[XTX] MARKETS

March 30, 2023

Via Electronic Mail rule-comments@sec.gov

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NE Washington, DC 20549

Re: Order Competition Rule, Release No. 34-96495; File No. S7-31-22

Dear Ms. Countryman,

XTX Markets appreciates the opportunity to comment on the Securities and Exchange Commission's (Commission) proposal to implement the Order Competition Rule. By way of background, XTX Markets LLC is a U.S. broker-dealer and an affiliate of XTX Markets Ltd. (collectively "XTX Markets"), a London-based proprietary trading firm. XTX Markets is a regulated quantitative-driven electronic trading firm with global operations. We trade equities, FX, futures, commodities, options, and U.S. Treasuries. XTX Markets executes daily volume of approximately $300 billion across all asset classes and geographies.

XTX Markets is a strong advocate globally for fair and transparent markets and is committed to making markets more efficient and competitive, in part by advocating for policies that reduce barriers to entry and level competitive playing fields between market participants. XTX Markets believes the Commission's proposed Order Competition Rule, with some modifications noted herein, will have the effect of substantially enhancing competition for retail marketable orders, which in turn will, in aggregate, generate enhanced savings for retail investors in the form of better prices on their orders than they receive today.

I. Summary of Rule Proposal

As proposed, the Commission's Order Competition Rule would require, absent an exception, all retail marketable orders to be exposed to an auction mechanism on a registered

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national securities exchange with 1% or more market share or qualifying ATS (both a "Qualified Auction Operator"), before they can be executed off exchange. Exceptions to this rule include where the retail marketable order can be traded at the midpoint of the NBBO off-exchange, orders received and executed when no auction is being operated, and orders sent to the continuous book of a registered national securities exchange that is a Qualified Auction Operator.

Importantly, the orders that initiate qualified auctions are only retail marketable orders as defined in the proposal. Per the proposal, the retail orders will be published to the SIP, with the following information: (1) symbol, (2) side, (3) size, (4) a limit price, and (5) generally, subject to an opt out process, the identity of the retail broker responsible for the retail customer order. These retail auctions will run for a minimum period of 100 milliseconds to a maximum period of 300 milliseconds. Any market participant may respond to an auction message on the SIP and those responses will be blind.

At the conclusion of the auction period, any execution will occur against the auction response order(s) at the best price. Executions can occur for orders in all NMS securities at increments of $0.001, and retail orders cannot be charged an access fee in the qualified auction but could receive a rebate of up to $0.0005 per share, while auction responders can be charged an access fee up to $0.0005 per share. The priority of execution when there are multiple auction responders at the best price cannot be based on time and cannot be linked to the broker-dealer that submitted the retail order. In addition, customer orders in the auction have priority over broker-dealer orders and displayed orders on the continuous book have priority over auction responses (however, non-displayed orders on the continuous book may not have priority over same-priced orders in the qualified auction).

For retail marketable orders that do not receive an execution in the qualified auction, the orders can be returned to the retail broker or an intermediary (wholesaler) for further order handling, including resubmission to another qualified auction (with or without a new limit price), submission to the continuous order book of an exchange that is a Qualified Auction Operator, or, in the case of a wholesaler, execution at a price no worse for the retail client as the limit price on the retail order when it was submitted to the qualified auction.

II. Discussion

XTX Markets believes implementation of the Order Competition Rule, with some changes discussed below, will lead to substantial savings in the aggregate for retail investors. Today, the execution of retail marketable orders is concentrated with a small number of wholesale broker-dealers with 65% -70% of retail order market share concentrated in the hands of two. There is no order-by-order competition today for retail marketable orders, and the

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arrangements governing the majority of retail order flow are characterized by pre-determined aggregate payment for order flow (PFOF), commonly \$0.001to \$0.002 per share, which is paid from the wholesaler to the retail broker-dealer.

