UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Financial Industry Regulatory Authority, Inc. **Regarding an Order Granting the Approval of** Proposed Rule Change Relating to Alternative Display Facility New Entrant	File No. SR-FINRA-2022-032

CITADEL SECURITIES, LLC'S STATEMENT IN OPPOSITION TO ORDER APPROVING PROPOSED RULE CHANGE

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INTRODUCTION

With its proposed rule change (the "Proposal"), FINRA asks the Securities and Exchange Commission to rework the longstanding system the Commission set up in Regulation NMS to accommodate a single alternative trading system, IntelligentCross ATS. Regulation NMS provides a special status for certain displayed quotations to buy or sell stock—but *only* if the quotations are immediately and automatically executable. IntelligentCross's displayed quotations do not meet that standard, because IntelligentCross incorporates an intentional delay before executing orders. IntelligentCross nevertheless seeks to grab by regulatory fiat a greater share of the trading market. The Commission should reject that attempt.

The Proposal falters at the gate because FINRA failed to satisfy its burden of establishing that its proposed rule change would comply with Regulation NMS and other legal requirements. IntelligentCross touts its system as "unique," yet FINRA failed to account for those differences to explain why the Commission should confer on IntelligentCross a special regulatory benefit.

More than that, FINRA could never meet its burden because IntelligentCross quotes are not immediately executable. IntelligentCross has purposefully programmed a delay into its order execution system. That intentional delay is, by itself, inconsistent with the ordinary meaning of "immediate." Even under the Commission's more recent understanding of "immediate," however, the Proposal still fails because IntelligentCross's delay impairs fair and efficient access to its displayed quotes. The intentional delay creates an asymmetry that favors liquidity providers over liquidity takers, results in a high rate of novel non-matches, and requires the use of an unprecedented and misleading price-sliding scheme. All of that is fundamentally contrary to the speed and certainty Regulation NMS is meant to ensure.

If that were not enough, the Proposal would stifle competition and efficiency, contrary to the Commission's statutory mandate.

The inefficiencies, uncertainty, and unfairness that will ensue from the Proposal matter. Traders rely on the expectation that their orders will immediately execute against any matching resting orders on the market. But that expectation—on which securities trading depends—will be undermined by the Proposal. By bestowing protected status on IntelligentCross's quotations, the Proposal would force traders like Citadel Securities, LLC ("Citadel") to route orders to an alternative trading system that will not immediately execute those orders against matching quotes, thereby unfairly giving liquidity providers a window to cancel their orders if the market moves in their favor and increasing the risk that incoming orders will not be fulfilled. And that is just one of the myriad problems with the Proposal.

Citadel therefore respectfully submits this statement urging the Commission to reverse the approval of the Proposal by the Division of Trading and Markets (the "Division"), pursuant to delegated authority, and reject in its entirety FINRA's Proposal.

BACKGROUND

I. THE HISTORY AND OPERATION OF REGULATION NMS

A. The Commission's Promulgation of Regulation NMS

In 2005, the Commission adopted Regulation NMS "to modernize and strengthen the national market system ('NMS') for equity securities." 70 Fed. Reg. 37,496, 37,496/3 (June 29, 2005). Regulation NMS introduced a series of initiatives, the foremost being the Order Protection Rule (Rule 611). The Commission adopted the Order Protection Rule to "reinforce[] the fundamental principle of obtaining the best price for investors when such price is represented by automated quotations that are immediately accessible." *Id.* at 37,497/1. That is, Regulation NMS aimed to improve the efficiency of "price discovery" for securities. *Id.* at 37,499/2.

In promulgating Regulation NMS, the Commission intended to invigorate competition among individual orders to buy or sell securities at the national level, without losing the benefits

of competition between individual markets (exchanges and other trading venues). *See* 70 Fed. Reg. at 37,499/1. It explained that "market fragmentation" had become of "increasing concern in the absence of mechanisms designed to assure that public investors [could] obtain the best price for securities regardless of the type of physical location of the market" in which the transaction was executed. *Id.* at 37,499/2 n.13. Indeed, when Congress mandated the establishment of an NMS in 1975, legislators expressed the underlying principle that "[i]nvestors must be assured that they are participants in a system which maximizes the opportunities for the most willing seller to meet the most willing buyer." *Id.* at 37,499/2 (quoting H.R. Rep. 94-123, 94th Cong., 1st Sess. 50 (1975)).

The Order Protection Rule "establishes intermarket protection against trade-throughs for all NMS stocks." 70 Fed. Reg. at 37,501/2. A trade-through occurs when one trading center executes an order at a price that is inferior to the best price available for that security displayed by another trading center. *Id.* at 37,498/2, 37,501/2. The Commission explained that "strong intermarket price protection offers greater assurance, on an order-by-order basis, that investors who submit market orders will receive the best readily available prices for their trades." *Id.* at 37,501/2. The Commission further explained that "[l]imit order users want a fast, efficient execution of their orders." *Id.* at 37,497/1 n.2.

Trade-throughs were previously addressed under rules established in 1978, which had become outdated by 2005. The old rules were drafted for a time when trading occurred on exchange floors and hence did not distinguish between automated and manual quotations, for which execution depended in part on discretion. 70 Fed. Reg. at 37,501/2–3 (citing Plan for the Purpose of Creating and Operating an Intermarket Communications Linkage Pursuant to Section 11A(c)(3)(B) of the Securities Exchange Act of 1934, 43 Fed. Reg. 17,419 (Apr. 24, 1978) (known

as the "Intermarket Trading System ('ITS') Plan")). Once immediately accessible automated quotations on electronic exchanges became possible, order routers still had to wait for a response from a manual market to execute an order, and so because markets should avoid trade-throughs under the ITS Plan, an order could "miss both the best price of a manual quotation and slightly inferior prices at automated markets that would have been immediately accessible." *Id.* at 37,501/3. The Order Protection Rule addressed this inefficiency problem by protecting only automated quotations. *Id.* In deciding that protected status would be afforded only to "quotations that are immediately and automatically accessible," and not to manual quotations, the Commission recognized that protection of manual quotations could lead to undue delays in the routing of investor orders. *Id.* at 37,534/2. Together with other aspects of the Order Protection Rule, the Commission intended that this change would "contribute to the maintenance of fair and orderly markets and, thereby, promote investor confidence in the markets." *Id.* at 37,502/2.

B. Protected Quotations under Regulation NMS

Under Regulation NMS, only certain bids and offers qualify for protection against trade-throughs; these are called "protected quotations." A "protected quotation" is an offer to sell, or bid to buy, an NMS stock that: (1) is displayed by an automated trading center; (2) is disseminated pursuant to an effective national market system plan; and (3) is an "automated quotation" that is the best bid or best offer of a national securities exchange or national securities association. 17 C.F.R. § 242.600(b)(50), (70)–(71). The Order Protection Rule requires that a trading center establish, maintain, and enforce policies reasonably designed to prevent trade-throughs of protected quotations (meaning, execution of orders at a price that is lower than a protected bid or higher than a protected offer), subject to limited exceptions. *Id.* §§ 242.600(b)(95), 242.611(a)(1).

As noted, a quotation must be an "automated quotation" to qualify for trade-through protection. To be an "automated quotation," a displayed quotation must "[i]mmediately and automatically execute[]" an immediate-or-cancel ("IOC") order. 17 C.F.R. § 242.600(b)(6). In arriving at this definition in 2005, the Commission declined to set a specified time frame for how long a displayed quotation takes to execute an IOC order to be considered "automated." 70 Fed. Reg. at 37,519/2. It explained that a specific time standard "may become obsolete as systems improve over time." *Id.* Instead, the standard for an automated quotation "should be 'immediate,'" that is, "a trading center's systems should provide the fastest response possible without any programmed delay." *Id.* The Commission explained that the "term 'immediate' precludes any coding of automated systems or other type of intentional device that would delay the action taken with respect to a quotation." *Id.* at 37,534/1.

