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March 16, 2016

Brent J. Fields
Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Investors' Exchange LLC; Application for Registration as a National Securities Exchange (File No. 10-222)

Dear Mr. Fields:

On March 4, 2016, IEX acknowledged what multiple commenters recognized long ago: exchanges' routers are held to a higher standard of fairness than dark pools' routers.[1] In Amendment 3 to its exchange registration application ("Application"), IEX eliminated the advantage previously bestowed on its router by agreeing to subject the IEX router to the same 350 microsecond delay that IEX imposes on its members. Nasdaq applauds IEX's reversal, but consequential deficiencies remain:

1. IEX still fails existing standards of fairness because Primary Peg orders managed by IEX are exempt from the 350 microsecond delay while displayed orders managed by members remain subject to the delay.

2. Important questions remain unanswered: should an artificially delayed quote be protected under Regulation NMS, and why is the "crumbling quote" an exchange function rather than a broker dealer function?

3. Because IEX did nothing to correct its prior misstatements about Nasdaq's router, Nasdaq is compelled to correct the record on that point.

In addition to these deficiencies, IEX provides far less detail in its Application than existing exchanges are required to provide when they change similar types of proposed rules. In spite of this lack of detail, Amendment 3 is over 400 pages long and it contains hundreds of modifications to the Form 1, the exhibits, and the IEX rule manual. As Nasdaq and other

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[1] Letters from Sophia Lee, General Counsel, IEX Group, Inc., dated March 4 and March 7, 2016.

commenters have noted previously, IEX provides scant description of or justification for its rules or for the individual proposed changes.

Accordingly, Nasdaq cannot support IEX's brash demand that the Commission hastily approve the Application and its poorly-described changes in only 14 days. Given the large number of changes, Nasdaq believes the Commission should provide the investing public a meaningful opportunity to comment on Amendment 3 by re-publishing the Application in the Federal Register for 21 days or more.

Discrimination Favoring Non-Displayed Orders. Amendment 3 does nothing to address IEX's existing discrimination in favor of dark liquidity. This discrimination exists because neither the "crumbling quote" nor the non-displayed orders (primary pegged and midpoint pegged orders) are subjected to the 350 microsecond delay coil. Instead, crumbling quotes and pegged orders are priced using real-time market information to which they automatically respond. Displayed liquidity does not and cannot respond automatically; it must be adjusted by the entering party based upon market information that is delayed 350 microseconds. As a result, non-displayed orders have at least a 350 microsecond advantage in responding to changes in the IEX order book. In other words, non-displayed orders will always be moved to safety first. Nasdaq questions whether creating this artificial, structural disincentive against displayed liquidity is consistent with the protection of investors and the promotion of fair and orderly markets.

Unanswered Questions Remain. Several questions remain about the application of Regulation NMS to an artificially delayed quote. As noted in Nasdaq's first comment letter,[2] in considering IEX's application, the Commission must determine whether, under the Commission's past interpretations of Regulation NMS, IEX's artificially delayed quotation would be protected against trade-throughs even if it is subject to an artificial programming delay and not "immediately and automatically" accessible. The Commission must also consider whether the programmed quote delay is consistent with SEC Rule 602(b)(2) under Regulation NMS even if a broker about to receive an order marketable against its quotation could unwittingly change its quotation, rendering it non-firm under that rule. Based upon Nasdaq's preliminary reading, Amendment 3 does not appear to address these issues.

Additionally, Amendment 3 does not address whether the IEX "crumbling quote" is properly considered an exchange function or a broker-dealer function and the consequences flowing from that determination. This was a critical issue when the Commission considering the Nasdaq Benchmark Order:

> Thus, NASDAQ's proposed Benchmark Order is not an exchange order in the traditional sense, in that it would not immediately enter the Exchange's order book (*i.e.*, NASDAQ Market Center) for potential execution. Instead, it essentially is an instruction that would reside outside of the matching engine and be processed by an Application, which would then route orders to NASDAQ, or another trading venue, using a selected algorithm, over

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[2] Letter of Joan Conley, Senior Vice President and Corporate Secretary, Nasdaq, Inc, to Brent J. Fields, Secretary, Commission (November 10, 2015).

> a particular period of time, to achieve a particular objective. Because NASDAQ is proposing to offer a novel order type designed to compete with services offered by broker dealers, the Commission must consider, among other things, whether the proposed rule change would impose an unnecessary or inappropriate burden on competition under Section 6(b)(8) of the Act.[3]

Based on Nasdaq's preliminary reading of Amendment 3, it still appears that the IEX "crumbling quote" suffers the same deficiencies the Commission identified in Nasdaq's Benchmark Order. Nasdaq needs a full opportunity to analyze that question during a new comment period. The public is entitled to a clear determination by the Commission of the applicable standard for such order types.

