

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-88501; File No. SR-IEX-2019-15)

March 27, 2020

Self-Regulatory Organizations; Investors Exchange LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Add a New Discretionary Limit Order Type Called D-Limit

I. Introduction

On December 16, 2019, the Investors Exchange LLC (“IEX” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt a new order type, the Discretionary Limit or “D-Limit.” The proposed rule change was published for comment in the Federal Register on December 30, 2019.³ On February 12, 2020, the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.⁴ This order institutes proceedings under Section 19(b)(2)(B) of the Exchange Act⁵ to determine whether to approve or disapprove the proposed rule change.

II. Description of the Proposed Rule Change

IEX proposes to establish a new order type, called a Discretionary Limit order (“D-

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 87814 (December 20, 2019), 84 FR 71997 (“Notice”). Comments on the proposed rule change can be found at <https://www.sec.gov/comments/sr-iex-2019-15/sriex201915.htm>.

⁴ See Securities Exchange Act Release No. 88186 (February 19, 2020), 85 FR 9513.

⁵ 15 U.S.C. 78s(b)(2)(B).

Limit”), which the Exchange explains “is designed to protect liquidity providers, institutional investors as well as market makers, from potential adverse selection by latency arbitrage trading strategies in a fair and nondiscriminatory manner. . . .”⁶

In the Notice, the Exchange explains how it has designed its market model around “ways to counter or reduce speed advantages that can harm investors by exposing them to execution at stale prices when their orders are traded against by traders with more complete and timely information about market prices.”⁷ The primary feature of that market model is the IEX “speed bump,” which employs physical path latency to introduce an equivalent 350 microseconds of latency between the network access point (the Point-of-Presence, or “POP”) and the Exchange’s system at its primary data center.⁸

Currently, the speed bump works together with non-displayed order types on IEX that are “pegged” to a given price, including the Discretionary Peg (“DPeg”) and the primary peg (“PPeg”) orders.⁹ DPeg and PPeg orders can “exercise discretion” to trade at prices more

⁶ Notice, supra note 3, at 71998. The Exchange uses the term “latency arbitrage” to refer to trading strategies used by market participants with sophisticated low-latency technology, who can rapidly aggregate market data feeds (including proprietary data products obtained directly from the exchanges) to react faster than other market participants, as well as the Exchange, when the national best bid and offer (“NBBO”) changes. See id. at 71997.

⁷ See id.

⁸ See id. The IEX speed bump applies to all incoming and outgoing messages except for inbound market data from other trading centers and outbound transaction and quote information sent to the applicable securities information processor. In addition, updates to resting pegged orders on IEX are processed within the IEX trading system and do not require separate messages to be transmitted from outside the system. The speed bump provides time for IEX to update resting pegged orders when the NBBO changes, so that the resting pegged orders are accurately pegged to current market prices.

⁹ See IEX Rule 11.190(b)(10) and 11.190(b)(8), respectively.

aggressive than their pegged prices.¹⁰ Specifically, IEX uses a proprietary mathematical calculation, the crumbling quote indicator (“CQI”), to determine when these pegged order types are eligible to exercise discretion.¹¹ As described in the Notice, the CQI is designed to predict whether a particular quote is unstable or “crumbling,” meaning that the NBB is likely about to decline or the NBO is likely about to increase.¹² The Exchange utilizes real time relative quoting activity of certain Protected Quotations and a proprietary mathematical calculation (the “quote instability calculation”) to assess the probability of an imminent change to the current Protected NBB to a lower price or Protected NBO to a higher price for a particular security (“quote instability factor”).¹³ When the quoting activity meets predefined criteria and the quote instability factor calculated is greater than the Exchange’s defined quote instability threshold, IEX treats the quote as “unstable,” and the CQI is on at that price level for up to two milliseconds (hereafter referred to as the “quote instability determination price level” or the “CQI Price”).¹⁴ During all other times, the quote is considered stable, and the CQI is off. IEX assesses the stability of the Protected NBB and Protected NBO for each security.¹⁵ When IEX determines, pursuant to the CQI methodology, that the current market for a specific security is unstable – meaning there is a heightened probability of an imminent quote change at the NBB or NBO – IEX’s system will prevent DPeg and PPeg orders on that side of the market from exercising discretion and trading at a price that is more aggressive than their default resting

¹⁰ See Notice, supra note 3, at 71998.

