March 18, 2016

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street N.E.
Washington, D.C. 20549

Re: Investors' Exchange, LLC Application; Release No. 3475925, File No. 10-222

Dear Mr. Fields:

We are writing on behalf of not just ourselves as traders, but on behalf of all but a handful of favored high-transaction-volume firms. We favor the IEX application being implemented as a transparent alternative to existing exchanges, and we have empirically found IEX orders to lower transaction costs relative to those alternatives.

We are not against HFT in principle, as we don't reflexively resist change. Computers should be allowed to respond to news, price changes, and world developments. There are plenty of legal, fair, and socially beneficial versions of HFT.

The problem is that in practice, the compensation structure of all existing exchanges unfairly rewards high volume customers in manners aside from mere bulk-discount pricing, instead granting them favors at the expense of lower volume customers. Exchanges and some brokers disregard their own egalitarian rules by allowing favored customers to jump the line over unfavored customers. This flouts the spirit of the Manning rule and other customer protection rules. The exchanges often ignore the evidence of favoritism for obvious conflict-of-interest reasons. Three primary examples come to mind:

1) Time priority for customer limit orders, as dictated by NYSE's own Rule 964NY(b)(2)(A) and Nasdaq's Rule 4757(a)(1), is frequently not honored. It is exceedingly common for favored customers to join the visible limit orders of unfavored retail customers at a later time, but the favored customers still receive fill priority. Relatedly, subpennying in contravention of Reg NMS Rule 612 is employed by favored exchange clients and tolerated by exchanges.
2) Customer orders to remove liquidity are front-run, as exchanges offer co-located server algos hosted by prioritized customers the option to initiate their own orders to remove the same liquidity that the unprioritized customer order is attempting to remove. If the prioritized customer accepts the offer to front-run, the prioritized customer's order is then re-routed to other exchanges just ahead of the unprioritized customer's order. The time lag between the reception of a customer order and the decision whether to front-run it is so small that exchanges claim that the prioritized customer's order actually arrived first, which is often false. This activity is most obvious to the non-prioritized customer when trading relatively low volume instruments with infrequent trading activity.
3) If non-prioritized customers enter limit orders as "hidden" in order to prevent predatory time-priority rule violations as described in #1, the order is only filled when the market crosses that order without immediately filling an order already visible on the order book, and price improvement is never granted to the unfavored customer. Instead, prioritized customer orders receive the full benefit of the entire price improvement in the case of order crossing.

The net result of these effects is that markets are far less liquid for unfavored customers than they appear. To make a decision to buy or sell, unfavored customers must be prepared to incur substantial transaction costs that directly benefit favored customers. For favored customers, the markets are indeed as liquid as they appear, and they are given a free pass to wait for outside unfavored orders to come in before actually deciding whether to add or remove liquidity, and at what price. IEX allows the customer to avoid the above-mentioned costs. As a practical matter, all deprioritized customers, if they do the math, will prefer the latency introduced by IEX.

In addition to the above-mentioned advantages that exchanges grant to high-volume customers at the expense of unprioritized customers, the use of IEX would cause a few additional knock-on effects benefiting the integrity of the market as a whole:

1) The risk of quote-stuffing, which overwhelms exchange servers, causing momentary actual liquidity lapses and "flash crashes" or "flash spikes" will be greatly reduced. The latency introduced by IEX adds an additional layer of actual, unephemeral liquidity to the market that serves to dampen momentum and liquidity lapses, akin to how human market makers used to dampen markets during irrational or momentary price overshoots. By limiting the importance of being the absolute fastest in the market, market-making competition on the basis of factors besides quote game-playing, which only the absolute fastest and most prioritized customers can successfully deploy, will be encouraged. Moreover, lack of liquidity is a feedback loop, as has been seen numerous times in the past with seemingly increasing frequency. The malicious feedback loop of illiquidity generated by HFT game-playing with quotes can be stymied early in the process through the presence of actual liquidity on the IEX books, eliminating unnecessary volatility. Instead, the reduced volatility will drive the feedback loop the other way—encouraging ever more liquidity providers because they know they are operating on the same level playing field as everyone else. The barrier to entry will no longer involve investing hundreds of millions in top-tier technology infrastructure and committing to doing high-volume sufficient to warrant access to the faster feeds from the current exchanges.
2) Spoofing and layering, which every professional trader can witness happening every day at almost every moment in the market in most equity securities, will be greatly disincentivized. It is obvious that prioritized HFTs attempt to game other market participants by presenting limit orders that the algo doesn't intend to get filled, and which the HFT can ensure aren't filled because their cancellation is given priority by exchanges over non-prioritized customers' remove liquidity orders. Nanex calls this "quote fading" and "phantom liquidity," and we experience this every day. IEX's introduction of latency provides an alternative venue of actual liquidity where market participants that actually intend to fill and get filled may transact. If potential spoofers know their order might actually be filled, then that discourages spoofing in the first place.
3) Private capital will be discouraged from being wasted on the arms race of having the newest and fastest technology infrastructure. Currently, high-volume players are spending billions to out-compete one another one speed, as the absolute fastest players gather the vast majority of the gains coming at unprioritized customers' expense. Instead, the advantages of being first will be minimized w/ IEX's speed bump, and the capital that would have been spent on accumulating zero-sum gains can instead be spent on something more productive for society.

If the advantages currently granted to high-volume customers continue unabated, then some traders who allocate capital on a longer timeframe, but incur immense transaction costs in doing so, may unfortunately be forced to forgo longer-term capital allocation strategies and instead seek employment with firms conducting enough volume to be given order priority by exchanges, thereby removing elements of competitive efficient capital allocation from the system. The favoritism currently present in the market encourages consolidation towards ever higher-and-higher volume outfits, unnecessarily introducing a benefit of scale to the market and paring the diversity of opinions that leads to market efficiency.

In light of all the public comments, IEX presents favorable public policy advantages. If IEX's application is accepted, the market will shift back to rewarding efficient longer-term capital allocation rather than short-term price gaming based around speed and favoritism.

This is written and agreed to by a large group of individual traders and is submitted anonymously to prevent retribution by existing exchanges or others. We simply intend to convey to the SEC what has gone on in the market for years, as we are sure the SEC is able to verify itself even more easily than we can. We feel the arguments speak for themselves. We support allowing the IEX application.

/s/ Large group of anonymous traders