CITADEL | Securities

May 4, 2023

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090

Re: IntelligentCross ATS Proposal (File No. SR-FINRA-2022-032)

Dear Ms. Countryman:

Citadel Securities appreciates the opportunity to provide further comments to the Securities and Exchange Commission (the "Commission") on the proposal by the Financial Industry Regulatory Authority, Inc. ("FINRA") to add the IntelligentCross ATS to the Alternative Display Facility (the "FINRA Filing").[1] Simply put, the FINRA Filing should be disapproved.

IntelligentCross operates an alternative trading system – a Commission-regulated electronic trading system that matches orders for buyers and sellers of securities. Market participants can elect to display quotations on the IntelligentCross ASPEN Fee/Fee order book in order to attract trading interest.[2] The FINRA Filing would classify the displayed quotations on ASPEN Fee/Fee as "protected quotations" under Regulation NMS. That is unlawful and harmful. Under the rules that govern our national market system, "protected quotations" are quotations that are "immediately and automatically" executable,[3] and importantly, Commission regulations *require* market participants to route orders to market centers with protected quotations.[4]

However, inconsistent with the Commission's requirements for "protected quotations," the IntelligentCross matching process includes an intentional delay before orders are executed against resting quotations. This results in "maybe" quotations that do not provide market participants with execution certainty.   Requiring market participants to route orders to "maybe" quotations is precisely what Regulation NMS sought to avoid, and the FINRA Filing, which says otherwise, should therefore be disapproved – as nearly every commenter agrees.[5] Even without this basic legal defect, the FINRA Filing is woefully deficient, as it falls well short of otherwise "demonstrat[ing]" the proposal's consistency with the Exchange Act, as required by Commission rules.

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[1] 87 FR 79401 (Dec. 27, 2022), available at: https://www.finra.org/sites/default/files/2022-12/sr-finra-2022-032-federal-register-notice.pdf (the "FINRA Filing").

[2] The FINRA Filing covers the "ASPEN Fee/Fee" order book. IntelligentCross has two other limit order books which are not covered by this filing.

[3] *See* 17 C.F.R. § 242.600(b)(71), (b)(70), (b)(6).

[4] *See* Rule 611. In addition, market centers with protected quotations obtain a share of revenues generated by the SIP.

[5] *See, e.g.,* comment file at: https://www.sec.gov/comments/sr-finra-2022-032/srfinra2022032.htm.

I. Quotations Displayed on IntelligentCross Are Not "Protected Quotations"

The FINRA Filing is fatally flawed at the outset: FINRA proposes to classify quotations displayed on IntelligentCross as "protected quotations," but they clearly are not, under both the plain text of Regulation NMS and the Commission's subsequent guidance.

A. The FINRA Filing Is Contrary To Regulation NMS

In order to qualify as a "protected quotation" under Regulation NMS, IntelligentCross displayed quotations must meet the definition of an "automated quotation."[6] The "automated quotation" definition is set forth in 17 C.F.R. § 242.600(b)(6):

> *Automated quotation* means a quotation displayed by a trading center that:
>
> (i) Permits an incoming order to be marked as immediate-or-cancel;
>
> (ii) Immediately and automatically executes an order marked as immediate-or-cancel against the displayed quotation up to its full size;
>
> (iii) Immediately and automatically cancels any unexecuted portion of an order marked as immediate-or-cancel without routing the order elsewhere;
>
> (iv) Immediately and automatically transmits a response to the sender of an order marked as immediate-or-cancel indicating the action taken with respect to such order; and
>
> (v) Immediately and automatically displays information that updates the displayed quotation to reflect any change to its material terms.

Under the plain text of § 242.600(b)(6), an "automated quotation" must be "immediately and automatically" executable. "'Immediately' means 'immediately.'"[7] And that it must occur "instant[ly]," or "without delay."[8] As the Commission itself put it, the term "immediate" requires "the fastest response possible *without any programmed delay*,"[9] and thus "precludes any coding of automated systems or *other type of intentional device that would delay the action taken with respect to a quotation*."[10]

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[6] 17 C.F.R. § 242.600(b)(70).

[7] *Garcia v. Concannon*, 67 F.3d 256, 260 (9th Cir. 1995) (Reinhardt, J., concurring).

[8] *Black's Law Dictionary* 916 (10th ed. 2014).

[9] Regulation NMS, 70 FR at 37519 (emphasis added).

[10] *Id.* at 37534 (emphasis added).