C. The Commission's 2016 Interpretation

In 2016, the Commission reversed its position regarding the kind of order execution required to meet the definition of an "automated quotation." The Commission re-interpreted "immediate" "as not precluding a *de minimis* intentional delay." *See* Commission Interpretation Regarding Automated Quotations Under Regulation NMS, 81 Fed. Reg. 40,785, 40,786/1 (June 23, 2016) (the "2016 Interpretation"). To decide which delays would qualify as *de minimis*, the Commission rejected a "bright line" threshold of "one millisecond," and instead set a standard: a *de minimis* intentional delay must be one "so short as to not frustrate the purposes of Rule 611 by impairing fair and efficient access to an exchange's quotations." *Id.* at 40,786/1, 40,790/2, 40,792/3. In concluding that *de minimis* intentional delays could fit under the meaning of "immediate" in Regulation NMS, the Commission reasoned that quotations could not be accessed "instantaneously," and that processing times were now faster than they were a decade later. *Id.* at

40,788/3–89/1. The Commission acknowledged that this interpretation could "increase the overall latency in accessing a particular protected quotation" and affect efficiency. *Id.* at 40,789/3.

II. FINRA'S PROPOSAL TO DESIGNATE INTELLIGENTCROSS AS A NEW ENTRANT TO THE ALTERNATIVE DISPLAY FACILITY

A. The Proposal

In December 2022, FINRA proposed adding IntelligentCross as an active quoting participant to the Alternative Display Facility ("ADF"). Notice of Filing of a Proposed Rule Change Relating to Alternative Display Facility New Entrant, 87 Fed. Reg. 79,401, 79,401/1 (Dec. 27, 2022). The ADF is a facility for certain market participants to display quotations in NMS stocks. *See id.* at 79,401/2. ADF market participants' quotations can receive protected-quotation status, and so to qualify, they must meet the requirements of Regulation NMS. *Id.* at 79,401/2–3. FINRA acts as a gatekeeper to ensure that a prospective ADF participant meets its requirements. *Id.* at 79,401/3.

IntelligentCross is a NMS stock trading system that wants to display certain orders on the ADF. According to IntelligentCross, its system has a matching schedule for each security, and it creates that schedule using an overnight optimization process based on historical performance measurements. 87 Fed. Reg. at 79,402/2. Based on the schedule, the system creates randomized match events—when orders to fill bids or offers (incoming orders) execute against the bids or offers (resting orders)—that occur every 150 to 900 microseconds. *Id.* When an incoming order for a security arrives before a scheduled match event, it becomes eligible to participate in the next match event. *Id.* In other words, the IntelligentCross system intentionally delays when matching orders execute so that they do so only when the system's programmed match event is set. During the delay, IntelligentCross must display the would-be matching order on its system if required to do so under Regulation NMS; to avoid having a bid and an offer posted at the same price on its

system (which Regulation NMS forbids), IntelligentCross slides the price of the would-be match by one cent. The resulting "quote" is not real and cannot be accessed (as discussed further below, *see infra* at 29-32).[1]

The IntelligentCross matching process operates on "a near-continuous basis throughout the day." 87 Fed. Reg. at 79,402/2. At the time of each match event, IntelligentCross retrieves the market-wide best protected bid and offer ("NBBO") and processes all the orders that have arrived and have not been cancelled in price-time priority. *Id.* at 79,402/3. In some situations, however, an incoming order may not execute against a resting order at a match event time, such as when an existing resting order cancels prior to the next match event. *Id.* at 79,403/2. IntelligentCross has represented that non-match events occur in a "minority of cases." *Id.* at 79,403/3. From January to November 2022, 4.2 percent of potential matches did not complete because a displayed order was canceled. *Id.*

FINRA determined that despite the delay that IntelligentCross has programmed into its matching process, its quotations meet the definition of an "automated quotation" under Regulation NMS. 87 Fed. Reg. 79,403/1. FINRA relied on the Commission's staff's guidance (as opposed to the Commission's 2016 Interpretation) opining that "delays of less than a millisecond are at a *de minimis* level . . . , consistent with the goals of Rule 611." *Id.* (quoting Staff Guidance on Automated Quotations under Regulation NMS (June 17, 2016), https://www.sec.gov/divisions/marketreg/automated-quotations-under-regulation-nms.htm). Accordingly, it determined that the proposed rule change to add IntelligentCross to the ADF was consistent with the requirements for FINRA rules laid out in the Securities Exchange Act. *See* 15 U.S.C. §78*o*-3(b)(6), (9), (11).

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[1] *See* Letter from Stephen John Berger, Managing Director, Global Head of Government & Regulatory Policy, Citadel Securities, LLC, dated May 4, 2023 ("Citadel May 4 Letter"), at 6-7.

B. Public Commentary

The Proposal faced overwhelming opposition, from all segments of the market. Citadel explained the various problems that would arise should the Commission approve the Proposal and grant IntelligentCross quotations protected status.[2] Among other problems, Citadel explained that IntelligentCross's system favors liquidity providers (traders who place a bid or an offer), who can cancel their bids or offers during IntelligentCross's programmed delay if they recognize that an order is executing at a price more favorable to them at other exchanges, leaving liquidity takers (traders who fill bids or offers) without execution of orders that they expected to be filled. *See* Citadel Aug. 3 Letter at 4. Other commenters—including Nasdaq, Inc., FIA Principal Traders Group, Securities Industry and Financial Markets Association ("SIFMA"), Investors Exchange LLC ("IEX"), and Healthy Markets Association—expressed various concerns, too, such as concerns that IntelligentCross's matching process lacked transparency, was inconsistent with existing practices, and could wreak havoc on markets should it be added to the ADF, particularly since it would not be held to the same standards required of exchanges.[3] Only one commenter (other than IntelligentCross itself) expressed support for the Proposal.[4]

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[2] *See* Letter from Stephen John Berger, Managing Director, Global Head of Government & Regulatory Policy, Citadel Securities, LLC, dated Jan. 23, 2023 ("Citadel Jan. 23 Letter"); Citadel May 4 Letter; and Letter from Stephen John Berger, Managing Director, Global Head of Government & Regulatory Policy, Citadel Securities, LLC, dated Aug. 3, 2023 ("Citadel Aug. 3 Letter"). All comments are available at www.sec.gov/comments/sr-finra-2022-032/srfinra2022032.htm.

[3] *See* Letter from Tyler Gellasch, President and CEO, Healthy Markets Association, dated Jan. 13, 2023; Letter from Brett Kitt, Associate Vice President & Principal Associate General Counsel, Nasdaq, Inc., dated Jan. 17, 2023; Letter from Joanna Mallers, Secretary, FIA Principal Traders Group, dated Jan. 17, 2023; Letter from Ellen Greene, Managing Director, Equities & Options Market Structure, SIFMA, dated Feb. 8, 2023; Letter from Joanna Mallers, Secretary, FIA Principal Traders Group, dated Mar. 8, 2023; Letter from Tyler Gellasch, President and CEO, Healthy Markets Association, dated Mar. 14, 2023; Letter from John Ramsay, Chief Market Policy Officer, IEX, dated Apr. 14, 2023; Letter from John Ramsay, Chief Market Policy Officer, IEX, dated Aug. 4,2023 ("IEX Aug. 4 Letter").

[4] *See* Letter from Nataliya Bershova, Head of Execution Research, Sanford C. Bernstein & Co., LLC, dated Jan. 17, 2023.

C. The Division's Approval Order

Despite the overwhelmingly negative commentary, the Division, pursuant to delegated authority, approved the Proposal on August 24, 2023. *See* Order Approving Proposed Rule Change Relating to Alternative Display Facility New Entrant, 88 Fed. Reg. 59,958 (Aug. 30, 2023). In contrast to FINRA, the Division found that IntelligentCross's intentional delay was *de minimis*—and hence its quotations could meet the definition of "automated"—not because the delay was under a millisecond, but solely because it is "well within geographic and technological latencies experienced today that do not impair fair and efficient access to an exchange's quotations or otherwise frustrate the objectives of Regulation NMS," without any further analysis. *Id.* at 59,961/2. The Division rejected arguments that IntelligentCross's system favors liquidity providers because "[b]oth sides—the buyer and the seller—can cancel their orders at any time prior to a match and must wait equally for the next scheduled match event to occur in price-time priority, thus not resembling an asymmetric delay as supposed by certain commenters." *Id.* at 59,964/3. It further stated that it was unpersuaded by comments that explained that it would be difficult for market participants to adapt to IntelligentCross protected quotations by repeating IntelligentCross's assertion that it is "already widely used by most major broker-dealer and electronic trading firms." *Id.* at 59,965/1; *see also id.* at 59,963/3. The Division similarly dismissed the numerous other arguments made by various commenters. *Id.* at 59,965/1–68/1. And in a single footnote without further analysis, the Division stated that it "considered the proposed rule's impact on efficiency, competition, and capital formation." *Id.* at 59,960/1 n.54. The Division was satisfied that the proposed rule change was consistent with the requirements of the Exchange Act and relevant rules and regulations. *Id.* at 59,960/1–2.

