March 31, 2023

VIA E-MAIL

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-0609
rule-comments@sec.gov

Re: **Order Competition Rule (File No: S7-31-22)**

Dear Ms. Countryman:

CTC, LLC[1] ("CTC") respectfully submits this letter in response to the U.S. Securities and Exchange Commission's ("SEC" or "Commission") most recent proposal to amend the regulation governing the national market system ("NMS") under the Securities Exchange Act of 1934 ("Exchange Act") to add a new rule designed to promote competition as a means to protect the interest of individual investors and to further the objectives of an NMS ("Proposal").[2] As described in the Proposal, the rule would prohibit a restricted competition trading center from internally executing certain orders of individual investors at a price unless the orders are first exposed to competition at that price in a qualified auction operated by an open competition trading center, with some limited exceptions.

Though we have concerns about its highly prescriptive approach, CTC generally supports the Proposal because it introduces beneficial order-by-order competition into the equities markets, it addresses longstanding concerns about too few retail orders going to the exchanges for inclusion in price discovery, and it is thoughtfully constructed to preclude gaming opportunities and reduce unintended consequences. CTC respectfully requests that the SEC consider going further to incentivize market participants to display competitive quotes by enabling displayed liquidity to interact directly with incoming retail orders and encourages the Commission to introduce a similar fair and open auction requirement in the options markets.

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[1] CTC, LLC is a registered broker-dealer that is a proprietary options market maker and a member of the Chicago Board Options Exchange, the C2 Options Exchange, Cboe BZX Options, BOX Options, NYSE Arca Options, NYSE American Options, Nasdaq ISE, and Nasdaq Phlx.
[2] Exchange Act Release No. 96495 (December 14, 2022), 88 FR 128 (January 3, 2023)

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As described in the Proposal, Broker-dealers route more than 90% of individual investors' marketable orders in NMS stocks to wholesalers.[3] While the majority of these orders do receive some price improvement as compared to the displayed quotes, the wholesaler's execution does not face any competition at all. This is in contrast to being routed to an open competition trading center, such as a national securities exchange, where they would participate in order-by-order competition, which can lead to significantly better prices for these orders.[4] CTC supports this Proposal because it introduces additional order-by-order competition into the equities markets which we believe will result in better prices for retail investors.

Another significant concern that has persisted in the US equities markets for years is that there is too little retail order volume going to lit exchanges because it is locked up by wholesalers who execute the best orders for themselves. Because the majority of this order flow never ends up on lit markets, it is not fully included in the price discovery process, which undoubtedly has a deleterious effect on execution quality. CTC believes that encouraging significantly more retail orders to go to lit exchanges or other open competition trading centers will lead to more accurate price discovery. CTC supports this Proposal because it addresses this longstanding concern by encouraging the participation of significantly more retail orders in a full, public, price discovery process, leading to better prices which, in turn, will encourage added retail order volume, thus resulting in a virtuous competitive cycle that makes markets more efficient.

However, as a market making firm, CTC feels very strongly that the auction requirement found in the Proposal does not go far enough to improve market structure. In order to have truly efficient and transparent markets, where publicly available quotes reasonably reflect the best prices and liquidity available, there must also be an incentive for market participants to display quotes with competitive prices and greater size. **This incentive only exists when displayed quotes have the opportunity to directly interact with incoming orders on an open competition market center.** Therefore, while we support the proposed auctions because they will contribute to more efficient markets, CTC respectfully urges the Commission to go further to incentivize market participants to display competitive quotes by enabling displayed quotes to directly interact with incoming retail orders. This could be accomplished, for example, by including an exemption to the auction requirement in cases where the public exchange quote meets some reasonable standard of quote quality, provided that the executing firm attests and can demonstrate that it makes routing decisions in a manner that is agnostic to the participation, or presumed participation, of itself or its affiliates on the quote in question (to prevent circumventing the spirit of the rule by allowing firms to skip auctions only when they believe they are routing to their own quote).

