

August 14, 2020

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

Re: IEX D-Limit Proposal (File No. SR-IEX-2019-15)

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 Investors Exchange LLC (“IEX”) to introduce a new “Discretionary Limit” (“D-Limit”) order type (the “Proposal”).¹ This letter is limited to issues raised in IEX’s response to our most recent comment letter,² without prejudice to concerns we have raised in prior letters.

I. IEX Has Failed to Completely and Accurately Describe the Proposal

Despite publishing a lengthy response, IEX has still refused to clearly answer the central question: *What types of liquidity taking orders can be adversely impacted by the Proposal?* As a result, IEX has not met its burden under the Securities Exchange Act of 1934 (“Exchange Act”) to demonstrate that the Proposal is consistent with the Exchange Act and the rules and regulations issued thereunder.³

To provide the Commission with concrete examples of the impact of the Proposal rather than rely on generalizations, we provided data based on actual trading activity on IEX to demonstrate how the Proposal will discriminate against all types of liquidity takers (including retail investors), in particular when executing larger orders that must be routed to multiple exchanges. We outlined in detail how this occurs:

- (1) A large order is routed simultaneously to multiple exchanges;
- (2) The IEX CQI observes the executions occurring on other exchanges while the portion of the order sent to IEX is delayed by the IEX speedbump;

¹ 84 FR 71997 (Dec. 30, 2019), available at: <https://www.govinfo.gov/content/pkg/FR-2019-12-30/pdf/2019-28024.pdf> (the “Proposal”).

² Letter from John Ramsay, Chief Market Policy Officer, IEX (Aug. 3, 2020), available at: <https://www.sec.gov/comments/sr-iex-2019-15/sriex201915-7534417-222147.pdf> (“IEX Third Response Letter”).

³ See Rule 700(b)(3) of the Commission’s Rules of Practice.

- (3) By the time the portion of the order sent to IEX exits the speedbump, the IEX CQI will be ON (and the displayed D-Limit quotes will be repriced) simply as a result of IEX observing our smart order router executing the large order across multiple venues;
- (4) The portion of the order sent to IEX is unable to access displayed D-Limit quotes, leading to a decline in fill rates. Any unfilled portion would then need to be re-routed to other exchanges to secure the necessary liquidity, with prices likely worsening as other market participants react to the fact that the rest of the large order has already been executed and publicly reported.

This sequence of events results in the Proposal discriminating against all types of liquidity takers, including retail investors. In its latest response letter, IEX continues its refusal to clearly acknowledge that the CQI can be triggered by ordinary trading activity. Instead, IEX misleadingly asserts that there is an “infinitesimally small chance that an order sent by a retail investor to her broker [. . .] would happen to arrive on IEX during a 2-millisecond window of time when the CQI is on.”⁴ However, what IEX purposefully ignores is that this is exactly what happens when the execution of the retail investor order is actually what causes the CQI to turn ON in the first place.

IEX’s refusal to clearly acknowledge that the CQI can be triggered by ordinary trading activity is at odds with commenters on both sides of the debate. In fact, the most recent letter in favor of the Proposal states: “It certainly will discriminate broadly against liquidity takers, as Citadel and others have helpfully pointed out.”⁵ IEX’s refusal to clearly acknowledge that the CQI can be triggered by ordinary trading activity is also inconsistent with statements made by IEX prior to the Proposal.⁶

As our last letter clearly shows, the CQI can be – and will be – triggered by ordinary trading activity, including larger orders that are sent simultaneously to more than one venue for execution, undermining the execution experience for all types of liquidity takers, including retail and institutional investors. Other than dismissive language, IEX has to date failed to explain how they accounted for this market impact and how the Proposal is therefore “narrowly-tailored” to protect against purported “latency arbitrage” activities. This failure to completely and accurately describe the Proposal and its effects on the market should be fatal under the Exchange Act. Under the Exchange Act, IEX has the burden to provide sufficient and accurate information regarding the Proposal in order for the public to provide meaningful comment and for the Commission to make

⁴ IEX Third Response Letter at page 11.

