June 12th 2018

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Securities Exchange Act Release No. 83272; File No. SR-NASDAQ-2018-038

Dear Mr. Fields**:**

Themis Trading appreciates the opportunity to comment on the above-reference proposed rule change by the Nasdaq Stock Market ("Nasdaq") to change the terms of its Midpoint Extended Life Order ("MELO").

Déjà vu All Over Again

We oppose the rule change for essentially two grounds of reasoning. First, it would offer advantages to professional traders in a way that seems to contradict the purpose that Nasdaq gave when it asked the SEC to approve the MELO order type. Second, it appears on its face to violate the prohibition against sub-penny pricing of Rule 612, and Nasdaq has not sought or been granted an exemption from that rule. We will discuss these in more detail below.

Background on MELO and Proposed Change

Nasdaq sold the MELO order type to the Commission and the industry as a way of attracting more orders from participants, particularly institutional investors, "that are less concerned with time to execution to receive executions at the midpoint of the NBBO, while deemphasizing speed as a factor in achieving the execution." Nasdaq said that MELO was meant to "increase access to, and participation on, Nasdaq for investors that are less concerned with time to execution, but rather are looking to source liquidity, often in greater size, at the midpoint of the NBBO against a contra-party Order that has met the same objectives."

In general, MELOs are non-displayed orders pegged to execute at the midpoint of the national best bid or offer ("NBBO") but are not eligible to execute until one-half second after the order is accepted by Nasdaq. As the order type exists now, MELOs may have a limit price, but if the limit is outside the midpoint price when the order is received, the holding period does not begin to run until the midpoint is equal to or better than the limit. MELOs only interact with other MELOs, not any other orders on the Nasdaq book, and they have time priority among each other based on when the holding period begins to run.

Nasdaq is proposing to add a "Price Improvement Only" ("PIO") option, which would allow a MELO to execute only if the midpoint price provides the order with price improvement of at least a half-penny, as measured against the limit price. The holding period will begin when the order is accepted by Nasdaq, but only if the midpoint price is better than the limit price set by the participant at that time, and if not, the holding period would begin when the midpoint changes such that the midpoint would provide price improvement beyond the limit price.

For example, for an order to buy designated MELO-PIO with a limit price of 11.03, if the NBBO is 11.00 by 11.06, the order will never execute at 11.03 unless the NBBO collapses to, say, 11.00 to 11.04, at which point the 11.02 midpoint is a price improvement over the 11.03 limit. Once the price change happens, the holding period starts to run, and if the quote is stable at the new price for a half-second, the order is eligible to execute.

Who is the PIO Option Intended to Help?

It seems to us that the rule change is intended to help certain market participants to, in effect, enter sub-penny price limits in an indirect way. Consider the following example of a MELO entered by an electronic market marker based on the way the order type operates today:

10:30:00:000
NBBO is 10.01 x 10.02
Market maker enters a MELO order to buy with a 10.02 limit

10:30:00:500
NBBO remains at 10.01 x 10.02
MELO order goes live and is eligible to trade

10:30:00:600
NBBO moves to 10.01 x. 10.03
Market maker has no intention of buying at 10.02 and must cancel its MELO order to avoid an execution at that price.

10:30:00:700
NBBO reverts to 10.01 x 10.02
Market maker reenters its order, which will become executable if the market remains stable for 500 milliseconds.

In effect, with its proposed change, Nasdaq is trying to allow the market maker to avoid an execution at its stated limit price ***but also retain its time priority.*** Its *actual* limit in this scenario is 10.015, and it can avoid the risk of execution against another MELO order, most likely an institutional investor, at its stated limit price. Nasdaq says in its filing that PIO will “afford members more flexibility with respect to their use of MELO” and will give them “a measure of protection against unfavorable movements in the NBBO that may occur during half-second Holding Periods that are unique to MELOs”.

