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VIA E-MAIL

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

Re: Securities Exchange Act Release No. 77441 (March 24, 2016), 81 FR 17749 (March 30, 2015) (SR-NYSEArca-2016-44) (the "Proposal") and Order Instituting Proceedings Regarding Investors' Exchange LLC ("IEX") Form 1 Application (Release No. 34-77406; File No. 10-222)

Dear Mr. Fields:

NYSE Arca, Inc. ("NYSE Arca" or the "Exchange") appreciates the opportunity to respond to comment letters submitted in connection with the Proposal to add a new Discretionary Pegged Order on the Exchange.¹ As described in the Proposal, the proposed Discretionary Pegged Order would use an exchange-provided algorithm to assess the quality of the market to determine at what price to trade an undisplayed order pegged to the PBBO. Because IEX's response contends that the Commission should approve the Discretionary Peg Order proposed by IEX in its application seeking registration as an exchange, but should not approve the Exchange's identical Proposal, the Exchange is also submitting this response to the public comment file on IEX's exchange application.²

Overview of Comment Letters

Citadel expressly urges the Commission to disapprove the Proposal and notes that the proposed Discretionary Pegged Order encroaches on the traditional role of broker-dealers and would use inherent competitive advantages that exchanges have over broker-dealers.³ Citadel further notes that the proposed order type would introduce

¹ See Letter from Sophia Lee, General Counsel, IEX Group, Inc. to Mr. Brent J. Fields, Secretary, U.S. Securities and Exchange Commission ("Commission"), dated April 15, 2016 ("IEX Letter"); Letter from John C. Nagel, Managing Director and Sr. Deputy General Counsel, Citadel LLC to Brent J. Fields, Commission, dated April 20, 2016 ("Citadel Letter").

² See Securities Exchange Act Release Nos. 75925 (Sept. 15, 2015, 80 FR 57261 (Sept. 22, 2015)) ("Form 1 Application") and 77406 (March 18, 2016), 81 FR 15765 (March 24, 2016) (Notice of Filing of Amendment Nos. 2, 3, and 4 to Form 1 Application) (File No. 10-222).

³ See Citadel Letter, supra note 1.

additional complexity into the market and questioned how the Commission could or would effectively review and police such order types.

In arguing that the Commission should not approve the Exchange's Proposal, IEX seeks to distinguish its own, identical Discretionary Pegged Order (now referred to as a "D-Peg"), which IEX has proposed as part of its application for registration as an exchange. On the one hand, as part of its Form 1 Application, IEX is seeking approval of its "D-Peg" Order, which is an order type that replicates broker-dealer pricing evaluation behavior. On the other hand, IEX accuses the Exchange, which has proposed the identical order type, of being part of the "broader problem" of the "unchecked proliferation in order types." In other words, IEX wants to join the ranks of registered exchanges, add complexity to the market with novel order types, and have the Commission deny other exchanges the opportunity to compete on a level-playing field.

Response

Would Discretionary Pegged Order Functionality Impose an Unnecessary or Inappropriate Burden on Competition?

As the Exchange noted in the Proposal, the primary question for the Commission on the Proposal is whether it would be consistent with the Act for exchanges to offer a feature that is typically performed by broker-dealers. Specifically, with the Discretionary Pegged Order, the Exchange would be evaluating the quality of the market and determining at what price to trade an order. As Citadel correctly observes, it would be a predictive order type and performs a function historically provided by broker-dealers on behalf of their customers.⁴

In response to this point, IEX claims that its proposed D-Peg is not a broker-dealer function because it is a feature that could only be effectively used by a broker or exchange that can "analyze market-wide price changes faster than the participants seeking to pick off pegged orders with the same information" and because of various regulatory obligations to which brokers are subject, "they are unlikely to successfully perform the same function." This, of course, is an interesting position for IEX to take

⁴ As commenters on the IEX Form 1 Application have observed, the Commission previously disapproved the Nasdaq Stock Market LLC's ("Nasdaq") proposal to offer a "Benchmark Order" that would seek to achieve the performance of a specified benchmark, e.g. a Volume Weighted Average Price, over a specified period of time for a specified security. In disapproving the Nasdaq proposal, the Commission emphasized that "[b]ecause NASDAQ is proposing to offer a novel order type designed to compete with services offered by broker-dealers, the Commission must consider, among other things, whether the proposed rule change would impose an unnecessary or inappropriate burden on competition under Section 6(b)(8) of the Act." See Securities Exchange Act Release No. 68629 (Jan. 11, 2013), 78 FR 3928, at 3931 (Jan. 17, 2013) (SR-NASDAQ-2012-059) ("Nasdaq Disapproval Order").

given that it currently performs its D-Peg functionality as a broker. IEX further concedes that its D-Peg is only effective because, combined with IEX's intentional delay via its POP/coil, it analyzes price changes faster than other participants. In other words, IEX's D-Peg only works because IEX has created a burden on competition. If approved as an exchange, IEX would be using its superior position vis-à-vis other market participants by intentionally delaying the ability for brokers to respond to market-wide price changes so that IEX can perform its pricing check faster for its undisplayed orders. So by IEX's own admission, a broker would be hindered in performing the same function as a D-Peg on IEX.