On August 25, the Commission decided *sua sponte* that it would review the delegated action and stayed the Approval Order pending its review.[5]

LEGAL STANDARD

Under the Commission's Rule of Practice 431(a), "[t]he Commission may affirm, reverse, modify, set aside or remand for further proceedings" the Approval Order. 17 C.F.R. § 201.431(a). The Commission's review is *de novo*, based on "careful consideration [of] the entire record," including FINRA's Proposal, all comments, and all submitted statements. *See*, *e.g.*, Order Setting Aside Action by Delegated Authority and Approving Proposed Rule Change, 85 Fed. Reg. 85,807, 85,807/3 (Dec. 29, 2020). The Commission may only affirm the Approval Order if FINRA meets its burden of demonstrating that the proposed rule change is consistent with the requirements for FINRA rules laid out in the Securities Exchange Act.

ARGUMENT

I. FINRA HAS NOT MET ITS BURDEN TO SHOW THAT ITS PROPOSED RULE IS CONSISTENT WITH THE EXCHANGE ACT AND REGULATION NMS.

When FINRA proposes a change to one of its rules, the Commission's regulations place on FINRA "[t]he burden to demonstrate that [the] proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder." 17 C.F.R. § 201.700(b)(3)(i); *Bloomberg L.P. v. SEC*, 45 F.4th 462, 470 (D.C. Cir. 2022) ("It is ultimately FINRA's burden to demonstrate that its proposed rule change is consistent with the Act and applicable rules and regulations."). FINRA "must explain why the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder" and its "description of the proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency

[5] *See* Letter from J. Matthew DeLesDernier, Deputy Secretary, SEC to Faisal Sheikh, Assistant General Counsel, FINRA, dated Aug. 25, 2023.

with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding." 17 C.F.R. § 201.700(b)(3)(i). "A mere assertion that the proposed rule change is consistent" with the requirements of the Exchange Act and its implementing regulations "is not sufficient." *Id.* The purpose of these requirements is to "elicit information necessary for the public to provide *meaningful comment* on the proposed rule change and for the Commission to determine whether the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder." *Id.* (emphasis added).

FINRA did not come close to meeting its burden to show that the rule change is consistent with the Exchange Act and Regulation NMS, and the proposed rule change must be rejected for that reason alone. FINRA simply asserted in its proposal that the change is consistent with non-binding guidance issued by *staff* that is directly at odds with the Commission's 2016 Interpretation of Regulation NMS. 87 Fed. Reg. at 79,403/1. Commission regulations require FINRA to demonstrate that its rule change is "consistent with the Exchange Act and the rules and regulations issued thereunder," 17 C.F.R. § 201.700(b)(3)(i), not simply that it is consistent with nonbinding interpretive guidance, which "'do[es] not have the force and effect of law,'" *Perez v. Mortg. Bankers Ass'n*, 575 U.S. 92, 97 (2015). To the extent FINRA relied on non-binding guidance to support its conclusion that its proposed rule change was consistent with Regulation NMS, it had an obligation to explain in sufficient detail why that guidance correctly interprets Regulation NMS. 81 Fed. Reg. at 40,790/2 (the guidance "does not obviate the requirement of individualized review of proposed access delays, including *de minimis* delays, for consistency with the Exchange Act and Regulation NMS"). FINRA did not—and cannot—satisfy that obligation. As explained below, *see infra* at 15-17, a trading center does not "[i]mmediately and automatically execute[] an order," 17 C.F.R. § 242.600(b)(6)(ii), if it intentionally delays execution of that order. FINRA provided

no analysis for its conclusion that intentionally delayed executions are immediate and automatic, and it did not meet its burden to make that showing by simply citing the erroneous non-binding guidance issued by staff.

Even if Regulation NMS permitted trading centers displaying protected quotations to intentionally delay execution (it does not), FINRA also offered no analysis to support its further conclusion that intentional delays of less than one millisecond are categorically *de minimis* and consistent with Regulation NMS. This failure is particularly problematic because the 2016 Interpretation explicitly *rejected* a "bright line *de minimis* threshold" of "one millisecond" and emphasized that its "interpretation does not obviate the *requirement* of individualized review of proposed access delays, including *de minimis* delays, for consistency with the Exchange Act and Regulation NMS." 81 Fed. Reg. at 40,790/2, 40,792/3 (emphasis added).

Yet FINRA ignored the requirement that it conduct an individualized review of IntelligentCross's intentional delay, instead concluding that delays of less than one millisecond are per se consistent with Regulation NMS based on guidance issued by the Division. 87 Fed. Reg. at 79,403/1. As explained below, *see infra* at 18-19, the Division's guidance is inconsistent with the 2016 Interpretation's rejection of a categorical one-millisecond rule and is therefore void. But in any event, FINRA has a clear burden, imposed by 17 C.F.R. § 201.700(b)(3)(i) and emphasized in the 2016 Interpretation, 81 Fed. Reg. at 40,790/2, to explain how IntelligentCross's intentional delay is consistent with the requirement that protected quotations be displayed by a trading center that immediately and automatically executes IOC orders.

FINRA also failed to explain how many other features of IntelligentCross's matching mechanism are consistent with the Exchange Act and Regulation NMS. FINRA did not even attempt to explain how forcing trading centers to direct orders to a system that asymmetrically

advantages liquidity providers is consistent with the Exchange Act's requirements that FINRA rules be designed "to promote just and equitable principles of trade" and "not designed to permit unfair discrimination between customers, issuers, brokers, or dealers." 15 U.S.C. § 78*o*-3(b)(6). Nor did FINRA explain how the asymmetry between liquidity providers and liquidity takers on IntelligentCross's system is consistent with Regulation NMS's requirement that "[a]ny trading center that displays quotations in an NMS stock through an SRO display-only facility shall not impose unfairly discriminatory terms that prevent or inhibit any person from obtaining efficient access to such quotations." 17 C.F.R. § 242.610(b)(2).

In addition, FINRA acknowledged that approximately 9 percent of potential match events on IntelligentCross's book do not execute due to its intentional delay. 87 Fed. Reg. at 79,403/3. But it did not explain why that frequency—let alone the frequency of non-match events that would occur if its proposed rule were adopted—is consistent with the Exchange Act or Regulation NMS.

Finally, FINRA did not explain how IntelligentCross's use of its novel and unprecedented price-sliding mechanism is consistent with the requirement that IntelligentCross "[i]mmediately and automatically execute[]" IOC orders against "displayed quotation[s]" given that price-slid quotations do not actually exist and are therefore impossible to access. 17 C.F.R. § 242.600(b)(6)(ii). Nor did it explain how IntelligentCross's use of price-sliding is consistent with the requirement that a protected quotation be displayed by a trading center that "[i]mmedi-ately and automatically displays information that updates the displayed quotation to reflect any change to its material terms." *Id.* § 242.600(b)(6)(v).

Because FINRA has not met its burden to demonstrate, in sufficient specificity and detail, that its proposed rule change is consistent with the Exchange Act and its implementing regulations,

the Commission does not have a "sufficient basis" to make that finding and it must disapprove FINRA's proposal. *See* 17 C.F.R. § 201.700(b)(3)(i).

The Commission cannot remedy FINRA's failure to show that its proposed rule change is consistent with the Exchange Act and Regulation NMS by offering new justifications for the rule that have never been exposed to public comment. As a self-regulatory organization, it is *FINRA's* "burden to demonstrate that [its] proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder." 17 C.F.R. § 201.700(b)(3)(i); *see Bloomberg*, 45 F.4th at 470. FINRA must meet this burden in its "Form 19b-4" submission, which requires FINRA to submit all "information necessary" for the Commission to conclude that the rule change is consistent with the Exchange Act and its implementing regulations. 17 C.F.R. § 201.700(b)(3)(i). The Commission cannot do FINRA's work for it in an approval order, which would deny the opportunity "for the public to provide meaningful comment on the proposed rule change." 17 C.F.R. § 201.700(b)(3)(i). Nor may FINRA remedy its failure to include the analysis it was required to include in its Form 19b-4 proposal by filing subsequent comment letters or relying on arguments made in comments on its proposal. When a notice of a proposed rule change "fail[s] to articulate the legal basis" supporting the proposal, it deprives interested parties of "a fair chance to 'comment.'" *Global Van Lines, Inc. v. ICC*, 714 F.2d 1290, 1298 (5th Cir. 1983).

