



December 20, 2015

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

RE: Investors' Exchange, LLC ("IEX"); Notice of Filing of Application, as Amended, for Registration as a National Securities Exchange under Section 6 of the Securities Exchange Act of 1934; Release No. 34-75925; File No. 10-222.

Dear Mr. Fields:

BATS Global Markets, Inc. ("BATS") appreciates the opportunity to submit a second comment letter on IEX's application for registration as a national securities exchange. BATS would like to take this opportunity to reiterate its strong support in favor of IEX's registration as a national securities exchange. BATS believes IEX's model, which includes the much discussed 350 microsecond speedbump, will only serve to enhance competition among exchanges and other trading venues. BATS believes the only outstanding issue requiring resolution is, as discussed below, that unfilled orders sent to the IEX router bypass the 350 microsecond speedbump. While that current configuration creates unfairness, BATS believes, based on its understanding of the IEX architecture, that issue could be quickly resolved while preserving all the benefits the 350 microsecond speedbump provides investors accessing the IEX order book. As such, BATS urges quick resolution of that outstanding issue and no further delay in the Commission's approval of IEX's application.

The Commission Should Approve IEX's Form 1 with the 350 Microsecond Delay on Incoming Orders and Outbound Market Data.

In our first comment letter, we recommended a reconsideration of what it means to be an automated quotation in light of IEX's proposed point-of-presence ("POP"), resulting in a 350microsecond delay in accessing IEX's quotes.¹ In particular, BATS noted that in Regulation NMS, the Commission articulated that the term "immediate," as part of the definition of "automated quotation," precluded any coding of automated systems or other type of intentional device that would delay action taken with respect to a quotation. Because of the unambiguous nature of this definition, along with the fact that the standard was set ten years ago in a vastly different market, BATS supported the reconsideration of the definition of "automated quotation" and believed that the Commission should articulate clear standards for permissible delays in the

¹ See Letter to Brent Fields, Secretary, SEC, from Eric Swanson, EVP and General Counsel, BATS (November 3, 2015) ("BATS Letter"), at 1-4.

context of approving IEX's Form 1 application. When adopting the 1975 Amendments, Congress stated that "communications systems designed to provide automated dissemination of last sale and quotation information with respect to securities will form the heart of the national market system."² Failure to articulate clear standards of what is "the heart of the national market system" would be inconsistent with the Commission's statutory obligations.

IEX responded to BATS's recommendation by positing that the unambiguous language in Regulation NMS should not be applicable to IEX's systems and that further clarification was not needed.³ In particular, among other reasons, IEX stated that the POP promotes fair access to quotations by the general public, and as such, due to IEX's focus on public investors, the automated quotation definition is met despite the artificial delay in IEX's systems.⁴

As we stated in our initial comment letter, BATS fully supports a reinterpretation of "automated quotation" which would encompass IEX's proposed delay. But while BATS appreciates IEX's focus on protecting public investors, BATS believes that the Commission should articulate clear and rational regulatory standards applicable to all trading venues and market participants. Regulation NMS was adopted by the Commission to further its statutory responsibility of facilitating the establishment of a national market system to link together the multiple individual markets that traded securities. As stated in the Regulation NMS adopting release, the Commission wanted to "formulate rules for the national market system that adequately reflect current technologies and trading practices and that *promote equal regulation of stocks and markets*."⁵ The Commission needs to set clear standards to ensure equal regulation of market participants, and piecemeal development of the national market system could lead to unequal regulation unsupported by reasoned decision-making. The development and refinement of the national market system is crucial to all investors, both public and professional, on all trading venues.

IEX can Ensure Fairness by Inserting the POP Between the Matching Engine and the IEX Routing Broker-Dealer.

IEX analogizes the POP's coiled fiber as merely equivalent to being physically located 38 miles away from other market participants. IEX describes the POP as a "simple and fair way to manage the interaction of orders on the Exchange" and that "[t]here is no way for any IEX participant to pay for faster access or circumvent the POP."

Again, BATS supports IEX's introduction of a 350 microsecond delay. As IEX details in its comment letters, there are natural latencies in the market today that are longer than the 350

² See S. Rep. No. 94-75 (1975), at 9.

³ See Letter to Brent Fields, Secretary, SEC, from Sophia Lee, General Counsel, IEX Group, Inc. (November 13, 2015) ("IEX Letter I").