⁵ Letter from R. T. Leuchtkafer (Aug. 3, 2020), available at: <https://www.sec.gov/comments/sr-iex-2019-15/sriex201915-7513054-221998.pdf>

⁶ See, e.g., “The Evolution of the Crumbling Quote Signal,” Allison Bishop, IEX White Paper (2017) at page 2, available at: <https://iextrading.com/docs/The%20Evolution%20of%20the%20Crumbling%20Quote%20Signal.pdf> (“We might ask: who is this trader swooping in to take advantage of the resting order on venue V at this stale midpoint price? It could be a **large seller who has himself taken out all of the buy interest at \$10.00** on venue W, in which case it is no surprise that this seller can anticipate the change in the NBBO. **There is not really anything to do about this case, this is just something that happens as part of normal, healthy market behavior** [emphasis added]”).

an affirmative finding that the Proposal is consistent with the Exchange Act. IEX's most recent response letter appears to attempt to shift this burden, focusing on attempting to undermine our actual trading data and analysis while refusing to provide clear and accurate answers to the fundamental question of "*what types of liquidity taking orders can be adversely impacted by the Proposal?*" As a result, IEX has failed to satisfy its burden under the Exchange Act.

II. The Proposal Is Unfairly Discriminatory

In the event IEX were to accurately, but belatedly, concede that the Proposal broadly discriminates against all types of liquidity takers, including retail investors, the question is then whether this discrimination is unfair under the Exchange Act. This requires an analysis of (a) the scope of the discrimination and (b) whether any alternatives exist to mitigate the discriminatory impact. On both of these points, IEX's latest response letter clearly demonstrates that IEX has failed to satisfy its burden to provide the Commission with sufficient basis to make an affirmative finding that the Proposal is not unfairly discriminatory.

A. *The Proposal Materially Harms Retail Investors*

We provided data showing that (i) a material percentage of retail orders that we route to IEX are being executed when the CQI is ON, and (ii) to the extent IEX has displayed liquidity (which one should assume if the Proposal is approved), we expect that at least 2.5 million retail orders per month would be negatively impacted by the Proposal.

IEX attempts to discredit the data we provided in various ways, including by questioning whether the 2.5 million statistic included retail orders that were internalized⁷ and by asserting that these figures represent "a subset of a subset of a subset of all the orders Citadel receives from retail broker-dealers."⁸ While it is true that we route more than 2.5 million retail orders per month, our prior comment letter was clear that we executed over 2.5 million retail orders during the month of May 2020 that required more size than was available at the NBBO across all exchanges at the time of routing. This means each of these 2.5 million retail orders were indeed routed to lit exchanges to execute against the full quote and were of a size that was larger than the full quote. Further, nearly half of these 2.5 million retail orders were for a notional value of less than \$10,000. Providing data showing that the Proposal may negatively impact tens of millions of retail orders annually should prompt a more thoughtful response than IEX's baseless assertion that "Citadel has provided no data or evidence to suggest, let alone establish, that retail investors will be in any way negatively impacted by D-Limit."⁹

⁷ IEX Third Response Letter at page 9.

⁸ IEX Third Response Letter at page 9.

⁹ IEX Third Response Letter at page 12.

For its part, IEX has provided no data assessing the potential impact of the Proposal on retail investors. IEX claims that there is no way for the exchange to do so,¹⁰ which is a surprising position given that, among others, firms submitting retail orders to IEX may be designated as a “Retail Member Organization” under the IEX Retail Program¹¹ and/or may use dedicated ports to route retail orders. IEX also has not provided data assessing the potential impact of the Proposal on larger orders sent by other types of market participants, including institutional investors, that are sent simultaneously to more than one venue for execution.

B. IEX’s Favored Routing Alternative is Not Workable

Given the Proposal’s discrimination against liquidity takers, we highlighted the potential alternative of preferencing IEX when routing to access displayed liquidity on multiple exchanges. This means (1) routing first to IEX, (2) waiting for 350 microseconds (the length of the IEX speedbump), and (3) then routing to other external venues. This would prevent the IEX CQI from observing the executions occurring on other exchanges while the portion of the order sent to IEX is delayed by the IEX speedbump.

Despite refusing to acknowledge that retail investors could be adversely impacted by the Proposal if the steps above are not taken, IEX appears to assert that market participants should preference IEX when routing to access displayed liquidity on exchanges, stating repeatedly that firms should “account” for the IEX speedbump and that “it would be easy for Citadel to execute market sweeps (to the same extent others can) by simply taking account of the speedbump.”¹² “Accounting” for the IEX speedbump means routing to IEX first and intentionally delaying routing to other exchanges when accessing displayed liquidity.

In our prior comment letters, we detailed a number of issues with routing retail orders in this manner, including whether intentionally delaying the routing of marketable orders is consistent with the “fully and promptly” best execution standard¹³ and the routing implications to the extent other exchanges implement similar mechanisms, perhaps with differing durations.

In response, IEX attempts to introduce confusion by asserting that the total time it takes to process and execute a retail order is often longer than 350 microseconds, and therefore it should not be a problem to intentionally delay the routing of marketable orders by the length of the IEX speedbump.¹⁴ Of course, what really matters is the time it takes to fully execute an order after it is first exposed to the market (and other market participants begin reacting to that information). Among numerous misstatements regarding how retail orders are executed, IEX asserts that retail

¹⁰ IEX Third Response Letter at pages 5-6.