Yet the Division, in approving FINRA's proposed rule change, ignored FINRA's novel one-millisecond rule for determining whether an intentional delay is consistent with Regulation NMS, instead concluding (incorrectly) that IntelligentCross's intentional delay is consistent with Regulation NMS because it is "well within geographic and technological latencies experienced today." 88 Fed. Reg. at 59,961/2. It concluded (incorrectly) that IntelligentCross's system does not discriminate between liquidity providers and takers because both buyers and sellers may cancel

an order during the intentional delay. *Id.* at 59,964/3. It appears to have determined that the current percentage of non-match events that occur on IntelligentCross due to its intentional delay is consistent with Regulation NMS because non-match events occur in a minority of cases. *Id.* at 59,966/3. And it appears to have determined that IntelligentCross's unprecedented "price-sliding" mechanism is consistent with Regulation NMS because it is designed to implement Rule 610's prohibition on the display of quotations that lock a market. *Id.* at 59,963/2.

Each of these rationales is plainly erroneous, as explained below, *see infra* at 20-35. But the Commission need not even consider them. None of them was offered by FINRA in its proposed rule change, so interested parties had no meaningful opportunity to comment on them, as required by 17 C.F.R. § 201.700(b)(3)(i). Accordingly, on the present record, the Commission does "not hav[e] a sufficient basis to make an affirmative finding that [FINRA's] proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder," *id.*, and the Commission must therefore disapprove FINRA's proposal.

II. FINRA'S PROPOSAL DOES NOT COMPLY WITH REGULATION NMS.

A. IntelligentCross's Quotations Cannot Meet the Definition of Protected Quotations under Regulation NMS.

Quotations on IntelligentCross cannot receive the protection of the Order Protection Rule because they are not "automated quotations." IntelligentCross programs an intentional delay before execution of an IOC order, and therefore, it does not "[i]mmediately and automatically execute[]" IOC orders. 17 C.F.R. § 242.600(b)(6).

When the Commission adopted the "automated quotation" definition in Regulation NMS, it understood that the definition of "immediate" meant that "a trading center's systems should provide the fastest response possible *without any programmed delay*." 70 Fed. Reg. at 37,519/2 (emphasis added). This understanding of the term "immediate" was correct.

An *immediate* execution cannot, by definition, incorporate a programmed delay. The ordinary meaning of "immediate"—as the Commission recognized in 2005—means "[o]ccurring without delay." *See Immediate*, *Black's Law Dictionary* 764 (8th ed. 2004); *Immediately*, *New Oxford American Dictionary* 845 (2d ed. 2005) ("without any intervening time or space"). Of course, an "immediate" execution does not mean an instantaneous execution of an IOC order, which would be a physical impossibility. But an intentionally delayed execution—no matter the length of the delay—cannot be immediate because there is an intervening act in the chain of causation between receipt of an order and execution. *See Immediate*, *Black's Law Dictionary* ("without an intervening agency"). That is, inserting a delay such that order execution is intentionally slower than it would otherwise be means that a system is not executing "immediately." It is—at the microsecond level—effectively pausing. (A pause which, as explained below, results in a material effect on trades.) As the term was understood in 2005, executing "immediately" means executing *without interruption*.

To the extent the 2016 Interpretation allows a trading system with intentional delays built in to gain protected-quotation status, it is wrong. In opining that intentional delays were permissible for "automated quotations," the 2016 Commission reasoned that execution of quotations was always subject to some delay, noting that processing times were longer in 2005—but it was precisely because a specified time standard could become obsolete that the 2005 Commission declined to set one. *Compare* 81 Fed. Reg. at 40,789/1, *with* 70 Fed. Reg. at 37,519/2. What matters is not how long immediate execution took in 2005 (and whether an intentional delay would be just as long as processing times then), but that automated quotations execute at contemporaneous processing times so that one particular trading system does not bestow an unfair advantage on certain market participants or otherwise create inefficiencies in the NMS. Further, Regulation NMS's

definition of "automated quotations" is meant to distinguish them from manual quotations, which are excluded from protected status. By allowing a system with intentional delays to be considered "automated," the Commission's 2016 Interpretation has ushered in the blurring of this distinction. If the Commission wishes to consider a change to the definition of "automated quotation" such that it does not require immediate execution of orders, then the Commission must institute a formal rulemaking to amend Regulation NMS. *See*, *e.g.*, *Elec. Privacy Info. Ctr. v. U.S. Dep't of Homeland Sec.*, 653 F.3d 1, 5–8 (D.C. Cir. 2011) (explaining that a substantive change to the regulatory regime requires notice-and-comment rulemaking). If not, then the Commission must retract its erroneous 2016 Interpretation.

By programming a delay between the receipt of an IOC order and execution of that order, IntelligentCross's quotations cannot meet the definition of an "automated quotation." The unique features that IntelligentCross touts are exactly why its quotations are not "automated."

B. Even if the 2016 Interpretation Were Valid, the Proposal Is Inconsistent with Regulation NMS Because IntelligentCross's Programmed Delay Is Not *De Minimis*.

Even assuming that the 2016 Interpretation is consistent with Regulation NMS, the Proposal still fails. As a reminder, the Proposal can be adopted only if IntelligentCross's displayed quotations execute "immediately" against an incoming order. 17 C.F.R. § 242.600(6), (70)–(71). Under the 2016 Interpretation, "the term 'immediate'" bars any "type of intentional device that would delay the action taken with respect to a quotation unless" that delay is "*de minimis*"—that is, "so short" that the delay does "not frustrate the purposes of Rule 611 by impairing fair and efficient access to an exchange's quotations." 81 Fed. Reg. at 40,786/1, 40,790/1. IntelligentCross's novel intentional delay does not pass that test.

1. *FINRA and the Division Wrongly Adopted a Bright-Line Test, Rather than Addressing Whether the IntelligentCross Intentional Delay Impairs Fair and Efficient Access.*

The Commission explicitly eschewed a bright-line test for determining whether a delay is *de minimis*. 81 Fed. Reg. at 40,792/3 ("establishing a bright line *de minimis* threshold is not appropriate at this time"); *see* IntelligentCross July 14 Letter at 4 ("the Commission did not establish a bright line de minimis threshold"). Instead, "in light of the evolving nature of technology and the markets," the Commission said that it would determine "whether particular access delays are *de minimis* in the context of individual exchange proposals." 81 Fed. Reg. at 40,792/3–93/1. In each case, the question is whether the intentional delay would "impair a market participant's ability to fairly and efficiently access a quote, consistent with the goals of Rule 611." *Id.* at 40,790/1. Fundamental to Regulation NMS is the distinction between manual quotations (those that are not immediately and automatically executable) and protected quotations (those that are). *See*, *e.g.*, 70 Fed. Reg. at 37,501/3, 37,504/3, 37,518/2, 37,534/1–2. "Access" to a quote, therefore, includes the ability to successfully execute against that quote. *See id.* at 37,539/2 ("Access to quotations" is "sometimes referred to as 'order execution access'"); *see also* 17 C.F.R. § 242.610(c) ("any fee or fees for the execution of an order" are "[f]ees for access to quotations"). In short, then, a protected quotation must allow for fair and efficient execution of an incoming order, as determined on a proposal-by-proposal basis.

Despite the Commission's clear direction, FINRA and the Division both applied the wrong test. For its part, FINRA concluded that the IntelligentCross delay is *de minimis* simply because it is "less than one millisecond." 87 Fed. Reg. at 79,403/1. That "mere assertion" is "not sufficient" under Commission rules, 17 C.F.R. § 201.700(b)(3), and is plainly incorrect. FINRA relied on guidance from Commission *staff*, which said that "delays of less than a millisecond are at a *de minimis* level that would not impair fair and efficient access to a quotation." 87 Fed. Reg. at

79,403/1 (quoting Staff Guidance on Automated Quotations under Regulation NMS). How or why the staff reached that conclusion is anyone's guess—just before the Commission said in the 2016 Interpretation that a "bright line" rule was "not appropriate," it explicitly stated that it was "not adopting" the view "that delays of less than one millisecond are *de minimis*." 81 Fed. Reg. at 40,792/3. The Division had no authority to depart from the Commission's 2016 view; assuming that interpretive rule were consistent with Regulation NMS, it binds agency employees. *See Yale-New Haven Hosp. v. Leavitt*, 470 F.3d 71, 80–81 (2d Cir. 2006) ("[a]n interpretative rule binds an agency's employees" (quoting *Warder v. Shalala*, 149 F.3d 73, 82 (1st Cir. 1998)); *Splane v. West*, 216 F.3d 1058, 1064 (Fed. Cir. 2000). The Proposal was therefore wrong to rely on that bright-line test. FINRA's clear legal error here is reason alone to reject the Approval Order. *See supra* Part I.