The Exchange believes that the Commission should clearly articulate the boundaries of when an exchange may and may not offer services that are otherwise performed by broker-dealers and when it would be appropriate for an exchange to monitor the quality of the prices in a market to determine how to price an order. If the Commission finds that the Proposal would not be consistent with the Act because it would impose an unnecessary or inappropriate burden on the ability of brokers to compete, this finding should be applied consistently, including disapproving IEX's proposed D-Peg functionality.

Should the SEC be Evaluating the Quality of Exchange-provided Predictive Order Types?

If the Commission determines that a Discretionary Pegged Order would not impose an unnecessary or inappropriate burden on competition, the secondary question is what level of review the Commission should conduct when assessing the quality of predictive order types. Citadel raises the concern that an approval of the Discretionary Pegged Order would lead to a proliferation of formula-based, predictive order types and questions whether the Commission would propose guidance or limitations on how such order types may operate.

The Exchange agrees that Commission approval of the Proposal or IEX's D-Peg Order would lead to exchanges offering more such predictive order types. Though inconsistent with the Commission's previous disapproval of Nasdaq's Benchmark Order,⁵ NYSE has not opposed IEX's proposed D-Peg Order. However, the Exchange requested that, in order for other exchanges to fairly compete, the Commission clearly articulate the boundaries of when an exchange may and may not offer services that are otherwise performed by broker-dealers and, in particular, when it is appropriate for an exchange to monitor the quality of the prices in a market to determine how to price an order.⁶ The Exchange filed the Proposal because if IEX is approved to offer D-Peg

⁵ See NASDAQ Disapproval Order, *supra* note 4.

⁶ See Letter from Elizabeth K. King, General Counsel & Secretary, NYSE Group, to Brent J. Fields, Secretary, Commission, dated November 12, 2015.

functionality, the Exchange believes that in order to compete, it would be compelled to offer similar predictive order type functionality.⁷

In its comment letter, IEX claims that the Exchange did not provide sufficient justification for how the proposed Discretionary Pegged Order would assist customers to receive best execution on the Exchange. IEX further claims that it is not sufficient for the Exchange to copy the same algorithmic formula as IEX, because IEX's proposed formula was tailored for its model, which favors undisplayed orders over displayed orders. The Exchange believes this comment is a patent attempt to prevent other exchanges from offering features that IEX seeks to offer.

Of course, IEX did not provide any detailed justification in its Form 1 Application of why its D-Peg would assist customers in receiving best execution. Its comment letter on the Proposal is the first time that IEX provides any information regarding how it determined its calculation. Interestingly, its explanation also exposes a flaw in IEX's proposed exchange model, because IEX freely admits that its calculation is premised on IEX having superior information regarding the status of orders on its book, which means that a broker-dealer would be limited in its ability to provide similar services on behalf of its customers. The Exchange believes this explanation makes it clear that IEX's proposal places an unfair burden on competition. By contrast, the Exchange's Proposal does not suffer from this problem because its proposed Discretionary Pegged Order would not have an unfair advantage over broker-dealers who want to offer similar services to their clients.

The Exchange based its Discretionary Pegged Order functionality on that proposed by IEX because the Exchange believes that if the Commission approves IEX's D-Peg order type, the Commission would have already evaluated the merits of the functionality under the Act and therefore the Commission would approve the Exchange's identical order type. The Exchange believes that over time and based on client feedback, the Exchange would consider changes to the specific formula used to assess the quality of the market or would consider offering additional types of Discretionary Pegged Orders to serve the trading needs of different market participants. The Exchange would file a separate proposed rule change if it seeks to change the formula or add other types of Discretionary Pegged Orders.

The Exchange believes that the effectiveness of a particular exchange order type in serving the trading needs of market participants should be market-driven rather than determined by the Commission. An offering of a Discretionary Pegged Order would be

⁷ When the Exchange filed the Proposal on March 11, 2016, the Commission's time to act on IEX's Form 1 Application was March 21, 2016. Accordingly, IEX could have been approved to offer its D-Peg functionality well before the Exchange would have been approved to offer similar functionality. It was only after the Exchange filed the Proposal that the Commission extended its time to act on IEX's Form 1 Application. See supra note 2.

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an optional order type, and if market participants do not believe that the formula appropriately predicts market movement, they simply do not have to use the order type.

The Exchange therefore believes that it would be inappropriate for the Commission to find that an exchange's predictive order type accurately predicts pricing movement, as IEX suggests it should. Instead, brokers should continue to exercise independent judgment of whether an exchange's order type offerings would assist it in meeting best execution obligations and not be able to rely on a Commission assessment of the viability of one manner of predicting prices as compared to another.

Conclusion

If the Commission approves IEX's proposed D-Peg, other exchanges should be able to compete on a level-playing field. The Proposal is intended to do just that. Whether the Commission determines to approve or disapprove the Proposal, the Exchange believes that such finding should be consistently applied across all exchanges. The Exchange further believes that Commission review of proposed predictive order types should not be based on the quality or basis for a specific formula being proposed by an exchange (or prospective exchange). Rather, market participants should decide whether a predictive order type offering by an exchange meets its goals.

Sincerely,



Elizabeth K. King

cc: Mary Jo White, Chair
Michael Piwowar, Commissioner
Kara Stein, Commissioner
Stephen Luparello, Director, Division of Trading & Markets
Gray Goldsholle, Deputy Director, Division of Trading & Markets
David Shillman, Associate Director, Division of Trading & Markets
Dan Gray, Senior Special Counsel, Division of Trading & Markets