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

Re: File No. SR-PHLX-2023-40; Release No. 34-98280

Dear Ms. Countryman:

Investors Exchange LLC ("IEX") is writing to comment on the referenced filing (the "Filing")[1] by Nasdaq PHLX LLC ("PHLX")[2] to introduce a new order type labeled "Contra Midpoint Only" and certain related order types ("CMO"). The Filing reflects a somewhat modified version of a previous version of the CMO that Nasdaq filed earlier this year using its Nasdaq Stock Market LLC license and later withdrew. IEX commented on this earlier filing, and we incorporate that earlier letter by reference in this letter.[3]

Introduction and Summary

IEX believes this latest version of the CMO idea should not be approved since it raises the same concerns that we identified earlier, as described below. To summarize, we believe CMO would: (i) unfairly segment and discriminate against certain investor and other orders seeking to access liquidity based solely on the price and size of those orders; (ii) risk leaking information about the presence of these orders to CMO users; and (iii) differ in key respects from other order types that have as their objective creating better execution opportunities for investors.

In brief, Nasdaq describes CMO as a non-displayed order type priced at the midpoint ("Midpoint") between the national best bid and the national best offer (the "NBBO"). Nasdaq will "remove" a CMO resting on the Nasdaq's order book upon entry of certain types of incoming orders. Specifically, Nasdaq will automatically remove a CMO order if an incoming contra-side order that would otherwise execute against the CMO order and is priced "through" the price of the CMO meets any of the following conditions:

- The incoming order is designated as a displayed order and is larger in size than the size of the CMO; or
- The incoming order is not displayed, is priced to the "far side" of the NBBO (e.g., if a buy order, is priced at or better than the national best offer price), and is larger in size than the size of the CMO.[4]

When a CMO order is removed, the exchange would "automatically" submit a new CMO on behalf of the user priced at the Midpoint. The new CMO order would receive a new timestamp, but the user would not receive a notice of cancelation.

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[1] See Securities Exchange Act Release No. 98280, 88 FR 62129 (September 8, 2023).
[2] For convenience, we refer in this letter to PHLX and its affiliated exchanges collectively as "Nasdaq".
[3] See https://www.sec.gov/comments/sr-nasdaq-2022-077/srnasdaq2022077-20158139-326230.pdf.
[4] The Proposal describes certain variations to the basic CMO type that are not relevant for purposes of these comments.

Comments

Need for Clarity on the Operation of the Order Type

First, we note the description in the Filing of how CMO would operate and the draft PHLX rule language are unclear in some respects. In the case of both scenarios described above, the Filing indicates that in the case of any incoming order meeting the parameters, the CMO will be removed and "immediately" replaced by a new CMO, which by definition is always priced at the Midpoint. In the case of the first scenario, Nasdaq provides a hypothetical explaining that the CMO will not interact with the incoming order and will be removed and replaced by a new CMO, with a new Midpoint price that reflects the impact of the incoming order. This new order would then have an ability to interact with new incoming orders at that updated price. In describing the second scenario, in contrast, Nasdaq states that CMO is intended in certain cases to give the user the potential for price improvement regardless of a change in the NBBO. Nasdaq provides the following hypothetical:

> In a second example, assume again that the National Best Bid is $10.00 and the National Best Offer is $11.00. Participant A again enters Order 1, which is a CMO to buy 100 shares of X that is priced at $10.50. While Order 1 is resting on the Exchange Book, Participant B enters Order 2, which this time is a Non-Displayed Order to sell 200 shares at $10.00. CMO functionality would activate for Order 1 both because Order 2 is larger than Order 1 and because Order 2 is priced at the far side of the NBBO. The System would resubmit Order 1 as Order 3, priced at $10.00. Order 3 would then execute at $10.00, again providing price improvement to Participant A.[5]

This raises several questions. First, CMO is defined as an order type that is always priced at the Midpoint, but the hypothetical suggests that in this scenario the replacement CMO would be priced not at the Midpoint but at the NBBO. Second, if the incoming order bypasses the original CMO, resulting in removal and replacement with a new CMO with a new timestamp, as in the first scenario, it is not clear how the new CMO could be assured of executing against the incoming order (which might execute first against other resting interest with priority at $10). Third, if the intent is that the CMO will execute automatically against the better-priced dark order, as implied by the example, then what is accomplished by removing and replacing the original CMO with a new one in that scenario?

Beyond the need for clarification, the Filing raises more fundamental concerns as described below.