In approving the Proposal, the Division made the same basic error, adopting a different, but equally incorrect, bright-line *de minimis* test. The Division ignored FINRA's reliance on the erroneous one-millisecond rule. Instead, the Division said, in a single sentence with no further analysis, that the IntelligentCross delay is consistent with Regulation NMS because "the delay imposed by IntelligentCross is well within geographic and technological latencies experienced today that do not impair fair and efficient access to an exchange's quotations or otherwise frustrate the objectives of Regulation NMS." 88 Fed. Reg. at 59,961/2. Again, the Commission explicitly rejected that view in the 2016 Interpretation, consistent with its no-bright-line-rule approach. The Commission said: "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*." 81 Fed. Reg. at 40,792/2–3 (emphasis added). To give any meaning to the

second half of that sentence, one must conclude that the length of the delay (as compared to geographic and technological latencies) is not the only relevant factor. *See* Citadel May 4 Letter at 4–5.

The Commission should set the record straight—under the 2016 Interpretation, each proposal must be evaluated based on the specific facts and circumstances to determine whether an intentional delay impairs fair and efficient access to (*i.e.*, execution against) a quotation, consistent with Regulation NMS's distinction between manual and automated quotations.

2. *Analyzed Under the Appropriate Test, IntelligentCross's Intentional Delay Is Not* De Minimis.

IntelligentCross's intentional delay impairs fair and efficient execution of quotations for at least three reasons, any one of which means that the Proposal should be rejected.

Structural Asymmetry. The Proposal would result in an asymmetry that gives a structural advantage to liquidity providers. As explained above, the basic problem with the Proposal is the up-to-900-microsecond delay between the time that IntelligentCross receives an incoming order and when that order actually executes against a resting quote. During that delay, a liquidity provider can cancel its quotation—resulting in a non-match. That option to cancel is not equal, however, especially when a liquidity taker attempts to execute a large order that will execute across multiple venues, such as an intermarket sweep order ("ISO"). As Citadel previously explained, when a liquidity taker attempts to execute a large order, it sends that order out to multiple venues so that the taker can fill the entire order at once. In theory, all of the trades should match at essentially the same time to avoid any price change. But the IntelligentCross delay means that executions occur on other venues *before* they occur on IntelligentCross's. The delay allows a liquidity provider on IntelligentCross to see those other executions and cancel its resting quote before the

incoming order (which has already been received) is actually executed. *See* Citadel Aug. 3 Letter at 5–6.

This is not a hypothetical. Citadel explained, with data to prove it, that an intentional delay of just 470 microseconds is enough time for a liquidity provider on IntelligentCross to observe trades executed on other venues and decide to cancel in response. *Id.* at 6. And the data shows that the intentional delay on IntelligentCross was very rarely less than 500 microseconds and was 800 to 900 microseconds for about 75% of the relevant incoming IOC order executions. *Id.* As explained in more detail below, about 4% of would-be trades on IntelligentCross *already* fail to execute because a party cancels during the delay. That number would only rise were there a significant increase in the number of orders routed through IntelligentCross—exactly what the Proposal is intended to, and would, do.

That asymmetry is not fair. It gives liquidity providers a structural advantage—an option to cancel their resting orders during the delay. That option has significant commercial value for liquidity providers on IntelligentCross and imposes an unwarranted tax on liquidity takers—incoming orders are likely to be filled only when they would be commercially beneficial for the liquidity provider. If a liquidity provider sees that someone is executing an ISO to purchase stock, it can expect the price of that stock to rise as a result—more demand and less supply means higher prices. If the provider has time to cancel before the order executes, then the taker will not get his expected purchase and will likely have to pay a higher price to fill the rest of his desired order because the remainder of the ISO will have executed already, leading to a price increase that will advantage the provider. IntelligentCross's delay thus gives liquidity providers (and only liquidity providers) a valuable weapon at the expense of liquidity takers.

The randomized nature of IntelligentCross's intentional delay makes the problem worse. *See* Citadel Jan. 23 Letter at 6–7; *cf.* IntelligentCross Feb. 16 Letter at 5 n.18 ("Each day starts with a [new] prepared matching schedule for each security that does not change throughout the day."). It prevents a liquidity taker from knowing how to stagger orders to avoid the harm the asymmetry causes. *Cf. Citadel Sec. LLC v. SEC*, 45 F.4th 27, 33 (D.C. Cir. 2022) (blessing the practice of "sending orders" to a particular exchange "a hair sooner" so that "the orders hit all the exchanges in the same instant").

IntelligentCross offered two responses during the comment period, which the Division adopted, but neither works. First, IntelligentCross says that anybody, a liquidity provider or taker, has the same right and ability to cancel during the intentional delay.[6] But that is no answer at all, in particular for larger orders like ISOs that are carried out on multiple market centers.[7] There is absolutely no precedent for a cancellable ISO. It has never existed and does not now. Indeed, cancelling an ISO cannot be allowed if the portion of the order the taker wants to cancel is set to match at a lower price than some other portion of the ISO. That should never happen anyway, because the notion of a taker cancelling an ISO is inherently illogical. An ISO is meant to sweep a large number of shares across the market. Even if a liquidity taker could in theory cancel an ISO

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[6] As explained, in adopting this argument, the Division referred to the ability of "the buyer and the seller" to "cancel their orders." 88 Fed. Reg. at 59,964/3. That reasoning reflects a fundamental misunderstanding of a basic component of the market. Securities trading does not refer to buyers and sellers, but to liquidity providers and takers, who can be either buyers or sellers. *See*, *e.g.*, *Citadel*, 45 F.4th at 30. The problem with the IntelligentCross delay is that it gives liquidity providers the option to cancel, which is a valuable structural asymmetry.

[7] Even the notion that a taker could cancel an IOC order in a non-ISO context stretches the meaning of an IOC order perhaps beyond what it can bear. The entire point of Regulation NMS and an IOC order is that the order will execute (or cancel) automatically as soon as it reaches the market center. *See* 70 Fed. Reg. at 37,519/1–2 ("The trading center also must immediately and automatically respond to the sender of an IOC order. To qualify as 'automatic,' no human discretion in determining any action taken with respect to an order may be exercised after the time an order is received."). Any cancel message a taker sends after the IOC order should be ineffective because the trade will have already executed or cancelled of its own force. More generally, 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. 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*.

(or some piece of one), it would never be in his interest to do so, and would likely violate Regulation NMS.

When pressed, IntelligentCross itself admits that an ISO cannot be cancelled by the liquidity taker before execution. *See* IntelligentCross July 14 Letter at 5 n.19 ("With respect to Intermarket Sweep Orders ('ISOs'), one commenter states that '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.' *See* Citadel Letter II. That is not the case."). To the extent that the Division intended to stake out the view that an ISO can be cancelled, it did not even do so explicitly—certainly not the way to work such a major change.

Abandoning its initial layer of defense, IntelligentCross next argues that a trading center has fulfilled its obligation so long as an order is "routed to execute"—in other words, IntelligentCross thinks that whether a liquidity-taking order executes does not matter. IntelligentCross Feb. 16 Letter at 5; *see* 88 Fed. Reg. at 59,965/1 (Division echoing this argument). But that is not the point of the language IntelligentCross cites. Rule 611 sets forth the general rule that a trading center cannot trade through a protected quotation, but there is an exception when "the trade-through was effected by a trading center that simultaneously routed an intermarket sweep order to execute against the full displayed size of any protected quotation in the NMS stock that was traded through." 17 C.F.R. § 242.611(b)(6). This language is a recognition that geographic and technological latencies might result in technical violations of the rule if one venue (with a slightly higher resting order price) executes before another. *See* 70 Fed. Reg. at 37,504/3 (the "exception enables trading centers that receive sweep orders to execute those orders immediately, without waiting for better-priced quotations in other markets to be updated"). But the assumption underlying all of

Regulation NMS, including the exception, is that orders routed simultaneously will execute immediately. That explains why an ISO is an exception to the normal trade-through rules—an ISO can execute all at once, even if not at the NBBO, to ensure a broad sweep. Otherwise, as IntelligentCross liquidity providers know and hope to exploit, the large order will cause prices to change. In the end, then, there is no good response to the structural advantage that IntelligentCross's intentional delay creates—that unfairness means that the delay is not *de minimis*.

