December 5, 2022

Submitted electronically

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Securities Exchange Act Release No. 34-94866 (SR-MEMX-2021-10)

Dear Ms. Countryman:

MEMX LLC ("MEMX" or the "Exchange") appreciates the opportunity to provide additional comments to the U.S. Securities and Exchange Commission ("Commission") on the above-referenced proposed rule change (the "Proposal"). The Proposal, which was filed by the Exchange on September 1, 2021,[1] seeks to implement a retail midpoint liquidity program (the "Program") that would provide an opportunity for retail investors to receive substantial price improvement at the midpoint of the national best bid and offer ("NBBO"), while allowing institutional and other investors to interact with retail order flow on a national securities exchange.

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1 See Securities Exchange Act Release No. 92844 (September 1, 2021), 86 FR 50411 (September 8, 2021) (SR-MEMX-2021-10) ("Notice"). The Proposal was further amended by the Exchange on January 27, 2022. See Securities Exchange Act Release No. 94189 (February 8, 2022), 87 FR 8305 (February 14, 2022) ("Amendment No. 1").

On May 6, 2022, the Staff of the Division of Trading and Markets ("Staff") disapproved the Proposal.[2] The Staff's disapproval was based on its analysis of the Program's proposed priority rules, which would give priority to Retail Midpoint Liquidity ("RML") Orders that publicly signal their willingness to trade with incoming retail orders ahead of midpoint peg orders entered on the MEMX order book that are willing to trade with any counterparty (i.e., not only retail investors) but are fully non-displayed. On May 10, 2020, the Commission initiated review of the Staff's decision, which was taken pursuant to delegated authority, and stayed the order.[3] The Exchange writes now to request that the Commission reverse the Staff's disapproval of the Program.

The Staff's disapproval, if left to stand, would deprive retail investors and other market participants of the benefits of the Program and reversal of that decision is appropriate for three reasons: (1) it is not "unfairly discriminatory" under Section 6(b)(5) of the Exchange Act[4] to provide priority to investors that attract retail order flow to the exchange by signaling their willingness to trade with retail orders; (2) MEMX rules and the rules of other exchanges have long provided priority at the midpoint to specific order types, contrary to the implicit requirements the Staff now reads into the Exchange Act for the first time; and (3) the Disapproval Order is at odds with the Commission's stated goals for the U.S. equity market, and has furthered the very problem that the Commission intends to address through upcoming rulemakings on equity market structure that would mandate the execution of retail orders in mechanisms similar to the Program.

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2 See Securities Exchange Act Release No. 94866 (May 6, 2022), 87 FR 29193 (May 12, 2022) (SR-MEMX-2021-10) ("Disapproval Order").

3 See Letter from Assistant Secretary J. Matthew DeLesDernier to Anders Franzon, General Counsel, MEMX, dated May 10, 2022, *available at* https://www.sec.gov/rules/sro/memx/2022/34-94866-letter-from-assistant-secretary-051022.pdf.

4 15 U.S.C. 78f(b)(5).

Background

Change is afoot in the U.S. equity market. Driven, in part, by a narrative pushed by some of our peers that the "playing field is not level," the Commission now seems poised to enact several reforms that would have a significant cumulative impact on equity trading. MEMX has been an active contributor to this debate and has recommended several changes that would eliminate or reduce inefficiencies that we have observed, including, for example, inefficiencies created by current tick size and round lot regimes.[5] These recommendations are backed by substantial data analysis, and we hope to see them reflected in the Commission's upcoming rulemaking efforts.

At the same time, the Commission is also considering more prescriptive rulemaking, particularly around retail order execution. These rules would likely have the effect of pushing more retail order flow onto national securities exchanges in programs similar to this one – effectively substituting the venue competition that exists under the current market structure with order competition – with far-reaching consequences for investors and the entire market ecosystem. While the exact content of this proposal is yet to be seen, it stands to reason that any mandate forcing market participants to use such mechanisms would have to be justified based on some failure of the competitive market to provide mechanisms that meet the Commission's objectives.