CTC believes that the Proposal has been thoughtfully constructed to preclude gaming opportunities, such as including the 1% share volume in NMS stocks requirement to qualify as an open competition trading center.[5] This requirement prohibits routing marketable retail orders to venues where only a few preferred

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[3] Proposal, p. 6

[4] The Proposal indicates that the current isolation of individual investor orders from order-by-order competition results in suboptimal price improvement for such orders. This "competitive shortfall" is estimated to be approximately $1.5 billion or more annually. Proposal, p. 271 and Table 19

[5] Proposal, p. 89

counterparties are actually connected. That said, CTC is concerned with the information leakage represented by disclosing the side and quantity of the order being auctioned for an extended period of time (hundreds of milliseconds) before execution. We respectfully suggest that the auction mechanism be changed to require only the quantity, but not the side, of the order being auctioned – or that another mechanism be found to ensure that third parties won't use the public disclosure of auction announcements in a manner that is inconsistent with fair, orderly, and efficient markets.

CTC believes that this Proposal has been appropriately tailored to reduce unintended consequences by setting forth five exceptions[6] to the general rule requiring that individual investor orders be exposed to order-by-order competition in fair and open auctions before such orders could be internalized by wholesalers. This approach allows investors to continue to receive the benefits of segmentation through better prices but without the negative effects of those orders being isolated from order-by-order competition.

That said, it is worth noting that this proposal is extremely prescriptive. As a rule, CTC supports a principles-based approach to regulation, as we believe it allows exchanges and market operators to innovate subject to a requirement of maintaining fair and orderly markets pursuant to just and equitable principles of trade. We also recognize the challenge in trying to achieve the market structure outcomes the SEC is after, with which we agree, without being prescriptive (for example, we acknowledge that a vague SEC requirement that "retail order must be submitted to competitive processes" would perhaps leave too much room for interpretation, enabling market participants looking to maximize internalization rates to seek those venues which interpret this requirement in the most permissive way possible). Given this, we believe the current proposal strikes a reasonable balance.

CTC is pleased that the Commission is taking action to introduce more competition into the market structure for NMS stocks and we respectfully request that the SEC consider a similar fair and open competition auction requirement in the options markets. While the options markets already possess widespread electronic auctions, they include multiple mechanisms which subvert fair and open auction competition of the sort contemplated by this rule. Some examples include:

- Designated Primary Market Maker ("DPM") or Specialist allocations, which include 100% entitlements to spread-crossing of 1-5 contracts (irrespective of how many other market makers are quoting at the price), creating a private market for spread-crossing retail orders with no competition whatsoever;

[6] The Proposal sets forth five exceptions from the order competition requirement, which include: 1) allowing executions of segmented orders by a restricted competition trading center while no open competition trading center is operating a qualified auction; 2) allowing execution of large orders (>= $200,000 market value) received by a restricted competition trading center; 3) allowing execution of segmented orders by a restricted competition trading center at a price that is equal to the NBBO midpoint or more favorable for the segmented orders; 4) allowing execution of segmented orders by a restricted competition trading center at a limit price selected by the customer that is equal to the NBBO midpoint or more favorable for the segmented orders; and, 5) allowing execution of orders that are less than one share and the factional component of a segmented order by a restricted competition trading center while no open competition trading center is operating a qualified auction for such orders. Proposal, p.101-105

- Initiator preference allocations (40-50%) in most price improvement auctions give a major advantage to entrenched players with wholesaling arms and are clearly anticompetitive;

- The ability to run auctions with no minimum market share (such as the prudent 1% minimum included in the Proposal) encourage wholesalers to route orders to venues with as few potential responders as possible, resulting in worse prices for customers;

- High costs for auction responders, which are explicitly hyped by exchange marketing teams, discourage third party market makers from price improving orders submitted by wholesalers. Likewise, "break-up fees" which, in wholesaler parlance, is paradoxically considered "breaking-up" their orders, also discourage price improvement; and,

- "SUM," "BOLD," and "Flash" auctions that use time priority, reward firms that invest in raw execution speed while never providing bona fide price improvement.

CTC supports this Proposal because it introduces beneficial order-by-order competition for marketable retail orders in NMS stocks and encourages significantly more retail order participation in the exchange price discovery process. CTC respectfully requests that the SEC consider going further to incentivize market participants to display competitive quotes by enabling displayed liquidity to interact directly with incoming retail orders and encourages the Commission to introduce a similar fair and open auction requirement in the options markets. For the reasons stated above, each of these measures would further promote competition, which is the hallmark of all efficient and well-functioning markets.

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Should you have any questions with respect to this letter, please contact our General Counsel, James Ongena at james.ongena@chicagotrading.com or (312) 863-4713, we would welcome the opportunity to discuss it further and appreciate the opportunity to respond.

Sincerely,

Eric Chern
Co-Founder

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