If that were not enough, the primary asymmetry results in a derivative one: The proposed rule would also favor IntelligentCross over other exchanges. Liquidity providers on IntelligentCross can "free-ride on the pricing heuristics and risk-taking capabilities of others by price-matching, with a free option to cancel later." Citadel Aug. 3 Letter at 6. Because liquidity providers have a structural advantage when they offer liquidity on IntelligentCross but not when they offer liquidity on other exchanges, and because the Proposal would require all orders to be routed through IntelligentCross, liquidity providers would have every incentive to post liquidity on IntellgentCross instead of other venues. That would not result in greater fairness or efficiency, particularly given the other current problems the IntelligentCross delay causes—all of which would be exacerbated if the Proposal were approved and all orders had to be routed through IntelligentCross when it purports to display the NBBO.

The IntelligentCross intentional delay would create an asymmetrical advantage for liquidity providers and for IntelligentCross. The Proposal should therefore be rejected and the Division's approval reversed. In addition, FINRA failed to grapple meaningfully with much of this, which provides another basis for rejecting the Proposal.

Non-matches. The intentional delay is not *de minimis* for the additional reason that it prevents nearly 9% of transactions from successfully executing. That stands diametrically opposed

to the entire point of Regulation NMS and automated quotations—liquidity takers should have confidence that their orders *will* execute against protected quotes. *See* 70 Fed. Reg. at 37,518/3 ("only quotations that are truly firm and fully accessible should qualify as 'automated'"). The high non-match rate for orders that were received into the matching engine on IntelligentCross show that its intentional delay impedes efficient execution and is therefore not *de minimis*. By comparison, this type of non-matching against a protected quote is not possible on any other venue that disseminates protected quotes.

As the Proposal noted, an incoming order does not execute against a resting order on IntelligentCross if the resting order is cancelled "at any time" before the next match event. 87 Fed. Reg. at 79,402/2 n.24. Consider the following sequence of events, laid out in Citadel's January 23, 2023, comment letter: (1) a liquidity provider displays a bid at the NBBO on IntelligentCross; (2) an incoming order is sent to execute against that displayed quote; (3) IntelligentCross receives the incoming order; (4) the liquidity provider cancels the displayed quote after the order is received but during the intentional delay; (5) no execution occurs. Citadel Jan. 23 Letter at 4. According to the Proposal, based on IntelligentCross's data, "4.2 percent of potential matches" on Intelligent-Cross "did not complete because a displayed order was canceled." 87 Fed. Reg. at 79,403/3.

That is not the only reason why a non-match occurs on IntelligentCross's system even after an incoming order that is a would-be match has been received. 4.7% of trades did not match because the NBBO changed during IntelligentCross's intentional delay, making the trade non-marketable. *Id.* In other words, say the NBBO had been a bid for stock at $5.00, and a taker routed a matching sell order to IntelligentCross to execute against that bid. If, during the delay, someone else posted a resting bid at $5.01, it would violate the trade-through rule for IntelligentCross to execute the match at $5.00.

In total, then, 8.9% of trades that would have executed on any other exchange fail to execute on IntelligentCross because of the intentional delay. And that number would almost certainly increase if every broker or dealer were required to route all orders through IntelligentCross when it purports to display the NBBO.

That result is inconsistent with the goals of Regulation NMS and is the opposite of fair and efficient access. Regulation NMS—and the Order Protection Rule, in particular—was designed to avoid just these situations. It gives special trade-through protection only to automated quotations (where trades execute as soon as an incoming order is received) as opposed to manual quotations (where a right to cancel or other delay makes the resting order a "maybe" quote). 70 Fed. Reg. at 37,501/3, 37,504/3, 37,518/2, 37,534/1–2. In the first situation described above, one party (almost always the liquidity provider) is allowed to cancel a resting order *after* a matching IOC order has been received. That has never before been conceived of, let alone given special blessing, by the Commission. It leads, most egregiously, to the structural asymmetry explained above, giving liquidity providers the valuable option to cancel any given trade. Even apart from that, however, these non-match events undermine the very certainty that Regulation NMS meant to promote by setting up a system that requires orders to route through the NBBO only for protected quotes. *Id.* at 37,532/2 (touting "certainty of execution" as a virtue of Regulation NMS).

The second situation, where a trade fails to execute because the NBBO changes during IntelligentCross's intentional delay, has the same basic flaw. Even parties that *want* to execute at a particular price—and would have executed at that price on any other venue—*cannot* do so at the price agreed when the market shifts because IntelligentCross makes them wait. *See* Citadel Jan. 23 Letter at 7. Despite the high incidence of non-matches that leaves a liquidity taker uncertain whether his trade will go through, the Proposal would *require* the liquidity taker to route his order

through IntelligentCross. That wastes time and means that at least one party to a transaction gets, at best, no deal at all or, in many cases, a worse deal than the deal it expected to receive—and would have received—if its order were immediately executed. This would detract from, and potentially undermine completely, the basic structure and efficiency of the market because markets become more volatile as fill rates decline. And again, the Proposal would only make matters worse.

IntelligentCross has responded that these non-matches are not "material" because "non-match events in IntelligentCross occur in a minority of cases," Regulation NMS does not guarantee an execution, and a non-match might result from a number of other factors. IntelligentCross Feb. 16 Letter at 8; IntelligentCross July 14 Letter at 4 & n.15. The Division accepted those rejoinders hook, line, and sinker. 88 Fed. Reg. at 59,966/3. But they miss the mark. Off the bat, there is no greater-than-50%-match rule that shields the IntelligentCross scheme from scrutiny. While it is true that non-matches occur on other venues on occasion for a variety of reasons and no trade is ever 100% guaranteed, that does not address the concern presented by IntelligentCross's delay. All of those other non-match events occur because a resting order is changed or cancelled or perhaps executed by a different IOC order *before* the IOC order at issue is actually received (for example, multiple liquidity takers may route orders to a protected quote, but only the first taker may be matched if the size of the protected quote is not large enough to accommodate the aggregate size of all the orders). Importantly, any such non-matches on other venues are not due to a structural advantage given to certain market participants over others. And those same kinds of structurally symmetrical non-match events undoubtedly occur on IntelligentCross too.

The data from IntelligentCross, however, is different—it shows that nearly 9% of trades fail to match *after* an otherwise-matching IOC order has been received (a number presumably in

addition to the percent of non-matches that occur for other reasons before the IOC order is received). IntelligentCross's intentional delay is the only reason for the non-matches that occur after it receives a matching IOC order. IntelligentCross presented, and the Commission discussed, no examples of non-matches akin to its own.[8] IntelligentCross's attempt to analogize the non-matches caused by its intentional delay to those incidental events makes apples and oranges seem similar by comparison.

IntelligentCross has also responded by arguing that its intentional delay is justified because it leads to better prices, *see* IntelligentCross July 14 Letter at 2, 5, but that is not so. To begin, at the time the resting order and incoming order were both received on IntelligentCross and should have matched, they matched at the best price (by definition). That the market subsequently shifted does not make the non-match more fair; in reality, it makes the non-match unfair for the party against whom the market moved, which typically will be the liquidity taker given the structural advantage provided to liquidity providers under the IntelligentCross system (rather than buying for $5.00 a share, he now has to buy for $5.01). But even if the IntelligentCross system led to better prices, that is not the only relevant criterion for protected-quotation status. As the Commission has explained, speed and certainty are countervailing interests, *see* Regulation NMS, 69 Fed. Reg. 11,126, 11,134/1–2 (proposed Mar. 9, 2004) ("some investors may believe . . . that speed and/or certainty of execution is more important than the possibility of a small amount of price improvement")—and, as it turns out, they are also the basic difference between manual and automated quotations. Thus, the Commission recognized that under Regulation NMS, "investors will have the choice of whether to access a manual quotation and wait for a response or to access an

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[8] IntelligentCross lamented the lack of non-match data from other venues. IntelligentCross July 14 Letter at 4 n.16. But any lack of proof or comparable evidence again highlights FINRA's failure to meet its burden.

automated quotation with an inferior price and obtain an immediate response." 70 Fed. Reg. at 37,518/2.