Unfair Discrimination

As detailed in our earlier letter, the proffered benefit of the order type is that it will prevent users from trading with certain incoming orders based solely on the size and price characteristics of those orders. We are not aware of another exchange order type that would discriminate against orders to access liquidity in this specific way. This necessarily raises the question of which participants would be most likely to benefit, and which not. Nasdaq does not offer any analysis of who would stand the most to benefit, but on its face, the most likely "use case" is for electronic market makers to avoid executions with participants seeking to access liquidity in

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[5] 88 FR at 62131.

size, which we believe are more likely to be sent on behalf of institutional investors. Further, investors and others seeking liquidity will have no ability to evaluate how often they may miss liquidity as a result of the use of CMO.

The use of existing Retail Liquidity Programs ("RLPs") on exchanges provides a useful counterpoint. These programs allow liquidity providers to use an order type to designate that they are willing to execute against designated retail orders while avoiding interacting with other order flow. The Commission has stated that proposals to segment orders, even in that limited context, need to be "carefully evaluated." The Commission has granted exemptive relief and approved such programs based on strict terms and conditions, based on findings that such programs are reasonably designed to attract retail orders to exchanges while offering the opportunity for meaningful price improvement to retail investors.[6]

In contrast, CMO would introduce a new form of segmentation without any indication that investors would stand to benefit. For the reasons explained here and in our previous letter, there are ample reasons to believe that they would not. Nasdaq has not, in any event, provided analysis or justification that would allow the Commission, in conducting this type of careful evaluation, to determine that CMO would provide a net benefit to investors or to market efficiency in general.

Information Leakage

In Nasdaq's earlier iteration, CMO orders would be automatically canceled in the event of incoming orders to the exchange having the display, price, and size characteristics described above. IEX previously commented that we believed the receipt of a cancelation message would provide a signal to CMO users that they could use to adjust their activity on other markets. In this version, as described above, the Filing states that the order would be "removed" rather than canceled and "immediately" replaced with a new order with a new time stamp and that the user would not receive a cancelation message. The filing indicates that this feature is intended to limit the potential for information leakage.

First, it is not clear that labeling the action as a "removal" rather than a "cancelation" is more than a change in nomenclature. In either case, the exchange is taking action on its own to remove (not simply to reprice) a resting order from its order book. As a matter of precedent, we would be concerned with the ability of an exchange to take this type of action without providing at least the option for members to receive direct notice that it has done so.

More fundamentally, we believe that CMO would still provide ample opportunities for information leakage. In particular, this can occur by a user's ability to detect the presence of a large order by observing executions on the exchange while the CMO order is on the order book. As an example: Assume that a CMO to buy 100 shares is resting at the Midpoint, when the NBBO for that stock is at $10.00-$11.00. If the exchange reports an execution, to which the user is not a party, for 100 shares at $10.00, the CMO user can deduce that an order in that symbol larger than its own has arrived (otherwise, it would have traded with the order). It can also compare the size of of the execution to the size of its CMO order to determine that the order has a

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[6] <u>See</u>, e.g., Securities Exchange Act Release No. 86619, 84 FR 41759 (August 15, 2019) (approving IEX's RLP); Securities Exchange Act Release No. 85160, 84 FR 5754 (February 22, 2019) (approving the RLP of the New York Stock Exchange on a permanent basis).

remaining size that has not been executed on the exchange. Further, the user will receive this information as quickly as it could have received a cancelation message. And, most important, it is information that no other participant is in a position to have (other than possibly another CMO user with an order in the same symbol at the same time).

Precedent and Comparison to Other Order Types

Nasdaq repeats the assertion in its earlier filing that CMO is comparable to other order types that permit "like-minded participants an ability to achieve their objectives in an efficient manner". In this regard, it claims that its M-ELO order type, which imposes a certain waiting period before buy and sell orders can trade, is analogous. As we noted before, CMO is in no way similar to M-ELO, which Nasdaq has said is designed to "matc[h] longer-term investors in a broker-neutral exchange." CMO users are not looking to trade with each other, and there is nothing "like-minded" about CMO users and the counterparties they may eventually trade with. CMO users might have a common interest in avoiding interaction with large institutional orders, but we do not believe that type of common interest is one that supports approval of the Filing.

Also, as we noted before, CMO is different from order types with the purpose of protecting users from speed-based trading strategies and "adverse selection". Nasdaq instead promotes CMO as a way for some participants to avoid "adverse executions", which is a nicer way of saying the ability to avoid trading with orders that are more likely than most to originate from investors.

Conclusion

We believe Nasdaq's refurbished CMO has all the same failings of the original version. Nasdaq has not come close to demonstrating that it meets the standards for approval. The Commission should say no.

Sincerely,

John Ramsay
Chief Market Policy Officer, IEX