646 365 6862
iextrading.com

changes to NYSE Rule 390, which had imposed a substantial barrier to competition among trading venues:

> *Section 11A(a) of the Exchange Act sets forth findings and objectives that are to guide the Commission in its oversight of the national market system. For purposes of evaluating market structure, these findings and objectives can be summed up in two fundamental principles:*
>
> *(1) the interests of investors (both large and small) are preeminent, especially the efficient execution of their securities transactions at prices established by vigorous competition; and*
>
> *(2)* ***investor interests are best served by a market structure that, to the greatest extent possible, maintains the benefits of*** *both an opportunity for interaction of all buying and selling interest in individual securities and* ***fair competition among all types of market centers*** *seeking to provide a forum for the execution of securities transactions.*[8]

UTP trading facilitates competition among equities venues and mitigates against potential monopoly concerns, including excessive fees, lack of technological innovation, and in some cases illegal behavior on monopoly markets.[9] There is wide consensus that the market benefited from tremendous innovation when various barriers to competition were lifted in the U.S. towards the end of the 1990s.[10] European regulators also made competition between venues a cornerstone of the modern European equities market regulatory framework with MiFID. Academic research finds that competition benefits the market.[11]

Of particular importance here, UTP encourages innovation via competition. The Commission is seeking to encourage innovation in the area of thinly traded securities. Suspending UTP would have the exact opposite effect by killing not just the incentives, but simply the ability for many market participants to innovate.

[8] File No. SR-NYSE-99-48, *Notice of Filing of Proposed Rule Change To Rescind Exchange Rule 390; Commission Request for Comment on Issues Relating to Market Fragmentation*, February 23, 2000. Emphasis added.
[9] *Justice Department Charges 24 Major Nasdaq Securities Firms With Fixing Transaction Costs For Investors*, Press Release, July 17, 1996, available at https://www.justice.gov/archive/opa/pr/1996/July96/343-at.html
[10] Even though UTP had existed for a long time, other barriers to competition, such as off-board trading restrictions, order handling limitations and fragmented quote displaying, used to prevent proper competition.
[11] See section 5.1 in *Competition Between Equity Markets: A Review of the Consolidation Versus Fragmentation Debate*, Gomber et al., Journal of Economic Surveys, 2016

3 World Trade Center
58th Floor
New York, NY 10007

t. 1 646 343 2000
f. 1 646 365 6862
iextrading.com

There is not enough evidence to justify UTP suspension

In general, the strength of the evidence required to support a regulatory intervention should be proportionate to how disruptive and costly the regulatory intervention would be.

Buying or selling a thinly traded security is more difficult and more costly than buying or selling a security for which sellers and buyers enter the market frequently. That much is not surprising. Relatively low volumes, relatively high costs or vague references to "fragmentation" are not evidence of a market structure failure that requires an overhaul of the UTP system in a way that substantially restricts competition. There is also no evidence that the existence of UTP is connected to declining volumes in the thinly traded segment of the market, which could be the results of trends in the underlying supply and demand for these particular assets.[12]

Substantial regulatory interventions, particularly when it has the express purpose to reduce competition, must be based on strong evidence of a market structure failure and reasonable confidence that the regulatory intervention will solve it. Both are lacking in the case of proposals to suspend UTP for thinly traded securities.

Comments on Nasdaq's application for termination of UTP for Nasdaq-listed stocks

Nasdaq recently applied for termination of UTP for up to 1,500 Nasdaq-listed stocks, or almost half of all Nasdaq-listed securities.[13]

In its application, Nasdaq states that it intends to implement a "no UTP" listing tier only if it obtains relief from a large number of rules and regulations, including, but not limited to, nonstandard tick sizes, the ability of issuers to pay market-makers, reduced disclosure obligations, and no order protection. Such a radical departure from today's markets is beyond the scope of this comment process. Certainly, the evidence is entirely lacking to support anything remotely related to such a wide-ranging set of regulatory exemptions. For this reason alone, Nasdaq's application should not be approved.