¹¹ See <https://www.sec.gov/rules/sro/iex/2019/34-86619.pdf>.

¹² IEX Third Response Letter at page 13, FN 50 and pages 13-15.

¹³ See FINRA Rule 5310.

¹⁴ See IEX Third Response Letter at page 12.

orders are routed to exchanges last, after routing to other broker-dealers and dark pools.¹⁵ In fact, we route to both exchanges and off-exchange venues as we sequentially search for midpoint liquidity and other inside-the-quote liquidity across external venues (and in no way are exchanges only at the end of the waterfall). To the extent there is insufficient liquidity at prices better than the displayed NBB (or NBO) to fill the entire order, then our smart order router will proceed to access liquidity at the displayed NBB (or NBO). IEX’s routing solution would introduce an intentional routing delay of 350 microseconds in the middle of that execution sequence as the smart order router begins to access displayed liquidity on exchanges, which creates a real risk that the market will move while orders are being intentionally held back from other exchanges to “account” for the IEX speedbump.¹⁶ Just as 350 microseconds is long enough for IEX to reprice D-Limit quotes before they can be accessed, it is also more than long enough for liquidity providers on other exchanges to reprice displayed quotes.

IEX also incorrectly claims that the Commission has endorsed preferencing IEX in this manner as part of approving IEX’s exchange application.¹⁷ In fact, the Commission specifically noted at the time that the approved order types in question were limited to non-displayed orders,¹⁸ whereas this Proposal applies to displayed orders. More generally, we do not believe the Commission can approve a proposed rule change when an SRO’s response to a structural and competitive problem *created by that proposed rule change* is for market participants to develop a way around the problem. Indeed, Commission staff noted just this year when disapproving EDGA’s proposed rule change to introduce an asymmetric speedbump that “a market participant’s ability to adapt its business model or alter its trading strategies in response to this proposed rule does not, by itself, demonstrate that the proposal would not permit unfair discrimination, and the Exchange has not provided adequate analysis to support its assertion.”¹⁹ This Proposal effectively compels market participants to route certain orders to IEX first and intentionally delay routing to other exchanges in order to successfully access displayed liquidity on IEX – potentially at a higher cost of execution – and raises a number of issues that the Commission has not previously considered.

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IEX has the burden under the Exchange Act to provide the Commission with sufficient basis to make an affirmative finding that the Proposal is consistent with the Exchange Act. In light of

¹⁵ See IEX Third Response Letter at page 10.

¹⁶ In contrast, as detailed in our prior comment letter, we successfully access displayed liquidity across multiple exchanges in order to fill larger orders without staggering routing as proposed by IEX.

¹⁷ IEX Third Response Letter at page 13.

¹⁸ See IEX Approval Order at 41156, FN 216 (“The Commission notes that IEX will only reprice pegged orders, which are non-displayed. Non-displayed orders are not reflected in an exchange’s quotations, and Rule 611 applies order protection to publicly displayed quotes only. Accordingly, an access delay that does not allow the repricing of displayed orders does not impact an exchange’s displayed quotation, and cannot be said to lead to ‘maybe’ quotations.”).

¹⁹ See Release No. 34-88261 (Feb. 21, 2020), available at: <https://www.sec.gov/rules/sro/cboeedga/2020/34-88261.pdf> at page 37.

the insufficient data analysis and the inaccurate statements regarding the impacts of the Proposal, which we and others have detailed throughout, we do not believe that the Commission can make such a finding because IEX has failed to satisfy this burden.²⁰

U.S. equity markets are more competitive and liquid than ever before, and we have consistently supported market structure initiatives designed to make markets more fair, efficient, and transparent. Competition and innovation has markedly improved conditions for all investors, who benefit from dramatically lower trading costs and increased market transparency. Retail investors in particular have benefited – not only do they frequently get better prices than those publicly quoted, but they often get their orders filled at such prices for more size than is publicly displayed. This Proposal represents a significant departure from the current market structure, unfairly favoring IEX liquidity providers without any corresponding obligation, compelling market participants to preference IEX over other exchanges, and adversely impacting tens of millions of orders submitted by retail investors annually.

We urge the Commission to disapprove this Proposal.

Please feel free to call the undersigned at [REDACTED] with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger

Managing Director

Global Head of Government & Regulatory Policy

²⁰ See *Susquehanna Int'l Grp., LLP v. Securities and Exchange Commission*, 866 F.3d 442, 449-50 (D.C. Cir. 2017).