¹¹ See id.

¹² See id.

¹³ See id.

¹⁴ See id.

¹⁵ See id.

prices.¹⁶

In this proposal, IEX seeks to adopt the D-Limit order type, which would work in conjunction with the CQI by adjusting its price when the CQI is on.¹⁷ A D-Limit order could be a displayed or non-displayed limit order that, upon entry and when posting to the Order Book, is priced to be equal to and ranked at the order's limit price.¹⁸

A D-Limit order would be adjusted to a less-aggressive price during periods of quote instability. As proposed, if, upon entry of a D-Limit buy (sell) order, the CQI is on and the order has a limit price equal to or higher (lower) than the quote instability determination price level (i.e., the CQI Price), the price of the D-Limit order will automatically be adjusted by IEX to one MPV¹⁹ lower (higher) than the CQI price. Similarly, when unexecuted shares of a D-Limit buy (sell) order are posted to the Order Book, if a quote instability determination is made and such shares are ranked and displayed (in the case of a displayed order) by IEX at a price equal to or higher (lower) than the CQI Price, the price of the order will automatically be adjusted by IEX to one MPV lower (higher) than the CQI Price.

A D-Limit order whose price is adjusted by IEX will not revert back to the price at which it was previously ranked and displayed (in the case of a displayed order).²⁰ Rather, the order will

¹⁶ See id.

¹⁷ IEX proposes to amend IEX Rule 11.190(b)(7), which is currently reserved, to add the D-Limit order type.

¹⁸ A non-displayed D-Limit order with a limit price more aggressive than the Midpoint Price will be subject to the Midpoint Price Constraint and be booked and ranked on the Order Book at a price equal to the Midpoint Price pursuant to IEX Rule 11.190(h)(2).

¹⁹ See IEX Rule 11.210.

²⁰ IEX Rule 11.190(h) provides for price sliding in the event of a locked or crossed market, to enforce the Midpoint Price Constraint, to comply with the display or execution requirements for a short sale order not marked short exempt during a Short Sale Period, or to comply with the Limit Up-Limit Down Price Constraint. As set forth in IEX Rule

continue to be ranked and displayed (in the case of a displayed order) at the new price, unless the order becomes subject to another automatic adjustment or if the order is subject to the price sliding provisions of IEX Rule 11.190(h). When the price of a D-Limit order is adjusted, the order will receive a new time priority. If multiple D-Limit orders are adjusted at the same time, their relative time priority will be maintained. Further, when the price of a D-Limit order is adjusted, the member that entered the order will receive an order message from the Exchange notifying the member of the price adjustment.

The Commission has received a number of comment letters on the proposed rule change.²¹ Many of those commenters support the proposal, and recommend that the Commission approve it. Commenters in support opine that the proposal is an innovative response to what some categorize as aggressive and “predatory” trading behavior by a small number of market participants that “plague” the displayed markets; and they support the D-Limit order as a transparent, widely-accessible, and not unfairly discriminatory means to counter those traders through an order type that will protect and thus encourage additional long-term investors and others to submit more displayed liquidity to exchanges, and thereby potentially increase the depth of displayed liquidity and narrow quoted spreads.²² Several other commenters, however,

11.190(h), an order that has been subject to price sliding will be repriced back to its more aggressive limit price when the market condition changes such that the condition necessitating the price sliding is no longer applicable. This is in contrast to the normal operation of a D-Limit order when it adjusts due to the CQI being triggered, at which point the D-Limit order’s adjusted price will not reprice.

²¹ See supra note 3.