IntelligentCross's displayed quotations are in no way "immediate." As set forth in the FINRA Filing, orders sent to IntelligentCross are subject to an intentional delay of between 150 and 900 microseconds before execution can occur.[11] That is irreconcilable with the term "immediate," as an intentional delay of up to 900 microseconds is flatly inconsistent with the unambiguous, plain meaning of the term "immediate" and with the Commission's own understanding that the term precludes "any programmed delay." The IntelligentCross displayed quotations do not meet the Commission's definition of an "automated quotation" as set forth in 17 C.F.R. § 242.600(b)(6), and thus are not – and cannot be – protected quotations under Regulation NMS. The FINRA Filing, which says otherwise, should be disapproved for this reason alone.

B. The FINRA Filing Is Also Contrary To The Commission's 2016 Interpretation

In 2016, instead of amending the "automated quotation" definition through notice-and-comment rulemaking, the Commission purported to reinterpret the term "immediate" as permitting a *de minimis* intentional delay.[12] That reinterpretation is flatly inconsistent with the plain text of Regulation NMS for the reasons discussed above, and therefore invalid.[13] But, even assuming the 2016 reinterpretation stands, the FINRA Filing must *still* be disapproved.

(i) There Is No Bright-Line Rule For "De Minimis" Delays

In the 2016 Interpretation, the Commission provided the following definition of *de minimis*: a delay so short as to not frustrate the purposes of Rule 611 by impairing fair and efficient access to an exchange's quotations.[14] In this regard, the 2016 Interpretation is clear that the length of the delay is *not* the only consideration:

- **Intentional delays of less than 1 millisecond are <u>not</u> automatically *de minimis*.** The FINRA Filing asserts that the IntelligentCross intentional delay meets the *de minimis* standard simply because it is less than one millisecond in length.[15] However, this is not a legally valid interpretation of the *de minimis* standard.[16] While a bright-line threshold of one millisecond was initially proposed,[17] the Commission explicitly

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[11] FINRA Filing at 79402.

[12] 81 FR 40785 (June 23, 2016) at 40786, available at: https://www.gpo.gov/fdsys/pkg/FR-2016-06-23/pdf/2016-14876.pdf (the "2016 Interpretation").

[13] *See, e.g.*, *Chase Bank USA, N.A. v. McCoy*, 562 U.S. 195, 211 (2011) (where "the text of a regulation is unambiguous, a conflicting agency interpretation … will necessarily be plainly erroneous or inconsistent with the regulation").

[14] 2016 Interpretation.

[15] FINRA Filing at 79403.

[16] *See* also our first letter at: https://www.sec.gov/comments/sr-finra-2022-032/srfinra2022032-20155725-323982.pdf.

[17] 81 FR 15660 (March 24, 2016) at 15665, available at: https://www.govinfo.gov/content/pkg/FR-2016-03-24/pdf/2016-06633.pdf.

decided not to adopt that standard. Instead the Commission stated that it "is **not adopting** the proposed guidance under this interpretation that delays of less than one millisecond are *de minimis*. (emphasis added)"[18] Contrary Staff guidance (cited by the FINRA Filing) is simply irrelevant, as the Staff are bound by, and cannot contradict, the Commission's clear decision.[19]

- **Intentional delays that are within (or even "well within") existing geographic and technological latencies are <u>not</u> automatically *de minimis.*** In formulating the *de minimis* standard, the Commission noted the geographic and technological latencies market participants experience when routing orders to market centers with automated quotations to comply with the Order Protection Rule (Rule 611), and reasoned that intentional delays of similar (or shorter) lengths **could** qualify as *de minimis*.[20] However, the Commission then expressly clarified that being well within existing geographic and technological latencies is *not* sufficient under the *de minimis* standard.[21]

  Instead, the Commission stated "intentional access delays that are well within the geographic and technological latencies experienced by market participants when routing orders are *de minimis* **to the extent they would not impair a market participant's ability to access a displayed quotation consistent with the goals of Rule 611**. (emphasis added)"[22] In order to give meaning to the latter half of this sentence, one must conclude that the length of the delay is *not* the only consideration. Otherwise, the Commission would have simply stated that intentional access delays that are well within the geographic and technological latencies experienced by market participants when routing orders **are** *de minimis*.

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[18] 2016 Interpretation at 40792. Further supporting the Commission's decision not to adopt a bright-line threshold, we note that one millisecond appears to be a purely arbitrary level that lacks any coherent justification.