Apart from the general concerns with reversing legislative and SEC policies in favor of UTP, we have the following additional concerns with Nasdaq's application.

---

[12] Indeed, there *is* evidence to show that other factors, such as the rise of ETF trading, have impacted the supply and demand for illiquid assets over time. See for example *ETF Trading and the Bifurcation of Liquidity*, Brogaard, Heath and Huang, January 2020, working paper available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3510359

[13] https://www.sec.gov/comments/s7-18-19/s71819-6848219-209750.pdf

IEX Group, Inc.

3 World Trade Center
58th Floor
New York, NY 10007

t. 1 646 343 2000
f. 1 646 365 6862
iextrading.com

First, despite Nasdaq's claims, it is unclear that suspending UTP would increase the market-wide level of displayed orders. What is clear is that suspending UTP would promote more displayed orders on Nasdaq. In fact, all participants submitting displayed orders would be compelled to go to Nasdaq. IEX is not aware of any evidence suggesting that suspending UTP would increase the market-wide level of displayed liquidity.

Second, Nasdaq envisions a regime where Nasdaq-listed companies would opt in or out of the "no UTP" listing tier. The question of whether listed companies should be able to decide which market their stock trades on has been considered by courts, Congress and the Commission numerous times. The answer is a resounding "no":

> *the Commission notes that Congress in enacting section 12(f)(1)(C) of the Act* [as part of the 1975 Amendments] *evidenced a clear intent not to allow an issuer to be the determinative factor in deciding whether a security should trade on an exchange or OTC.*[14]

> *The proposition that the issuer of a security has a right to limit the markets in which investors can trade its securities finds no support either in past practice in the securities markets or in Congressional or SEC policy. In fact, the consistent approach has been that trading in a security should be permitted in any market unless such trading would contravene some important policy […] The Subcommittee believes that restriction of trading in securities to a single market is a drastic measure, to be legislated only when the public interest clearly requires it. It is not a prerogative of corporate management, which has no legitimate interest in restricting the trading opportunities of investors who have acquired a company's shares.*[15]

Third, some of Nasdaq's arguments are based on the premise that UTP harms trading in all securities, thinly traded or not. Nasdaq argues that "[without UTP] market participants would no longer need to link to multiple venues" and that "concentrating all exchange trading [. . .] may assist broker-dealers in meeting their best execution obligations" and "would consolidate the surveillance of exchange trading". As discussed above, the general tradeoffs between increased fragmentation and increased competition have already been considered in adopting the current UTP regime, and Nasdaq has shown no basis for altering the balance between the two that is reflected in the current regulatory scheme.

---

[14] See 50 FR 20310 (Release No. 34-22026), May 15, 1985, at page 20313. See also additional comments and citations in Release No. 34-22026.

[15] Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, Securities Industry Study, S. Doc. No. 93-13, 93d Cong., 1st Sess. 120-21 (1973), as cited in *A New Approach to the Regulation of Trading Across Securities Markets*, Amihud and Mendelson, New York University Law Review, December 1996.

IEX Group, Inc.

3 World Trade Center
58th Floor
New York, NY 10007

t. 1 646 343 2000
f. 1 646 365 6862
iextrading.com

Conclusion

IEX and other market participants have repeatedly demonstrated that the current regulatory framework leaves ample room for innovation. Improvements to any part of the market via free-market innovation is always welcome. By contrast, there is not enough evidence of a market structure failure in the area of thinly traded securities to justify the costly regulatory intervention proposed by Nasdaq, which would severely limit competition. The termination of UTP would be costly and counterproductive by reintroducing known monopoly-related risks into the equities market and killing incentives for innovation.

Sincerely,

Benjamin Connault
Economist, IEX
benjamin.connault@iextrading.com

cc: The Hon. Jay Clayton, Chairman
The Hon. Hester M. Peirce, Commissioner
The Hon. Elad L. Roisman, Commissioner
The Hon. Allison Herren Lee, Commissioner
Brett Redfearn, Director, Division of Trading and Markets