This Raises Unanswered Questions

1) If MELO is designed, as Nasdaq claims, "to create more trading opportunities for investors with longer investment time horizons, including institutional investors", why are they changing it to allow a participant to avoid an execution based on a change in the NBBO that happens on a millisecond or microsecond time scale?

2) Who is asking for this rule change, and who is it really intended to benefit? To the extent that this is being proposed at the request of particular electronic trading firms, what is it about the existing MELO order type that is not serving their purposes? Why is this change preferable to requiring market makers to cancel and resubmit orders, incurring a new holding period, just like institutional investors using the order type? There is a strong inference that this change will have a significant difference in impact on market makers vs. the institutions Nasdaq claimed it was trying to help with MELO.

3) Alternatively, if particular market makers are not getting the "spread collection" they are seeking from using MELO, why would it not be preferable for those firms to simply opt not to use it? If the order type is really intended for natural investors with a longer investment horizon, why is the order type less useful if those market makers make that choice?

This change would make what is already a complicated order type more complicated, by creating two new versions of MELO orders, and in a way that serves participants most oriented toward speed-based trading, not the institutional investors Nasdaq says the order type was designed for.

The Proposal Subverts and is Inconsistent with Rule 612

Rule 612 of Regulation NMS provides that "no national securities exchange, national securities association, alternative trading system, vendor, or broker or dealer shall display, rank, or accept from any person a bid or offer, an order, or an indication of interest in any NMS stock priced in an increment smaller than $0.01 if that bid or offer, order, or indication of interest is priced equal to or greater than $1.00 per share."

Nasdaq makes a conclusory statement that MELO with PIO is "a non-displayed order that Nasdaq does not accept or rank at a sub-penny increment." Nasdaq suggests in its filing that the PIO feature is not inconsistent with Rule 612 because neither the exchange nor the member knows, at the time the order is entered, the price at which the order will be executed, and the order may or may not execute at a penny price.

Nasdaq seems to assume that Rule 612 is only concerned with the execution price, and if the order *may* ultimately be executed at a penny increment, the rule is satisfied. That reading is patently wrong. Under the plain language of the rule, it prohibits an exchange from accepting or ranking an order at a sub-penny increment. In the above hypothetical, if the member sends a PIO condition to a MELO order, the limit order price of $10.02 is a fake price. In fact, the order can *never* be executed at its stated limit price. The order's true limit is $10.015, but if a member tried to send an order with that limit price, it clearly would have to be rejected. The fact that the order *might execute* at a permissible increment has nothing to do with the fact that Nasdaq would be *accepting and ranking* the order in an unacceptable increment. Nasdaq is not permitted to make an end-run around the rule by allowing the use of a phony limit price, while giving priority to the order based on the unstated, sub-penny price.

If Nasdaq believes that there is some compelling policy argument for allowing the addition of the PIO condition to the MELO order type, notwithstanding the Rule 612 prohibition, it should request an exemption, supported by facts and arguments, just like any other market participant would have to do. It should not be allowed to bootstrap a preferential treatment under the rule to an exchange rule filing.

Summary

When Nasdaq introduced MELO, we were cautiously supportive. After all, we appreciated an innovation that catered to investors, and not to the high speed traders who are the exchange's largest revenue clients. However, with the introduction of MELO-PIO we fear that Nasdaq is

1) Coming up with ways to move intermediaries higher in the queue relative to investors, for whom the order type was supposed to benefit.
2) Increasing the chances that high speed intermediaries will be on the "right side" of any short term price move.
3) Creating a back door way of getting around accepting sub-penny orders.

It's like it's **Déjà vu** all over again. We have seen these order type changes before. We honestly just wish Nasdaq would stop playing this game, and instead get back to allowing supply and demand work simply and honestly. It is sad that the environment has now become one in which every exchange rule filing needs to be viewed most skeptically.

Respectfully Submitted,

Sal Arnuk and Joe Saluzzi
Partners, Co-Founders and Co-Heads of Equity Trading
Themis Trading LLC
10 Town Square, Suite 100 Chatham, NJ 07928
Office: 973-665-9600