As discussed in the sections below, the Staff's disapproval rests on a flawed analysis of the relevant statutory standards to the Program's proposed priority rule, applying those standards in a manner that is inconsistent with their historical application to the rules of both MEMX and other

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5 See Letter from Adrian Griffiths, Head of Market Structure, MEMX to Commissioners, dated March 30, 2022, *available at* https://memx.com/market-reform-recommendations ("MEMX Market Structure Letter").

national securities exchanges. On its own, this would warrant reversal. However, we also urge the Commission to think carefully about how the Proposal – and the disapproval thereof – fits into the debate on competition for retail order execution. Before engaging in broad efforts to reshape the U.S. equity market through its rulemaking authority, we respectfully request that the Commission consider how these same policy objectives can be fulfilled by *permitting* innovation by national securities exchanges rather than *mandating* the use of specific mechanisms by market participants.

I. IT IS NOT "UNFAIRLY DISCRIMINATORY" UNDER SECTION 6(B)(5) OF THE EXCHANGE ACT TO PROVIDE PRIORITY TO INVESTORS THAT ATTRACT RETAIL ORDER FLOW TO THE EXCHANGE BY SIGNALING THEIR WILLINGNESS TO TRADE WITH RETAIL ORDERS

The Disapproval Order rests on the Staff's analysis of the Program's proposed priority structure under the applicable Exchange Act standards, and in particular Section 6(b)(5) of the Exchange Act, which requires that the rules of a national securities exchange are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. As discussed in the Proposal, and in a comment letter submitted by the Exchange,[6] RML Orders entered into the Program – i.e., entered with the intent of trading with incoming retail orders – would light up a Retail Liquidity Identifier ("Identifier") in order to attract contra-side retail order flow. This Identifier plays an important role in the Program as market participants that route retail order flow are unlikely to ping an exchange program to source liquidity in the absence of information that there may actually be liquidity available in such programs. In exchange for lighting up the Identifier and assuming related information leakage risks, RML Orders would have priority over midpoint peg orders resting on the MEMX order book, which are fully non-displayed and do not

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6 See Letter from Adrian Griffiths, Head of Market Structure, MEMX, dated January 27, 2022, *available at* https://www.sec.gov/comments/sr-memx-2021-10/srmemx202110-20113077-265641.pdf ("MEMX Comment Letter").

contribute to attracting incoming retail orders to the Program. The Staff determined that this tradeoff was inappropriate under Section 6(b)(5). We disagree. In fact, the Program's proposed priority regime is generally consistent with the price-time priority allocation model used by most U.S. equities exchanges, which prioritize orders that attract contra-side marketable order flow.

Under the standard price-time priority allocation model in place on the Exchange and most other U.S. equities exchanges, orders at the same price are ranked in time priority, with displayed orders prioritized ahead of any non-displayed orders.[7] While RML Orders are not "displayed" in the same manner as displayed limit orders entered onto the MEMX order book, such orders do convey meaningful information to market participants looking to trade. This includes information about the price of the order (the midpoint of the NBBO), side (buy or sell), and size (at least one round lot). The Exchange expects that most market participants that route retail orders to the Program would do so on the basis of this information, which would be disseminated on both the securities information processors ("SIPs") as well as the Exchange's proprietary market data feeds. Similar to the treatment of displayed orders on the MEMX order book, the Exchange would give priority to such RML Orders ahead of fully non-displayed midpoint peg orders, which convey no information to the market and therefore do not contribute to attracting contra-side order flow.

The principal argument raised by the Exchange in support of the proposed priority structure at issue in the Disapproval Order was that the proposal appropriately balances the risks and incentives associated with RML Orders entered into the Program to provide liquidity to contra-side retail order flow. This balancing is necessary as the Program can only be successful if market participants are willing to enter RML Orders that light up the Identifier in order to attract and trade

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7 See e.g. MEMX Rule 11.9, Priority of Orders.

with incoming retail orders. The Staff rejected this argument, concluding instead that entering RML Orders into the Program came with "little risk (if any)"[8] and, in fact, "compounded benefits."[9] However, this conclusion appears to be based on the assumption that the only relevant risks come from "adverse selection"[10] – i.e., the risk that the price of a security will move against the posted order after a trade is consummated. This assumption is misplaced. In fact, neither the Exchange nor commenters discussed adverse selection risks in relation to the Program. Rather, the Exchange argued that "entering RML Orders involves some additional risk for those market participants as the Indicator will *signal whether there is a buyer or seller that is willing to trade with retail investors at the midpoint*."[11] This risk represents the potential for "information leakage," which can increase costs for buy-side institutions that are trading larger parent orders.