Indeed, the very fact that FINRA offered the Proposal (issued at IntelligentCross's urging)—which would require by regulatory fiat that more traffic be routed to IntelligentCross—undermines entirely the logic of IntelligentCross's argument. If IntelligentCross really offered superior prices or if price were the only relevant factor, then IntelligentCross would not need to seek a special protected status; market demand would *already* have every sensible person flocking to IntelligentCross.[9] Rather than rethink its product so that it can attract market power of its own force, IntelligentCross is instead attempting a regulatory market grab with the backing of the Commission. The Commission should see this Proposal for what it is and reject it. At the very least, it should require FINRA to (at least try to) explain how the Proposal complies with the goals embodied in Regulation NMS.

Price Sliding. The Proposal also fails to comply with Regulation NMS because the only way for IntelligentCross to execute its mechanism is to price slide—*i.e.*, display false bids or offers that are not accessible. *See* Citadel May 4 Letter at 6–7. This "unheard-of" scheme necessitated by IntelligentCross's intentional delay is neither fair nor efficient. Citadel Aug. 3 Letter at 3.

Regulation NMS requires exchanges to have and enforce rules that prevent brokers and dealers from "[d]isplaying quotations that lock or cross any protected quotation in an NMS stock." 17 C.F.R. § 242.610(d). A lock occurs when, for example, a bid price equals an asking price on the same or a different venue (there is an order to buy a share for $5.00 and an order to sell a share for $5.00). A cross occurs when a bid price exceeds an asking price on the same or a different

[9] IntelligentCross suggested that "many market participants . . . seemingly ignored or misunderstood" the purported "benefits" of its quote scheme. IntelligentCross July 14 Letter at 2. But IntelligentCross cannot mean to suggest that the widespread opposition to the Proposal, voiced by sophisticated market actors with varying interests and perspectives, is rooted in ignorance. The only reasonable conclusion is that those supposed benefits are illusory.

exchange (there is an order to buy a share for $5.01 and an order to sell a share for $5.00). The rule against locked or crossed quotations is fundamental to Regulation NMS, a basic premise of which is that "[w]hen two market participants are willing to trade at the same quoted price," they should be traded against each other based on time priority. 70 Fed. Reg. at 37,547/3. In other words, those two orders should have matched right away, rather than continuing to be displayed. The Commission therefore recognized that "the practice of displaying quotations that lock or cross previously displayed quotations is inconsistent with fair and orderly markets and detracts from market efficiency." *Id.* at 37,547/1; *see id.* at 37,584/2–3 ("Locked and crossed markets can cause confusion among investors concerning trading interest in a stock.").

That spells trouble for IntelligentCross's matching scheme. Its intentional delay means that there would be locking quotes on its own system for up to 900 microseconds, between the time that a matching limit order requiring display is received and the next match event. For example, imagine that IntelligentCross displays a resting sell order for 100 shares at $10.00. It then receives a limit order to buy 100 shares at $10.00. Those orders match and should immediately execute. But since it intentionally delays the match, IntelligentCross must display the limit order on the ADF in accordance with the Regulation NMS display rule. That is a problem for IntelligentCross because it cannot display the actual price of the order ($10.00) without violating Regulation NMS's prohibition on locking its market.

Recognizing the issue, IntelligentCross has attempted to devise a workaround. "IntelligentCross would display the [$10.00] buy order at $9.99." IntelligentCross July 14 Letter at 7 n.27. As it explains, "the order is 'price slid' and displayed one minimum price variation below the best offer in order [not to] create a locked market." *Id.*

While the workaround might technically solve one problem, it creates others—it is both misleading and inefficient. The $9.99 buy order that IntelligentCross displays—which might well be the market-wide NBBO—does not actually exist. And because the true $10.00 buy order has already pre-matched with a resting order on IntelligentCross's system, the buy order (whether displayed at $9.99 or $10.00) is not accessible to new incoming orders during the course of the IntelligentCross intentional delay. The time-priority rule requires that the buy order match the resting sell order at the next match event (assuming, of course, a non-match situation does not arise).[10] If IntelligentCross's false buy order is the NBBO (and if the Proposal were adopted), market participants would be "compelled to route orders to the venue" in an "attempt to access a displayed quote that only IntelligentCross knows is impossible to access." Citadel Aug. 3 Letter at 3. Requiring market participants to route orders to a venue based on a false bid or offer that is not accessible (but known only by IntelligentCross) is not fair. And it is a waste of time. This clearly contradicts Regulation NMS, which expects that a quotation will be "'immediately and automatically' executable, not completely inaccessible." *Id.*[11]

IntelligentCross admits that it is "possible" this scenario will occur, IntelligentCross July 14 Letter at 7, but wrongly suggests that its price-sliding practice is no big deal.[12] It cites data from June 2023 that it says shows that attempts to trade on a false resting order occur for .00035%

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[10] This is what makes the IntelligentCross price-sliding mechanism distinguishable from every other venue that has protected quotes. On other venues, an advertisement of a protected buy quote of 9.99 means that a liquidity taker trying to sell would be guaranteed to get a price of $9.99 (*or better*). In the case of IntelligentCross price-sliding, the opposite occurs: the liquidity taker would be guaranteed *no match at all*.

[11] As Citadel explained, IntelligentCross's price-sliding scheme would likely lead to "significant information leakage." Citadel Aug. 3 Letter at 3–4. When a quote "suddenly jumps from 9.95 by 10.00" (meaning that the best bid is $9.95 and the best offer is $10.00, or vice versa) "to 9.99 by 10.00," that is a strong indication that the 9.99 order is being delayed to match. *Id.* at 4 n.20. The person with the resting order at 10.00 "will be able to 'see' orders that are in a pre-match state and can respond accordingly," namely by deciding whether to cancel. *Id.*

[12] Neither FINRA nor the Division ever directly responded to the price-sliding concern. The most the Division did was cite IntelligentCross's letter to say that IntelligentCross uses price sliding to avoid displaying locked or crossed quotations. 88 Fed. Reg. at 59,963/2. That merely describes the problem; it does not even attempt to resolve the problem.

of trades. *Id.* While that still means that about 158 trades a day are misrouted based on IntelligentCross's misleading tactic, those numbers do not tell the whole story. As it does throughout, IntelligentCross bases its arguments on current data—*before* the Proposal would give its quotations protected status and require routing of significantly more orders to its system. In such a world, one would expect these incidences "to occur far more often." Citadel Aug. 3 Letter at 3. The Commission should therefore reject the Division's approval of the Proposal—or, again, because FINRA failed to consider or explain away any of these issues, reject the Proposal on that basis.

3. *The Division's Remaining Reasoning Does Not Withstand Scrutiny.*

In addition to the counterarguments addressed above, the Division offered a few additional reasons to support its decision to adopt the Proposal. None of them provides a solution to the problems IntelligentCross's intentional delay causes.

First, as alluded to earlier, the Division incorrectly concluded—in a single sentence, without further explanation—that the IntelligentCross intentional delay is no different from geographic or technological latencies that affect some trades. 88 Fed. Reg. at 59,961/2. In addition to being the wrong test, that conclusion is wrong on the merits. *See* Citadel Jan. 23 Letter at 5; Citadel May 4 Letter at 6 n.28.

A geographic latency is a delay caused by distance; for example, it will take slightly longer for an IOC order to travel from California to the New York Stock Exchange than for it to travel from New Jersey to that exchange. And a technological latency is a delay caused by the machine processing the trade, *i.e.*, a kind of computer glitch. Those kinds of delays are fundamentally different from IntelligentCross's intentional delay.

For one, geographic and technological latencies apply to all market participants without creating any kind of asymmetry. In other words, a request to cancel a resting quote is subject to

the same geographic and technological latencies as an incoming IOC order routed to execute against that displayed quote. So long as a cancel message is sent after an incoming order reaches the matching engine (or after an incoming order is sent from the same location as the cancel message), an execution would still occur before the cancel message is received. A geographic or technological latency therefore does not give either party to a trade a structural advantage, even if such latency were much longer than the length of the IntelligentCross intentional delay. Comparing the time of an intentional delay to that of a geographic delay for the purpose of evaluating the impact and fairness of an intentional delay is thus nonsensical—these two types of delays are wholly unrelated. And as noted above, this is not the standard set forth in the 2016 Interpretation.