Correcting the Record. Amendment 3 does not appear to correct a record containing misstatements about Nasdaq's router. In its February 19 comment letter, IEX discussed a 2012 Nasdaq filing concerning routing functionality.[4] As we explained in a prior comment letter,[5] the idea behind the 2012 filing was to make all events associated with each order – execution on Nasdaq, routing of shares that cannot be executed on Nasdaq, and transmission of information to all market participants – occur as close in time to one another as possible. In doing so, Nasdaq fills as much as possible of an incoming order on its own exchange, which is hardly surprising, since the order was sent to Nasdaq for execution in the first place. However, if a Nasdaq member does not wish to use Nasdaq's routing functionality, it has the ability to send an order directly to the Nasdaq matching engine, thereby bypassing the exchange system that handles orders designated for routing, and would receive an immediate confirmation of the order's execution on Nasdaq. Thus, the member accessing Nasdaq's matching engine would not be at a disadvantage vis-à-vis Nasdaq's routing broker (or the member that opted to use Nasdaq's routing functionality).

The attached graphic demonstrates several fallacies in IEX's comparison between Nasdaq and IEX's structure. First, IEX continues to misunderstand the physical and functional separation between Nasdaq's exchange systems and Nasdaq's broker-dealer, Nasdaq Execution Services ("NES"). The Nasdaq exchange contains numerous systems, including for example, systems for symbol maintenance, internal and external data dissemination, order management, order matching, and surveillance. In the graphic, those systems are all contained within the large black box. Those systems, in turn, comprise dozens of sub-systems. For example, the order management system ("OMS"), commonly referred to as "**R**outing **A**nd **S**pecial **H**andling" or "RASH", actually contains over a dozen separate, linked sub-systems that manage key exchange

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[3] Securities Exchange Act Release No. 68629 (Jan. 11, 2013), 78 FR 3928, 3931 (Jan. 17, 2013) (SR-NASDAQ-2012-059).

[4] Securities Exchange Act Release No. 67639 (August 10, 2012), 77 FR 49034 (August 15, 2012) (SR-NASDAQ-2012-071) (the "2012 filing").

[5] Letter of Joan Conley, Senior Vice President and Corporate Secretary, Nasdaq, Inc, to Brent J. Fields, Secretary, Commission (Jan. 29, 2016).

functions, including market access rule compliance, market maker quoting, and routing, as well as order attributes such as pegging, discretion, and reserve. The routing sub-system of the OMS is further differentiated into still other sub-systems for separate routing logic, including SCAN, STGY, and TFTY. These layered systems and sub-systems perform widely differing functions, using unique software, and often resting on separate hardware. Every exchange organizes its systems differently, combining some functions that Nasdaq separates and separating some functions that Nasdaq combines. There can be no dispute that, however these exchange systems are arranged, combined or separated, they are inextricably linked and part of the unified whole known and operated as an exchange.

NES is a facility of the Nasdaq exchange but not the exchange itself. NES is functionally separated from the exchange by a gateway, marked on the graphic. While an order resides on the exchange side of that gateway, exchange systems perform exchange functions to process that order and to create instructions for the proper treatment of that order. When the order is fully processed by the exchange, the order leaves the exchange by passing through the gateway; conversely, when an order leaves the gateway, it can no longer be processed by the exchange. Once an order passes through the gateway, the order has all the instructions and information it will ever get from the exchange. The instructions are a frozen snapshot based on information available within the exchange at the time of departure from the exchange. Once through the gateway, the order will not re-enter exchange systems, nor will it receive additional instructions or access additional data from exchange systems.[6] Once an order leaves the gateway to NES, it cannot be updated to reflect changes within the exchange. NES has no discretion to cancel or modify it if, for example, the exchange obtains information that might impact or alter those instructions.[7] Ignoring this physical and functional separation, IEX continues to confuse the OMS within the exchange and NES outside the exchange.

Second, IEX incorrectly stated that NES has preferential access to information about non-displayed orders in the Nasdaq exchange. Every system and sub-system within the Nasdaq exchange has access to the same data. Nasdaq gathers data from each exchange or the network processor and then it simultaneously "distributes" that data to all exchange systems.[8] NES, residing outside the exchange, does not receive this data and thus has no visibility into information about non-displayed orders in the Nasdaq exchange. In fact, NES has no visibility into information about any orders within the Nasdaq exchange, displayed or non-displayed. NES simply follows instructions contained in the orders it receives without regard to ongoing changes

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[6] Orders routed to away venues may return to the exchange if not fully executed. However, exchange systems treat those returning orders as new orders subject to new processing and new application of data.