[19] *See* Staff Guidance on Automated Quotations under Regulation NMS (June 17, 2016), available at: https://www.sec.gov/divisions/marketreg/automated-quotations-under-regulation-nms.htm (purporting to establish a bright-line threshold of one millisecond that was explicitly rejected by the Commission). Even assuming the 2016 Interpretation is an interpretative, as opposed to a legislative rule, interpretative rules are "certainly binding on agency officials." *Yale-New Haven Hosp. v. Leavitt*, 470 F.3d 71, 80–81 (2d Cir. 2006). The Commission should direct Staff to formally withdraw its unauthorized guidance, which only sows confusion about the Commission's current regulatory framework regarding intentional delays. It is notable that the only time Staff attempted to apply this unauthorized guidance, the Commission stayed and reviewed the delegated action, and the proposal was ultimately withdrawn. *See* https://www.sec.gov/rules/sro/chx/2017/34-81913-letter-from-secretary.pdf and https://www.sec.gov/rules/sro/batsbyx/2018/chx-withdrawal-sr-chx-2017-04.pdf.

[20] *See* 2016 Interpretation at 40789, FN 49.

[21] As detailed below, depending on how they are structured, intentional delays can have far more significant impacts (and thus frustrate the purposes of Rule 611) compared to geographic and technological latencies that are applicable to all market participants, even if the intentional delay is of a similar (or shorter) length.

[22] 2016 Interpretation at 40792. The actual *de minimis* standard set forth in the 2016 Interpretation uses similar language, requiring that an intentional delay not "frustrate the purposes of Rule 611 by impairing fair and efficient access to an exchange's quotations."

The conclusion that the length of the delay is *not* the only consideration is consistent with the Commission's recognition in the 2016 Interpretation that, by not adopting a bright-line threshold based on the length of an intentional delay, it could "assess the impact of intentional access delays on the markets"[23] and "[a]s it makes findings as to whether particular access delays are *de minimis* [, . . .] such findings create common standards that must be applied fairly and consistently to all market participants."[24]

Based on the above, the 2016 Interpretation clearly contemplates an assessment, and a subsequent finding, that is more involved than simply determining whether an intentional delay is within existing geographic and technological latencies. In order to determine whether an intentional delay is *de minimis* (i.e. whether it "frustrates the purposes of Rule 611"), it is necessary to consider the history and purpose of Rule 611, the Order Protection Rule..

The Order Protection Rule distinguishes between automated quotations and manual (non-automated) quotations in order to ensure that manual quotations were not provided with trade-through protection (meaning that market participants are *not required* by regulation to route orders to access manual quotations). In doing so, the Commission noted that manual quotations were not immediately accessible, and that this delay in responding could result in "'maybe' quotations" that did not provide market participants with execution certainty (resulting in worse execution outcomes).[25] In addition, the Commission noted the prevailing sentiment that "requiring [automated markets] to provide [such] outbound access to a non-automated market to reach the better price displayed on that other market, no matter how marginal that better price is and how long it takes the other market to execute the order (if at all), not only compromises the basic structure of their markets but also effectively grants an option to that slower market during the time period before the order is executed. This option has value, as there is a risk that the market for the stock may move before the order is executed."[26] As a result, the Commission made clear that the Order Protection Rule only protected "quotations that are truly firm and fully accessible"[27] and thus required automated quotations to "immediately and automatically" respond to an incoming immediate-or-cancel ("IOC") order.

Therefore, when determining whether an intentional delay "frustrates the purposes of Rule 611 by impairing fair and efficient access to an exchange's quotations" as required by the 2016 Interpretation, it is important to examine whether the operation of the intentional delay results in manual quotations (i.e. "maybe" quotations that do not provide market participants with execution certainty). If so, it would frustrate the purposes of Rule 611 to provide trade-through protection to these manual quotations (thereby *requiring* market participants to route orders to the relevant

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[23] *Id.* at 40792.

[24] *Id.* at 40793.

[25] Regulation NMS at 37527.

[26] 69 FR 11126 (March 9, 2004) at 11134, available at: https://www.sec.gov/rules/proposed/34-49325.pdf.

[27] Regulation NMS at 37518.

market center), regardless of whether the length of the intentional delay is within existing geographic and technological latencies.