Importantly, geographic and technological latencies also do not result in non-match events *after* an incoming order reaches a matching engine. Citadel May 4 Letter at 6 n.28. Absent an intentional delay like IntelligentCross's, when an incoming order is received and it equals a resting bid or offer, the two are immediately matched—no waiting for a match event, and no price-sliding in the meantime. Indeed, the post-receipt delay is what creates the asymmetry. These differences explain why the Commission has consistently recognized that *intentional* delays pose particular regulatory questions and "must be carefully scrutinized for consistency with the Exchange Act and Commission regulations." Citadel Aug. 3 Letter at 8; *see* 81 Fed. Reg. at 40,791/1 (the 2016 "interpretation applies only to intentional delays").

Moreover, as noted above, IntelligentCross's intentional delay is in addition to any geographic or technological latencies. So a 300-microsecond unintentional technological delay could lead to a 1200-microsecond total delay when an IOC is routed to IntelligentCross. Because the two operate differently (and cumulatively), geographic and technological latencies cannot justify IntelligentCross's intentional delay.

Second, the Division cited a recent D.C. Circuit opinion, *see Citadel Sec. LLC v. SEC*, 45 F.4th 27 (D.C. Cir. 2022), but that case is distinguishable from this one.[13] There, the court held that a 350-microsecond intentional delay did not violate Regulation NMS when used in connection with a new order type that was granted protected quote status. That delay differs from the one at issue here in several material ways. For starters, the delay did not enable a liquidity provider to elect whether to cancel its protected quote during the delay. *Id.* at 35. Here, by contrast, the delay gives liquidity providers a meaningful structural advantage—the discretion and option to cancel a protected quote for the sole purpose of preventing an execution. In addition, the delay there operated *before* an order reached the exchange; if a matching order reached the exchange before the price change, it would execute despite the delay. IEX Aug. 4 Letter at 2. Of course, the delay here occurs after an incoming order is received, undermining the purposes of Regulation NMS in distinguishing between manual and protected quotations. And further, the delay there was fixed at 350 microseconds, while IntelligentCross's delay is randomized (and typically longer), which as explained above, exacerbates the problems it causes.

Finally, the Division dismissed some concerns by stating that "no other commenter disputed" that "IntelligentCross is already widely used by most major broker-dealer and electronic trading firms." 88 Fed. Reg. at 59,965/1. But that logic suggests IntelligentCross should not have to force market participants to use their venue by regulatory fiat. The entire point of the Proposal is to increase traffic to IntelligentCross by regulation because it has not been able to acquire the market power it would prefer through the usual means. That some, or even many, broker-dealers currently use IntelligentCross for some purposes under certain circumstances does not address the

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[13] Notably, the proponent of the intentional delay at issue in that case has opposed FINRA's Proposal here. *See* IEX Aug. 4 Letter.

concern that the Proposal would be detrimental if the Commission forced all market participants to route to IntelligentCross's "maybe" quotations under all circumstances, regardless of whether doing so would harm the participant or its customers. Neither FINRA, the Division, nor IntelligentCross has offered any analysis based on that anticipated effect. *See*, *e.g.*, Citadel Jan. 23 Letter at 5; Citadel Aug. 3 Letter at 3, 6, 8.

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At the end of the day, the IntelligentCross intentional delay cannot be reconciled with the 2016 Interpretation that determined that Regulation NMS permits programmed delays only if they are *de minimis*. In some of the materials that IntelligentCross provided FINRA to support the Proposal, IntelligentCross touted its "unique matching process." *See* SEC Form 19b-4, File No. 2022-032, Ex. 3, at 3. IntelligentCross's uniqueness is a bug, though, not a feature. Regulation NMS grants a benefit—protected-quotation status—to specific venues that meet particular criteria. *See* 70 Fed. Reg. at 37,579/2–3 (the rule "provid[es] an incentive for non-automated markets to automate"). Given IntelligentCross's novel scheme, and the problems it creates, the Proposal fails. IntelligentCross is free to tinker with its matching system, but it has no right to—indeed, it cannot lawfully receive—special status for that system. IntelligentCross displays "maybe" quotes, not automated quotes. The Commission should reject the Proposal.

III. The Proposed Rule Change Would Not Promote Efficiency, Competition, and Capital Formation.

When reviewing a FINRA proposed rule change, the Commission must determine that the proposed change is designed to "protect investors and the public interest," 15 U.S.C. § 78*o*-3(b)(6), and must "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation," *id.* § 78c(f). The Commission "has a unique obligation to consider the effect of a new rule upon 'efficiency, competition, and capital formation,'

and its failure to 'apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation' makes promulgation of the rule arbitrary and capricious and not in accordance with law." *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011).

The Division utterly failed to fulfill its obligation to conduct an adequate economic analysis of the proposed rule change. The Division limited its analysis to a conclusory footnote stating: "In approving the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation." 88 Fed. Reg. at 59,960/1 n.54. Nowhere did it state what those impacts would actually be, in clear dereliction of its duty to inform the public and Congress of the impacts that the rule it was approving would have on efficiency, competition, and capital formation. The Division's failure is particularly troubling here, where the record indicates that the Commission cannot reasonably conclude that the proposed rule change "will" promote efficiency and competition. 15 U.S.C. § 78c(f).

On the contrary, the Proposal would stifle competition. As discussed above, *see supra* at 20-24, the rule would confer an inequitable competitive advantage to liquidity providers on IntelligentCross's book, who would be able to exploit IntelligentCross's intentional delay to selectively cancel their orders to the detriment of liquidity takers, whose orders the rule would require to be routed to IntelligentCross. *See* Citadel Aug. 3 Letter at 4–7. The Proposal would also impede competition between securities markets, frustrating one of the core objectives of the national market system. As the Commission explained when it adopted Regulation NMS, the national market system is designed to promote not only price competition between orders but also "fair competition among individual markets." 70 Fed. Reg. at 37,498/3. To that end, the national market system "incorporates two distinct types of competition—competition among individual markets and com-

petition among individual orders." *Id.* Promoting competition between securities markets is important because "[v]igorous competition among markets promotes more efficient and innovative trading services," which benefits investors and listed companies. *Id.* at 37,498/3–99/1. But the proposed rule would impede competition between markets by conferring an unfair advantage to IntelligentCross over securities exchanges. If the rule were approved, liquidity providers may flock from securities exchanges to IntelligentCross's platform not because it provides better services than securities exchanges but because IntelligentCross's intentional delay gives them an arbitrary competitive advantage over liquidity takers. The Division provided no response to this competitive harm that the rule would impose; indeed, there is no indication that it considered this issue at all.

Furthermore, and as discussed above, *see supra* at 24-29, the Proposal would degrade the efficiency of the national securities market. Forcing market centers to route the orders of liquidity takers to IntelligentCross to avoid trading through IntelligentCross's protected quotations would increase the frequency of non-match events. That is so because IntelligentCross's quotations may prove inaccessible for several reasons: (1) liquidity providers may cancel their orders during IntelligentCross's intentional delay; (2) the NBBO may move during IntelligentCross's intentional delay; and (3) IntelligentCross's price-slid quotations that are the NBBO would be inaccessible to incoming orders. A rule that would make it more difficult to execute matching bids and offers is the opposite of efficient. The Division completely ignored the effect that the Proposal would have on the frequency of non-match events, noting only that *at present* IntelligentCross's intentional delay prevents matches in about 9 percent of cases. 88 Fed. Reg. at 59,966/3 n.168. The Division abdicated its statutory duty to consider the *impact* that the Proposal would have on the percentage

of non-match events, evidently and inexplicably assuming that it would remain the same if quotations on IntelligentCross's book were given protected status.

Nor does IntelligentCross's representation that its matching process is designed to "maximize price discovery and provide an opportunity for investors to improve performance and achieve best execution"—which FINRA appears to have uncritically accepted—indicate that the Proposal would promote efficiency. 87 Fed. Reg. at 79,402/2. If IntelligentCross's matching system is as efficient and beneficial for investors as IntelligentCross suggests, it makes no sense that market participants would "effectively 'ignore'" its quotes, even though it "is already widely used by most major broker-dealers and electronic trading firms." IntelligentCross July 14 Letter at 2–3, 5.

Because the proposed rule would undermine competition and efficiency in the national securities markets, it is not in the public interest and the Commission must disapprove it.

CONCLUSION

The Commission should reverse the Approval Order and reject FINRA's proposed rule change to add IntelligentCross as a new entrant to the Alternative Display Facility.

Dated: October 29, 2023

<u>/s/ Stephen John Berger</u>

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