The Staff's minute focus on adverse selection risks – rather than the information leakage risks actually identified by the Exchange – appears to originate from an attempt to distinguish the Program's proposed priority structure from ordinary displayed order priority. Specifically, the Staff states that "[r]rewarding displayed orders with priority over non-displayed orders compensates them… for the chance of adverse selection when trading with certain counterparties."[12] By contrast, the Staff suggests that "market participants posting RML Orders would face little risk (if any) from the Retail Liquidity Identifier because RML Orders are uniquely counterparty-restricted whereas displayed orders are not so restricted."[13] Put another way, the Staff

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8 See Disapproval Order, supra note 2, at 29196.

9 Id.

10 Id.

11 See MEMX Comment Letter, supra note 6, at 6 (Emphasis Added).

12 See Disapproval Order, supra note 2, at 29196.

13 Id.

implies that displayed orders deserve priority because they face unique adverse selection risks that are presumably not present for non-displayed orders, which do not receive priority on an exchange, or RML Orders that are counterparty-restricted and only trade with retail orders.

This distinction is dubious. While the Staff is correct that displayed orders posted on an exchange face adverse selection risks, displayed order priority – i.e., priority of displayed orders over non-displayed orders – is not properly construed as compensating them for those risks. In fact, *both* displayed and *non-displayed* orders posted on an exchange face adverse selection risks. Indeed, the Commission itself has relied on the fact that non-displayed orders face adverse selection risks in other contexts. This includes the approval of a Form 1 application for another national securities exchange, Investors Exchange LLC ("IEX"), whose novel "speed bump" was based entirely on mitigating adverse selection risks faced by *non-displayed* pegged orders.[14]

Since, as the Commission itself has found, adverse selection risks affect both displayed and non-displayed orders, it makes little sense to conclude that displayed order priority is designed to compensate such orders for risks that are shared with all orders posted on an exchange. Instead, as the Exchange argued, it is more accurate to describe order priority for displayed orders as addressing the risks associated with *public display* and the benefits this display provides to the

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[14] See Securities Exchange Act Release No. 78101 (June 17, 2016), 81 FR 41141 (June 23, 2016) (File No. 10-222) ("IEX Form 1Approval Order") ("[T]he purpose of IEX's coil is to provide an intentional buffer that slows down incoming orders to allow IEX's matching engine to update the prices of resting "pegged" orders when away prices change to protect resting pegged orders from the possibility of adverse selection when the market moves to a new midpoint price."). As discussed in the IEX Form 1 Approval Order, pegged orders on IEX are all non-displayed. See id at 41152.

overall market, including increased transparency and the ability of such orders to attract the other side of the trade. These characteristics are shared with RML Orders that light up the Identifier.

Tellingly, while the Staff focuses on adverse selection and therefore assumes that entering RML Orders entails no risk to the firm entering such an order, the only commenter that addressed this topic came to the exact *opposite* conclusion.[15] That commenter, a buy-side institution that opposed the proposal, argued that it was not appropriate to force market participants to choose between entering an RML Order that "would leak sensitive order information" or entering a midpoint peg order that would not entail such a risk but would cede priority to RML Orders entered into the Program. In effect, the commenter suggested that the risk associated with lighting up the Identifier and signaling that there is a buyer or seller at the midpoint is *so great* that they would not be able to use the order type at all. While the Exchange disagrees with the commenter's ultimate argument, i.e., that this risk of information leakage negates their ability to use this order

15 See Letter from Sean Paylor, Acadian Asset Management, dated May 6, 2022, *available at* https://www.sec.gov/comments/sr-memx-2021-10/srmemx202110-20128035-289865.pdf. The Exchange notes that this comment was submitted on the same day that the Staff issued the Disapproval Order. As such, the Exchange never had an opportunity to respond to these comments and the Staff may have had limited opportunity to consider the comments prior to issuing the Disapproval Order. Nevertheless, the stark contrast between the Staff's unsupported conclusions about the risks entailed with entering RML Orders and the views of market participants that would face those risks is instructive, particularly when the commenter was not supportive of the proposal overall.