Wholesalers will generally also provide price improvement over the advertised NBBO directly to the retail customer order. However, the PFOF payment and price improvement to the retail customer are funded from the spread available to the wholesaler executing the order. As such, even in the absence of order-by-order competition, one would expect there to be a difference in the execution prices experienced by a retail customer of a broker-dealer receiving PFOF from a wholesaler and a retail customer of a broker-dealer that declines to receive PFOF from a wholesaler. And, in fact, the CEO of the second largest wholesaler has publicly confirmed that in the aggregate the former receives worse execution prices than the latter.[1]

Retail brokers are subject to a duty of best execution that requires them to obtain the best price for their customer order reasonably available in the market. We have long wondered how the duty of best execution can be reconciled with the existence of PFOF. Price improvement for customer orders and PFOF are inextricably in conflict. As PFOF goes up, price improvement goes down. An intuitive result, and one that FINRA has stated is inconsistent with the duty of best execution.[2]

While PFOF arrangements put the interests of retail brokers into conflict with the interests of their customers, we view the existence of PFOF as a symptom and not the cause of the inefficiencies with the current model for retail order execution. If the market for retail orders was truly competitive, PFOF should have been competed out of that market in favor of better prices for customer orders. That has not happened. The Commission's proposal to, for the first time, mandate order by order competition for retail orders will substantially enhance the competition for retail orders, competing down PFOF and, in turn, provide greater aggregate price improvement to retail orders.

XTX Markets wishes to stress than when we discuss increases in price improvement, we expect those enhancements to be realized in the aggregate. What we mean by this is that under the current non-competitive wholesale model, there is cross-subsidization of price improvement

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1 https://twitter.com/SquawkCNBC/status/1369995291148050432, at 2:04.

2 FINRA Regulatory Notice 21-23 (June 23, 2021) *Best Execution and Payment for Order Flow*. "[O]rder routing firms and firms receiving customer orders from other firms for handling and execution must regularly evaluate whether reliable, superior prices are readily accessible for the customer orders they handle, and these *firms may not negotiate the terms of order routing arrangements for those customer orders in a manner that reduces the price improvement opportunities that otherwise would be available to those customer orders absent payment for order flow*. (Emphasis added).

(and PFOF) across various categories of securities. For example, small retail orders are more profitable to trade with and can subsidize price improvement and PFOF for larger retail orders. Executions in securities with wider spreads can subsidize executions in securities with narrower spreads. And retail orders in large cap securities that are more actively traded can subsidize trading in small cap securities. As such, we would expect that for some securities subject to order by order competition, aggregate price improvement may decrease, while for other securities – in particular large cap securities, smaller retail orders, and securities with wider spreads – aggregate price improvement will increase, and that across all securities the total amount of price improvement will be greater than what is realized today.

This outcome highlights that the current non-competitive model distorts price discovery. Under the competitive model proposed by the Commission, these distortions will fall away, and each execution of a retail marketable order will reflect an accurate allocation of the economics of trading each given security, which in turn will enhance price discovery. And we are unconcerned with arguments put forward by some that subjecting retail marketable orders to order-by-order competition will require retail brokers to charge commissions on trades. This argument merely stresses the point that there are no free trades – there are non-transparent fees being paid today by retail investors in the form of PFOF at the expense of better execution prices. Better to compete away the non-transparent PFOF fees and subject any fees replacing them, commissions, or other fees, to transparent competition.

XTX markets is also encouraged by the efforts the Commission is taking to enhance the NBBO through the Order Competition Rule proposal and the companion proposal to redefine what constitutes a round lot for purposes of protected quote status and the inclusion of certain odd lots on the SIP. XTX Markets has been a critic of the quality of the existing NBBO as a benchmark for price improvement.[3] As the Commission noted in the Order Competition Rule proposal, there are a multitude of non-displayed midpoint orders that can easily be accessed on behalf of retail investors, as well as non-displayed round lots and odd lots that are often times better than the NBBO. Taking steps to display more of this information onto the SIP will enhance the quality of the NBBO. In addition, although the retail auctions contemplated by the Order Competition Rule proposal will run outside of the continuous order book, the integration of the two by virtue of awarding priority at the same price in the retail auctions to displayed orders on the continuous book will help enhance overall price discovery and the robustness of the NBBO.