This conclusion is further supported by the use of the word "access" in the 2016 Interpretation. As exemplified by Rule 610 of Regulation NMS (*Access to Quotations*), "access" to displayed quotations includes being able to execute against such quotations. If the Commission had intended that the amount of time it takes an exchange or ATS to process and respond to an IOC order was the only consideration when assessing the *de minimis* standard, it would have said so. In contrast, the use of the word "access" requires the Commission and FINRA to consider whether the relevant intentional delay unduly inhibits market participants from successfully executing against displayed quotations, thereby impairing fair and efficient access. This includes assessing the probability of execution given the intentional delay, as well as the specific reasons why an IOC order will fail to execute, when determining whether the intentional delay meets the *de minimis* standard.

(ii) The IntelligentCross Intentional Delay Is Not De Minimis

Under the above standard, the IntelligentCross intentional delay is not *de minimis*. In our first letter, we detailed how the IntelligentCross intentional delay results in "maybe" quotations that do not provide market participants with execution certainty. According to the FINRA Filing, nearly 9% of transactions that would have otherwise executed on ASPEN Fee/Fee did not occur because of the intentional delay, including because a liquidity provider canceled its displayed quote <u>after</u> an incoming order reached the IntelligentCross matching engine – the exact scenario the Order Protection Rule's distinction between automated and manual quotations was designed to avoid.[28]

In addition, there appear to be scenarios where the displayed bid and offer on IntelligentCross may be completely inaccessible to incoming orders since they will end-up matched together at the end of the next match event. In particular, one commenter detailed the following scenario:

"Prior to the following orders, the National Best Bid and Best Offer is $9.95 by $10.05.

- IntelligentCross receives a Displayed Day limit sell order 100 @ $10.00 that is displayed on the SIP creating a revised NBBO of $9.95 by $10.00.

- IntelligentCross then receives a Displayed Day limit buy order 100 @ $10.00. This order would trigger a match event. During the up to 900 microseconds of the match event, IntelligentCross would display the buy order at $9.99 on the SIP (the order is "price slid" and displayed one minimum price variation below the best offer in order to not create a locked market), creating an NBBO of $9.99 by $10.00.

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[28] Importantly, geographic and technological latencies do <u>not</u> provide liquidity providers with this type of option to cancel a displayed quote after an incoming order reaches the matching engine. We note that the incoming order does not have to be presented to the liquidity provider in order for this option to have significant value.

For the duration of the match event, the NBBO is made up entirely of two orders on the IntelligentCross ATS, with which new, incoming orders cannot interact."[29]

We also explained in our previous letter why a liquidity provider's option to cancel a resting quotation has significant commercial value for a liquidity provider, particularly when another market participant is attempting to execute a larger order, such as an intermarket sweep order ("ISO"), across multiple market centers.[30] IntelligentCross has no real response. Instead, it asserts that this scenario is "a hypothetical example that may or may not take place" even though this is precisely how market participants are required to use ISOs under Commission regulations.[31] As a result, IntelligentCross does not meet its burden of demonstrating consistency with Regulation NMS.

IntelligentCross also curiously argues that a liquidity provider's option to cancel a resting quotation does not benefit liquidity providers since liquidity removers purportedly had lower markouts 20 milliseconds after execution on ASPEN Fee/Fee than on exchanges.[32] In other words, IntelligentCross appears to argue that market participants are not disadvantaged by the intentional delay because the market moves less on average after an execution on IntelligentCross than after an execution on an exchange. While this data raises a number of questions, it does not show what IntelligentCross claims. Our understanding is that the majority of trading activity on ASPEN Fee/Fee occurs against liquidity that is *not* displayed. And one would expect average markouts to be lower on dark, non-displayed venues than on lit, displayed exchanges. Therefore, the IntelligentCross analysis is completely unrelated to whether the option to cancel a displayed quote unfairly advantages liquidity providers.

As noted by another commenter, "[t]he potential value of this option [to cancel a displayed quotation] lies in being able to determine whether or not to cancel, not just how often the option is exercised."[33] The option to cancel a displayed quote that results from the IntelligentCross intentional delay closely resembles the option detailed in Regulation NMS that liquidity providers on manual markets possessed compared to those on automated markets. The displayed quotations on IntelligentCross are "maybe" quotations that do not provide market participants with execution certainty. As a result, it would frustrate the purposes of Rule 611 to provide trade-through protection to these manual quotations on IntelligentCross.

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[29] *See* https://www.sec.gov/comments/sr-finra-2022-032/srfinra2022032-20158894-327116.pdf at 2.

[30] See our first letter at 5-6 for a detailed explanation.

[31] https://www.sec.gov/comments/sr-finra-2022-032/srfinra2022032-20157506-325781.pdf ("IntelligentCross Response Letter") at 8.