type,[16] the record clearly does not support the Staff's conclusion that there were no risks to balance or that the Exchange's attempt to balance those risks instead compounded benefits.[17]

When appropriately considering the actual information leakage risks raised by the Exchange, and the clear benefits provided by market participants that are willing to signal their availability to trade with incoming contra-side retail order flow, the Program "appropriately balances the risks and incentives associated with entering RML Orders."[18] Indeed, the Exchange understands that certain firms, including buy-side institutions, are willing to provide liquidity to retail investors at the midpoint of the NBBO. However, similar to the use of displayed orders on an exchange order book, we understand that market participants may not be willing to take on the risk of signaling that there is a willing buyer or seller at the midpoint if they would subsequently lose out on trading with order flow that they attract due to pre-existing non-displayed orders. While the Proposal would provide priority to the market participant whose order attracts the contra-side of the trade ahead of other midpoint peg orders, this is not "unfair" under Section 6 of the Exchange Act as it would establish a sensible balance between risks and benefits associated with each order

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16 The commenter also assumes that RML Orders would primarily be entered by market makers whereas midpoint peg orders may be entered by agency brokers on behalf of buy-side institutions. As a practical matter, this assumption is incorrect as the preponderance of resting midpoint peg orders are in fact entered by market makers. By contrast, the Program is designed to appeal to a broader range of market participants, including buy-side institutions, that generally do not use regular midpoint peg orders today.

17 The risks associated with information leakage are well documented and have been relied on by the Commission in its rulemakings. For example, the Commission explained that its recent rule on disclosure of order handling information would "further encourage broker-dealers to minimize information leakage." See Securities Exchange Act Release No. 84528 (November 2, 2018), 83 FR 58338 (November 19, 2018) (File No. S7-14-16). The Staff cannot simply ignore risks that the Commission has used to justify its own rulemakings when evaluating proposed rules filed by a national securities exchange.

18 See MEMX Comment Letter, supra note 6, at 6.

type in an analogous manner to displayed order priority for trading on an exchange order book. In turn, this would encourage market participants to enter RML Orders, which attract contra-side retail order interest and facilitate significant price improvement opportunities for retail investors.

II. MEMX RULES AND THE RULES OF OTHER EXCHANGES HAVE LONG PROVIDED PRIORITY AT THE MIDPOINT TO SPECIFIC ORDER TYPES, CONTRARY TO THE IMPLICIT REQUIREMENTS THE STAFF NOW READS INTO THE EXCHANGE ACT FOR THE FIRST TIME

In the Staff's telling, the question of whether different order types can have different priorities at the midpoint of the NBBO is a matter of first impression for the Commission. For example, the Disapproval Order states that: "MEMX's proposal does present a novel issue because MEMX seeks to award execution priority to a new type of Midpoint Peg order… over an existing type of Midpoint Peg Order.[19]" However, whether one order type can have priority over another is not a novel question at all. In fact, both MEMX and competing national securities exchanges have rules in place today that differentiate between order types when determining priority at the midpoint of the NBBO. For example, MEMX Rule 11.9(a)(B), states that "[w]here orders to buy (sell) are priced at the midpoint of the NBBO,"[20] orders are ranked within five different priority bands based on the order type used: "(i) Limit Orders to which the Display-Price Sliding instruction has been applied; (ii) Limit Orders with a Non-Displayed instruction; (iii) Orders with a Primary Peg instruction; (iv) Orders with a Midpoint Peg instruction; and (v) Reserve Quantity of Limit Orders."[21] Under this priority structure, midpoint peg orders are already prioritized behind three other order types, including orders entered with a primary peg instruction or non-displayed

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19 See Disapproval Order, supra note 2, at 29196.

20 MEMX Rule 11.9(a)(B). While orders subject to display-price sliding are considered "displayed" the remaining priority bands all reflect non-displayed orders.

21 Id.

limit orders. Similar priority structures have also long been available on the four U.S. equities exchanges operated by Cboe Global Markets Inc. ("Cboe") where orders posted at the midpoint are prioritized in as many as *eight* priority bands that differentiate between different order types offered on those exchanges.[22] The Staff apparently draws the line at RML Orders entered with the goal of facilitating greater price improvement opportunities for retail orders. We fail to see how this abrupt and unexplained change of course benefits retail investors or the broader market.