[7] See Nasdaq Rule 4758(b)(1).

[8] See Nasdaq Rule 4759 for a list of data sources. See also SR-NASDAQ-2015-xxx for a detailed description of how that data is collected and used across the Nasdaq exchange. As a dark pool, IEX is not required to disclose its data usage policies; as an exchange it must.

occurring in the Nasdaq matching system. Thus, IEX was incorrect when it argued that NES has preferential access to information.

Third, IEX misrepresented that Nasdaq exchange systems discriminate in favor of members that utilize Nasdaq routing strategies and against those that do not. This argument is factually incorrect, as demonstrated by the graphic. Using Nasdaq's order management system is optional, and members opting against using Nasdaq's OMS are not disadvantaged in any way. Members not wishing to use Nasdaq's OMS can enter orders via OUCH or FLITE protocols. Orders entered via OUCH and FLITE go directly to the matching system where they interact with the displayed and non-displayed liquidity residing there. Once executed, the execution information regarding OUCH and FLITE orders is immediately and simultaneously disseminated to all members – including an execution acknowledgement to the entering member.

Alternatively, members wishing to utilize Nasdaq's OMS for order routing can enter orders via RASH, QIX, or FIX protocols. Orders entered via RASH/QIX/FIX travel directly to the OMS which, as described above, has access to the same data used by the matching system to process displayed and non-displayed liquidity. The OMS identifies liquidity available in the matching system for a RASH/QIX/FIX order exactly as the matching system identifies the same liquidity for OUCH/FLITE orders. Once a RASH/QIX/FIX order is executed, the matching system immediately transmits execution data for RASH/QIX/FIX orders to all members, just as it does with OUCH/FLITE orders. If the OMS determines (based on instructions the entering firm embeds in the order) that the matching system contains insufficient liquidity to fill the RASH/QIX/FIX order, it will transmit a message instructing that the unexecuted portion of the order be sent to an away venue based on the information available to the OMS (and all exchange systems) at the time. Once that message leaves the gateway to NES, it is outside the exchange and can no longer be modified by the exchange. The information about RASH/QIX/FIX orders that emerges from Nasdaq's systems – the matching system and the gateway – puts RASH/QIX/FIX users that use NES in exactly the same informational posture as OUCH/FLITE users that use other routing options. Thus, as the graphic clearly demonstrates and contrary to IEX's claims, users of the OMS and NES enjoy no information advantage over members that use other routing options.

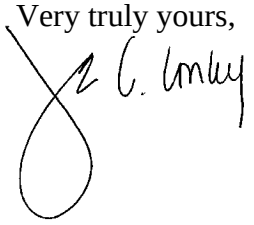
The graphic further demonstrates that NES has no advantage over other Nasdaq members. To the contrary, members that do not use the Nasdaq OMS enjoy a small time advantage over members that do. Specifically, assume member X enters an order to buy 1000 shares via OUCH/FLITE (A-1) and member Z simultaneously enters an order to buy the same 1000 shares via RASH/QIX/FIX (A-2). Order A-1 travels directly to the matching system, the matching system executes 500 shares of displayed or non-displayed liquidity, and then the matching system sends execution information to the member (D) indicating that member X had 500 shares executed and has 500 shares remaining unexecuted. Order A-2 travels to the OMS, the OMS sends 500 shares to the matching engine to execute against displayed or non-displayed liquidity and it sends 500 shares to the gateway (C) for delivery by NES to an away venue (E).

Neither order enjoys an information advantage because both orders are processed using the same market data. The OMS uses the same data to send orders to both systems, the matching system and the routing system; and, again, the OMS consumes the same data the matching

system consumes. Moreover, the average time elapsed from order entry to acknowledgement (A-1 to D) is shorter than the time elapsed from the OMS to acknowledgement of the 500 shares executed at the matching system (OMS to D); and the time elapsed from the OMS to exit of the 500 shares from NES (OMS to E) is even greater. Two critical facts are clear: (1) orders entered via OUCH/FLITE and orders entered via RASH/QIX/FIX receive the same treatment in the matching system, and (2) members utilizing OUCH/FLITE receive faster processing and order acknowledgement, leaving them well positioned for routing *vis a vis* NES. Accordingly, the record should reflect that NES has no advantage over other Nasdaq members.

If you have any questions regarding these comments, please do not hesitate to contact me.

Very truly yours,



cc: The Honorable Mary Jo White, Chair
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner
Stephen Luparello, Director, Division of Trading & Markets

Attachment to Nasdaq's IEX Comment Letter Dated March 16, 2016