[32] IntelligentCross Response Letter at 6.

[33] https://www.sec.gov/comments/sr-finra-2022-032/srfinra2022032-20164234-334053.pdf at 6.

II. The FINRA Filing Does Not Properly Examine the IntelligentCross Intentional Delay Under Commission Regulations

As the "gatekeeper" for the Alternative Display Facility ("ADF"), FINRA has the obligation to carefully examine whether ADF participants meet Commission regulations.[34] In addition, Rule 700(b)(3) of the Commission's rules of practice specifies that the "burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations thereunder [. . .] is on the self-regulatory organization that proposed the rule change." This includes demonstrating that IntelligentCross displayed quotations qualify as protected quotations. FINRA has not satisfied this burden.

First, as noted above, the FINRA Filing asserts that the IntelligentCross intentional delay meets the *de minimis* standard simply because it is less than one millisecond in length. That is simply incorrect. As noted above, any intentional delay is contrary to the plain terms of Regulation NMS. In addition, the *de minimis* standard in the 2016 Interpretation turns on far more than delay length alone. Since this is not a legally valid interpretation of the *de minimis* standard, the FINRA Filing does not properly examine the IntelligentCross intentional delay under Commission regulations. FINRA must show that the displayed quotations on IntelligentCross are not "maybe" quotations that fail to provide market participants with execution certainty as the result of an intentional delay. Given that the FINRA Filing does not even attempt to make this showing, the Commission should disapprove the filing for this reason alone. The Commission cannot come up with its own reasons later, but, rather, must remand the matter to FINRA to perform the proper analysis and expose *that* analysis to full notice and comment.

Second, as other commenters have noted, by giving liquidity providers the ability to cancel displayed quotations on an order-by-order basis, the IntelligentCross intentional delay resembles an asymmetric delay.[35] In response, IntelligentCross attempts to argue that senders of IOC and ISO orders could elect to immediately cancel those orders during the intentional delay, and thus have the same ability to cancel as liquidity providers.[36] However, IntelligentCross fails to explain *why* a market participant would want to cancel an order that it just sent less than a millisecond prior to access liquidity (in contrast to a liquidity provider that may want to avoid certain incoming orders). When an investor routes an immediate-or-cancel order to a trading venue to execute against a displayed quotation, it *wants* to execute against that quotation – immediately. In addition, IntelligentCross appears to be advancing a novel approach to complying with the intermarket sweep order exception under Rule 611 in suggesting that these orders could be immediately cancelled by the sender before execution.

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[34] Regulation NMS at 37586.

[35] *See, e.g.,* https://www.sec.gov/comments/sr-finra-2022-032/srfinra2022032-20156818-324983.pdf.

[36] IntelligentCross Response Letter at 4-5.

The Commission in other contexts has carefully scrutinized asymmetric delays to determine whether any discrimination is unfair and, therefore, inconsistent with the Exchange Act.[37] However, the FINRA Filing does not contain any analysis as to whether the IntelligentCross intentional delay may be inconsistent with (i) Exchange Act Section 15A(b)(6), which prohibits FINRA rules from permitting unfair discrimination, or (ii) Commission Rule 610(b)(2), which prohibits an ADF participant from imposing unfairly discriminatory terms that inhibit efficient access to displayed quotations.

Third, as other commenters have noted, the 2016 Interpretation did not focus on the final prong of the "automated quotation" definition, which requires that a market center "immediately and automatically display information that updates the displayed quotation to reflect any change to its material terms."[38] This proposal raises a number of new questions around the interpretation of that prong of the definition, including with respect to (a) how quickly IntelligentCross displayed quotations are updated (taking into account the intentional delay and any ADF-related delays) and (b) whether IntelligentCross displayed quotations are always accurately updated to reflect changes to material terms, given the "price-sliding" employed by IntelligentCross before a match event in order to avoid locked markets.[39] Once again, the FINRA Filing does not contain any analysis of these topics.

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FINRA has not met its burden, and we respectfully urge the Commission to disapprove this FINRA Filing.

Please feel free to call the undersigned with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger

Managing Director

Global Head of Government & Regulatory Policy

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[37] *See, e.g.,* https://www.sec.gov/rules/sro/cboeedga/2020/34-88261.pdf.

[38] https://www.sec.gov/comments/sr-finra-2022-032/srfinra2022032-20164234-334053.pdf at 10.

[39] *Supra* note 29.

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