III. THE DISAPPROVAL ORDER IS AT ODDS WITH THE COMMISSION'S STATED GOALS FOR THE U.S. EQUITY MARKET, AND HAS FURTHERED THE VERY PROBLEM THAT THE COMMISSION INTENDS TO ADDRESS THROUGH UPCOMING RULEMAKINGS ON EQUITY MARKET STRUCTURE THAT WOULD MANDATE THE EXECUTION OF RETAIL ORDERS IN MECHANISMS SIMILAR TO THE PROGRAM

Finally, it's worth re-considering the Disapproval Order in light of the Commission's much-anticipated rulemakings on U.S. equity market structure reform. As discussed in a speech by Chair Gensler in June – just one month after the Staff issued the Disapproval Order – the Commission is currently working on several rulemakings targeted at reforming the U.S. equity market.[23] While MEMX has shared recommendations with the Commission on several of the potential areas of reform being considered, one is particularly relevant to the Program, i.e., an initiative to require that retail orders are executed either: (1) at the midpoint of the NBBO; or (2) in mechanisms that allow for competition on an "order-by-order" basis. With the Commission seeking to use its rulemaking authority to enhance opportunities for retail investors to receive

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22 See e.g. Cboe EDGX Exchange, Inc. ("EDGX") Rule 11.9(a)(2)(B).

23 See "Market Structure and the Retail Investor:" Remarks Before the Piper Sandler Global Exchange Conference, Gary Gensler, Chair, Commission, dated June 8, 2022, *available at* https://www.sec.gov/news/speech/gensler-remarks-piper-sandler-global-exchange-conference-060822.

midpoint executions, and to facilitate more interaction between retail and other investors, one might imagine the Commission would welcome a mechanism designed with those goals in mind.

Presumably the Commission is of the view that the competitive market has not allowed these sorts of mechanisms to flourish, and that rulemaking is needed to fulfill the Commission's investor protection mission. We do not share the Commission's ostensible view that the market has failed retail investors, who today enjoy unprecedented market access, and whose orders are routinely filled with immediacy at improved prices. However, one need not have any particular view about current landscape to share in the irony that the competitive problems that the Commission now seeks to address are, in part, a problem of the Staff's making. Indeed, the Staff and the Commission appear to be working at cross-purposes, with the Staff blocking the very sorts of mechanisms that the Commission now intends to mandate through its rulemaking authority.

MEMX has been a strong proponent of competition in the capital markets. As we stated in a letter to the Commissioners earlier this year, "[c]ompetition is fundamental to financial markets because it incentivizes innovation, reduces costs, and encourages financial intermediaries to continuously improve the quality of the services that they provide to the investing public."[24] Simply put, our capital markets work best when competition is robust. MEMX, as a new competitor in the U.S. equity market and soon-to-be competitor in the U.S. options market, has a role to play in facilitating competition in the markets in which we participate. So too does the Commission. In fact, by Congressional mandate, the Commission is charged with facilitating competition in the capital markets as one of its primary goals and in conjunction with its broad

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24 See MEMX Market Structure Letter, supra note 5, at 2.

investor protection mission.[25] While the Commission might consider this part of its mission most frequently when engaging in rulemaking, it has other tools that should be used to promote competition, and this includes its role in assessing exchange rule proposals such as this one.[26]

At a time when the Commission is rethinking the very foundations of our market structure, it must consider what tools at its disposal are least disruptive. Expansive regulatory mandates come at a cost and that cost will be borne by investors. The Commission cannot simply use its rulemaking authority to mandate particular kinds of competition when the Staff's decisions prevent such competition from emerging in the free market. When regulation stands in the way of a competitive market, the solution is not more regulation but less. We urge the Commission to consider how it can improve its regulatory framework to allow for greater competition from all market participants.

Sincerely,

/s/ Adrian Griffiths

Adrian Griffiths
Head of Market Structure, MEMX

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25 15 U.S. Code § 78c(f) ("Whenever pursuant to this chapter the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.").

26 Id.