²² See, e.g., Letters from Thomas M. Merritt, Deputy General Counsel, Virtu Financial, LLC, dated, January 16, 2020; Marius-Andrei Zoican, Assistant Professor of Finance, University of Toronto-Mississauga, dated January 20, 2020; Daniel Aisen, Proof Services LLC, dated December 24, 2019; Mehmet Kinak and Jonathan D. Siegel, T Rowe Price, dated February 5, 2020; Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, dated February 11, 2020; and OTPP, CDPQ, and the Office of the New York

urge the Commission to disapprove the proposed rule change, arguing that it constitutes an unnecessary and inappropriate burden on competition that is unfairly discriminatory, circumvents the federal securities laws, would not be an automated and protected quote, may negatively impact investors particularly for larger orders, will lead to phantom liquidity/quote fading and declining fill rates, and lacks sufficient data to support the proposal.²³

III. Proceedings to Determine Whether to Approve or Disapprove SR-IEX-2019-15 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act²⁴ to determine whether the proposed rule change should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change and the comments received thereon. Institution of Proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved.

Pursuant to Section 19(b)(2)(B) of the Exchange Act,²⁵ the Commission is providing notice of the grounds for possible disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis and input concerning the proposed rule

City Comptroller, et al., dated February 24, 2020.

²³ See, e.g., Letters from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ, dated January 21, 2020; Joanna Mallers, Secretary, FIA Principal Traders Group, dated January 21, 2020; Adam Nunes, Head of Business Development, Hudson River Trading LLC, dated January 21, 2020; and Ellen Greene, Managing Director, Equity and Options Market Structure, SIFMA, dated February 5, 2020.

²⁴ 15 U.S.C. 78s(b)(2)(B).

²⁵ Id.

change's consistency with the Exchange Act, including Sections 6(b)(5) and 6(b)(8) thereof,²⁶ and the rules and regulations thereunder.

The Commission is instituting proceedings to further consider the proposal and the issues raised by the commenters on the proposal as it determines whether the proposed D-Limit order type is consistent with the Exchange Act and the rules and regulations thereunder. Specifically, the Commission is providing notice of the following grounds for possible disapproval under consideration:

- Whether the Exchange has demonstrated how its proposal is consistent with Section 6(b)(5) of the Exchange Act,²⁷ which requires the rules of IEX to not be “designed to permit unfair discrimination between customers, issuers, brokers, or dealers.”
- Whether the Exchange has demonstrated how its proposal is consistent with Section 6(b)(8) of the Exchange Act,²⁸ which requires that the rules of IEX not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Under the Commission's Rules of Practice, the “burden to demonstrate that a proposed

²⁶ 15 U.S.C. 78f(b)(5) and 15 U.S.C. 78f(b)(8), respectively. Section 6(b)(5) of the Exchange Act requires that the rules of a national securities exchange be designed, among other things, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest, and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. Section 6(b)(8) of the Exchange Act requires that the rules of a national securities exchange not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

²⁷ 15 U.S.C. 78f(b)(5).

²⁸ 15 U.S.C. 78f(b)(8).

rule change is consistent with the [Exchange Act] and the rules and regulations issued thereunder . . . is on the [SRO] that proposed the rule change.”²⁹ The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding,³⁰ and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations.³¹ Moreover, “unquestioning reliance” on an SRO’s representations in a proposed rule change would not be sufficient to justify Commission approval of a proposed rule change.³²

For the reasons discussed above, the Commission believes it is appropriate to institute proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act to allow for additional consideration of the issues raised by the proposal as it determines whether the proposal should be approved or disapproved.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposal is consistent with Sections 6(b)(5)

²⁹ Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

³⁰ See id.

³¹ See id.

³² See Susquehanna Int’l Group, LLP v. Securities and Exchange Commission, 866 F.3d 442, 446-47 (D.C. Cir. 2017) (rejecting the Commission’s reliance on an SRO’s own determinations without sufficient evidence of the basis for such determinations).

and 6(b)(8), or any other provision of the Exchange Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.³³

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-IEX-2019-15 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Numbers SR-IEX-2019-15. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

³³ Section 19(b)(2) of the Exchange Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of these filings also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make

available publicly. All submissions should refer to File Number SR-IEX-2019-15 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁴

J. Matthew DeLesDernier
Assistant Secretary

³⁴ 17 CFR 200.30-3(a)(57).