⁴ *Id.* at 5-7.

⁵ Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37524 (June 29, 2005) (emphasis added).

microsecond delay proposed by IEX. BATS believes the addition of IEX's innovation will further provide investors with a wide array of choices, and such an increase in competition will only strengthen the development of new technologies and services by trading venues.

But the Commission needs to ensure that this increase in competition occurs in an environment where all market participants have the ability to be treated equally. Congress directed the Commission to "create a fair field of competition," and in particular stated that an objective of the Commission would be "to enhance competition and to allow economic forces interacting within a *fair regulatory field*, to arrive at appropriate variations in practices and services."⁶ BATS believes that the delay offered by IEX is a reasonable response to economic forces. BATS believes, however, that IEX's proposal to provide its routing broker-dealer preferential access to the IEX matching engine does not create a "fair field of competition."

The problem with the IEX architecture in this context is that it is not actually analogous to being geographically located 38 miles away from other market participants. Instead, this architecture is analogous to the IEX routing broker-dealer being co-located to the IEX matching engine and co-located to other trading venues while all other market participants are 38 miles away from IEX. Thus, while no other IEX member or trading venue could receive faster access to IEX's trading system, IEX's routing broker-dealer is permitted to instantaneously react to executions on IEX. This is the difference between IEX's system of a coiled cable artificially creating geographical distances versus an exchange that is actually located 38 miles away from other market participants. For instance, if IEX's trading system actually was located 38 miles away from other trading venues and market participants, the delay inherent due to geographical distances would be applied to all messages going in and out of IEX, including those sent by or received by its routing broker-dealer. Even if IEX's routing broker-dealer was located immediately next to IEX's matching engine in such a situation, orders sent from the IEX routing-broker dealer would need to travel 38 miles before reaching another trading venue. As a result, the IEX routing-broker dealer would not have an advantage over other market participants.

But, by artificially creating a geographical distance between IEX and other market participants, IEX is able to allow its routing broker-dealer to bypass that distance and to take advantage of that information to the detriment of investors on other venues.⁷ As explained below, this disparate treatment in favor of IEX's routing-broker dealer not only unfairly discriminates against other broker-dealers, but it actually allows the IEX routing-broker dealer to engage in the exact type of latency arbitrage that IEX claims is plaguing the current market.

⁶ See S. Rep. No. 94-75 (1975), at 8 (emphasis added).

⁷ IEX repeatedly argues that IEX does not provide its routing broker-dealer with any market data but only gives it an order and where to route it to. IEX is missing the fundamental importance of such information. This is exactly the type of information that a broker wishing to route on their own behalf would need to route unexecuted portions of orders sent to IEX. As such, by delaying execution messages to brokers but not to its own broker-dealer, IEX is giving its routing broker-dealer preferential access to trading information.

In particular, IEX states that the POP “is designed to guard against the impact of latency arbitrage strategies,” specifically as it relates to pegged orders. However, the design of the POP, and the IEX routing broker-dealer’s ability to avoid the 350 microsecond delay, allows the IEX routing-broker dealer to take advantage of, on other venues, the same type of pegged orders that IEX is protecting on its exchange. Consider the following example:

Assume that the NBBO is \$10.00 (100) x \$10.01 (200). IEX is quoting at \$10.00 (100) x \$10.01 (100) and Exchange A is quoting at \$9.99 (100) x \$10.01 (100).

A market order to sell is entered into IEX for 200 shares. IEX will execute the incoming order against the displayed order on its book at \$10.00 for 100 shares and a message is sent out to market data recipients notifying them of the execution and corresponding NBBO update. Sequentially, IEX would give the balance of the order to its routing broker-dealer, which in turn would route the balance of the order to another trading venue. However, because the POP and its delay are applied to only the execution message and not the order sent by IEX’s routing broker-dealer, the routed order will reach the other trading venue before the execution message and corresponding NBBO update. If IEX routes 100 shares to another venue for execution, and that other venue has midpoint or pegged orders, the routed order will execute based on what IEX knows to be a stale, or non-updated NBBO. For instance, if the incoming order were to interact with a midpoint order at the other venue, it would execute at \$10.005 based on a stale NBBO of \$10.00 x \$10.01, instead of \$10.00, which is the correct price.

