

Re: Self-Regulatory Organizations; Investors Exchange LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Add a New Discretionary Limit Order Type Called D-Limit (File No. SR-IEX-2019-15)

Dear Ms. Countryman:

In Citadel's comment letter addressing IEX's proposal to add a new Discretionary Limit order type, they repeatedly expressed concern for retail investors, invoking "retail" 17 times throughout their letter. Citadel claimed its expertise in internalizing retail flow enabled it to "...readily appreciate the negative impact this Proposal will have on retail and institutional investors".¹

I am someone with very intimate knowledge about the retail and wholesaling process and this is the first comment letter that I have submitted to the SEC.

Citadel cares about Citadel

First, let me remind the SEC that Citadel is "not a charity" and makes comments based on what is best for Citadel, not for the benefit of anyone else. Back in 2004 when commenting on the proposed Regulation National Market System, Citadel wrote:

"We believe that the potential long-term impact of internalization is so corrosive to our national market system that the Commission should take every possible step to curtail this business practice."²

So before Citadel began to pay retail brokers hundreds of millions of dollars to internalize their order flow, Citadel actually believed that internalization was corrosive. Since that time, Citadel has become the largest retail internalization platform in the world and purports to be the voice of retail.

The SEC has shown that Citadel is not an advocate for retail investors

I do not believe that all wholesalers treat retail orders poorly and know of firms providing best execution to retail investors while also making money for themselves. However, Citadel has the unique distinction of being a retail wholesaler who has been fined \$22 million by the SEC for depriving retail investors of the best available prices for millions of trades over a two-year period, while falsely claiming otherwise to their retail brokers.³ In fact, it is ironic that Citadel is accusing IEX of using an asymmetric speed bump to "harm retail", when the SEC fine clearly lays out that Citadel used its own internal asymmetric understanding of market data to actually rip off retail orders that they purchase from retail brokers.

According to the SEC fine:

- *One strategy, known as FastFill, was triggered when the best price from one or more of the depth of book feeds that FastFill referenced was better than the best price disseminated by the SIP feed.*

¹ Citation.

² <https://www.sec.gov/rules/proposed/s71004/s71004-436.pdf>

³ <https://www.sec.gov/litigation/admin/2017/33-10280.pdf>

- *SmartProvide was triggered when the SIP NBB or NBO, as applicable, was better than the best bid or offer from one or more depth of book feeds. SmartProvide referenced only one depth of book feed for many securities and fewer than all of the depth of book feeds for other securities. Accordingly, at times, SmartProvide was triggered when the SIP NBB or NBO, as applicable, was from an exchange whose depth of book feed SmartProvide did not reference. In addition, SmartProvide sometimes could be triggered when the difference existed between the SIP and only one of the depth of book feeds SmartProvide referenced, and not the others.*
- *If triggered, and all other eligibility conditions for the strategy were met, SmartProvide routed a non-marketable order to be displayed in the market at a price that was less than the SIP NBO for a buy order or greater than the SIP NBB for a sell order. SmartProvide did not immediately internalize the marketable order at the SIP NBB or NBO, as applicable, or seek immediately to obtain shares at that price through routing.*

Citadel comment letter on IEX Discretionary Limit

Citadel’s comment letter on IEX Discretionary Limit contains a striking admission: they claim that a majority of the order flow sent to IEX represents retail investors and that 50% of their liquidity taking orders on IEX occur when the “Crumbing Quote Indicator” (CQI) is “on”.⁴

This statement is part of the reason that I am writing this letter, and also writing it anonymously to protect my identity and any potential backlash. From an insider’s perspective this a completely shocking admission by Citadel in their treatment of retail orders.

First, it should not be hard to understand that the probability that 50% of orders “representing retail” are being routed to IEX during a CQI being on, a time span that IEX claims to span 0.02% of the trading day. For retail investors spread throughout the world to all arrive at IEX in that narrow of a time window is mathematically impossible, and Citadel likely knows that.

Second, what Citadel is not clarifying is that retail orders are likely sent to Citadel at random times (initiated by actual retail investors living in different parts of the world), but Citadel likely *chooses* to route these orders to IEX *during* a CQI condition. The average speed of execution for a retail order, according to popular retail broker websites, is between 50 and 400 milliseconds. During that time, Citadel has a free option to hold the order and decide what to do with it. Based on the SEC fine mentioned previously, clearly they aren’t holding this order and waiting for a better price for retail to show up – they are waiting to make as much money for Citadel as possible.

IEX’s Crumbing Quote Indicator is an example of an algorithm attempting to predict the direction of a stock price change and Citadel is likely making a similar prediction. For example, when the CQI turns on in Boeing stock that the stock price is crumbling lower, and Citadel is holding on to a Boeing retail sell order, the logic might state: a) Citadel does not want to internalize and buy⁵, b) Citadel will route to an exchange, c) they might first seek a rebate from an exchange (such as Nasdaq BX), d) routing in a serial fashion for rebates will cause the quote to crumble, e) Citadel eventually routes to IEX during a CQI that Citadel themselves caused. This routing sequence also has the effect of neutralizing the marketability of

⁴ Citation.

⁵ <https://patents.justia.com/patent/7987128>

any IEX Discretionary Peg orders that might have otherwise given the retail investor a midpoint execution⁶.

None of what I just wrote is a shock to people with knowledge of how wholesalers make money (internalize the good, route out the bad), but Citadel was the only wholesaler bold enough to try and claim that something like IEX Discretionary Limit harms retail investors. None of this example has anything to do with retail being harmed. In fact, retail might be better off using IEX Discretionary Limit and getting their order out of the hands of Citadel. But IEX Discretionary Limit will certainly harm Citadel's ability to profit off of retail, which is neutral for retail, but bad for Citadel.

Third, there has been some mention of firms using retail orders to dislocate the stock quote, to create greater price impact, which increases their profit. This is a strategy that might also result in Citadel deciding to route a large portion of orders to IEX during a CQI, which again, is only good for Citadel and is damning of their treatment of retail orders.

Conclusion

I sincerely hope that the SEC is not fooled by Citadel's cries of concern for retail. Based on my experience, the real concern and focus should be on how retail orders are treated by Citadel. IEX Discretionary Limit is seeking to protect displayed orders from latency arbitrage. It has been smartly constructed to only operate in moments of asymmetric information, which are the moments where Citadel can make the most money. The SEC has proven, in their \$22 million fine of Citadel, that Citadel has used information asymmetry to their own private benefit, which is the reason Citadel's concerns should be discounted in the process of allowing IEX to deliver a much needed public benefit.

Respectfully,

Anonymous Industry Expert

⁶ <https://iextrading.com/trading/order-types/>