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3 https://www.linkedin.com/pulse/pi-benchmarking-alexander-gerko/?trackingId=L0AVZX7jv15dfTyAxYIGqA%3D%3D

A. Disclosure of Side and Limit Price

XTX Markets supports the Commission's proposal to mandate order by order competition for retail marketable orders. XTX Markets is concerned, however, that if certain aspects of the proposal are not modified, the auction mechanism will fail to deliver its intended results. In particular, we believe the information about each auction order published to the SIP should be limited to broker, symbol, and size, but should *not* disclose side – buy or sell, and should *not* include limit price, which is a proxy for side. XTX Markets is concerned that if the retail auction order message includes side or limit price, the result may be that retail investors will be subject to quote fading or trading ahead during the auction period, which would create a bad experience for retail orders. We are also sympathetic to concerns raised by another commenter that exposing side may dissuade institutional investors from participating in retail auctions out of concerns about information leakage.[4]

With respect to limit price, the Commission indicated in the proposal that the reason to include it is to "inform auction responders on how to price their orders and also, if the segmented order did not receive an execution in the qualified auction, [the limit price] would be the price (or better) at which the wholesaler or other restricted competition trading center subsequently could execute the segmented order as soon as reasonably possible."[5] Here too though, disclosure of limit price is a proxy for disclosing side and is totally unnecessary – executions of retail marketable orders in the auction must occur at or between the NBBO. There is no need to further bound the execution price in a competitive auction.

We suggest the Commission modify the proposal to remove side and limit price from the auction, and instead allow auction responses to be submitted on one or both sides of the market at the discretion of the responder. Alternatively, if the Commission feels strongly that limit price is necessary, we would support the proposal of another commenter who suggested including two-sided limit prices on the retail order in the auction with the same amount of price improvement on each side, which would achieve the same outcome.[6]

B. Volume Tiers

The Commission makes clear in the proposal that any fees charged for auction executions must be the same across auction responders and across all securities subject to an

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4 Letter to Vanessa Countryman, Secretary, SEC, from Allison Bishop, President of Proof Trading, February 8, 2023, commenting on the Order Competition Rule proposal.

5 Order Competition Rule proposal, Exchange Act Release No. 96495 (December 14, 2022) at p. 71.

6 *Id*

auction, i.e., preferential auction fees based on volume are prohibited. However, XTX Markets is concerned that the Commission does not prohibit the creation of tiers for trading on the continuous book that are based in whole or in part on volume a member executes in the retail auctions. XTX Markets believes the same concerns about leveling the playing field among all potential market participants who may wish to trade against retail orders in the auctions are present if a market participant is able to subsidize its auction pricing through volume discounts in the continuous book that are linked to executions in the retail auctions. Accordingly, XTX Markets asks that the Commission prohibit volume discounts in the continuous book that are based on retail auction activity.

III. Conclusion

XTX Markets strongly supports the direction the Commission is taking to fundamentally alter the manner in which retail marketable orders are integrated into the broader market. In doing so, XTX Markets believes this Commission will create an enduring model that inures to the benefit of retail investors through greater transparency and more competitive pricing. We have suggested some important modifications to the proposal that we believe will further the Commission's goal of realizing better outcomes for investors and leveling the playing field for market participants and we urge the Commission to adopt those modifications to ensure the success of the Order Competition Rule.

Further, we are aware that some commenters will likely raise a host of issues regarding the interaction between this proposed rule and existing Commission and FINRA rules, likely presented as a parade of horribles and unintended consequences that in the aggregate render the Order Competition Rule proposal unworkable. XTX Markets believes that many of the issues will on their face be legitimate practical concerns about specific order handling scenarios; however, we further believe that they are largely technical in nature and regardless can be resolved either in an approval order itself or through subsequent FAQs issued by Commission staff.

Thank you for the opportunity to provide XTX Markets' views on the Order Competition Rule proposal. If I can be of any further assistance, please do not hesitate to call me at [redacted].

Sincerely,

Eric Swanson
CEO, XTX Markets LLC

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime E. Lizarraga, Commissioner
Dr. Haoxiang Zhu, Director, Division of Trading and Markets