The above example reflects the same type of latency arbitrage IEX complains about. As currently architected, in addition to discriminating against other broker-dealers that must wait to receive an execution message through the POP before routing to other trading venues, IEX is disadvantaging the same orders on other venues that it seeks to protect on IEX.⁸ Thus, the IEX routing broker-dealer with its exclusive latency advantage will become a desired tool of those market participants that use latency arbitrage strategies. As a facility of an exchange, the IEX routing broker-dealer must be available to all broker-dealer members of IEX on a fair access basis, and it will be exploited by algorithms, proprietary trading firms and foreign broker dealers that will have full access to the IEX exchange and its facilities. The Commission’s approval of the IEX latency advantaged routing broker-dealer will result in other exchanges adopting similar techniques to protect their own resting orders from participants that may otherwise exploit the very market that was supposed to simplify our markets and protect investors. And then, of course, it will come full circle. When all exchanges adopt the solution that IEX is proposing, the same exact issues will re-emerge that IEX is purportedly resolving. If BATS implemented a 350 microsecond delay in reporting executions but not routing orders, all routed orders from BATS

⁸ This particular problem is not an issue so long as IEX operates as an ATS because IEX’s quotes are not incorporated into the NBBO. Only after IEX becomes a national securities exchange, and its quotes are incorporated into the NBBO, will midpoint orders be based on IEX’s quotes and the above scenario be possible.

to IEX would reach IEX and be executed before the quote update would reach IEX from BATS, even if IEX was utilizing BATS's direct feeds.

BATS believes it would be relatively simple, however, for IEX to resolve this outstanding issue and secure SEC approval of its Form 1 while still preserving all of the benefits the POP provides investors accessing the IEX order book. In particular, if IEX subjected orders sent from the matching engine to the POP on their way to the IEX routing broker-dealer, the current unfair advantage IEX is giving its broker-dealer would cease to exist. Consider the following updated example:

Assume again that the NBBO is \$10.00 (100) x \$10.01 (200). IEX is quoting at \$10.00 (100) x \$10.01 (100) and Exchange A is quoting at \$9.99 (100) x \$10.01 (100).

If the IEX routing broker-dealer was subject to the same 350 microsecond delay as all other market participants, the other venue could update its quotes before the IEX routing broker-dealer could execute against the stale midpoint pegged order. Taking the above example, the incoming order would execute against the displayed order on IEX's book at \$10.00 for 100 shares and a message would be sent out to market data recipients notifying them of the execution. Sequentially, IEX would give the balance of the order to its routing broker-dealer, which in turn would route the balance of the order to another venue. Because the POP and its delay is applied to both the execution message and the order routed by the IEX routing broker-dealer, the message would be able to reach the other venue before the routed order, and the other venue could update its view of the NBBO. As a result, the other venue could update its view of the NBBO to \$9.99 x \$10.01 and the incoming order would execute against the midpoint pegged order at the correct price of \$10.00.

IEX has argued that its POP in this context is architected no differently than exchanges that have used cable length to create latency equalization within their data centers to ensure fair access to their matching engine but have not applied that same cable length to their own routing broker-dealers. This argument fails, however, to acknowledge a few basic facts. The latency equalization at exchanges generally introduces mere single-digit microseconds of latency to the matching engine, and that latency is nearly, if not entirely, offset by the processing time the exchanges' affiliated routing broker-dealers are required to undergo to analyze market data and make routing decisions. Crucially, unlike IEX, which explicitly markets to its customers the architectural advantage of sending IEX an order first and then using the IEX routing broker-dealer to reach other trading venues, no existing exchange could make the same marketing pitch because, unlike IEX, no such actual advantage exists to using the exchanges' routing broker-dealers.

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BATS appreciates the opportunity to further comment on IEX's Form 1 application. BATS welcomes the additional competition and innovation that IEX brings to the market, and believes that the Commission should expeditiously grant IEX's registration as a national securities exchange. But in so doing, the Commission should provide clear guidance regarding automated quotations, and should require that orders sent from the IEX matching engine traverse the POP before arriving to the IEX routing broker-dealer to ensure the fair and efficient operation of the national market system. Please feel free to contact me at (913) 815-7000 if you have any questions related to this matter.

Sincerely,



Eric Swanson
EVP and General Counsel

Cc: Mary Jo White, Chair
Luis Aguilar, Commissioner
Michael Piwowar, Commissioner
Kara Stein, Commissioner
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