

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-86619; File No. SR-IEX-2019-05)

August 9, 2019

Self-Regulatory Organizations; Investors Exchange LLC; Order Granting Approval of a Proposed Rule Change to Establish a Retail Price Improvement Program

I. Introduction

On June 20, 2019, Investors Exchange LLC (“IEX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to establish a Retail Price Improvement Program (“Retail Program”) on the Exchange. The proposed rule change was published for comment in the Federal Register on July 5, 2019.<sup>3</sup> The Commission has received no comments on the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposed Rule Change

IEX proposes to adopt Exchange Rule 11.232 to establish the Retail Program, which the Exchange intends will incentivize IEX Members to add midpoint liquidity to the Exchange to provide additional opportunities for retail investors to obtain price improvement.

Specifically, under the Retail Program, IEX Members could apply to become a Retail Member Organization (“RMO”), which designation would permit them to submit certain agency or riskless principal orders that reflect trading interest of a natural person and that are designated with a “Retail Order” modifier. Any IEX Member will be able to submit a new liquidity-

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 86241 (June 28, 2019), 84 FR 32238 (“Notice”).

providing order type, a Retail Liquidity Provider (“RLP”) order, that would only be eligible to execute against an incoming “Retail Order” from a RMO, generally at the midpoint price of the National Best Bid and National Best Offer (“Midpoint Price”).

A. New Definitions

In connection with the Retail Program, the Exchange proposes three new defined terms. First, under existing Exchange Rule 11.190 (Orders and Modifiers), the term “Retail Order” would be defined as an agency order, or a riskless principal order that satisfies the criteria of FINRA Rule 5320.03, submitted by a Retail Member Organization, that is designated with a “Retail Order” modifier and reflects trading interest of a natural person, with no change made to the terms of the underlying order of the natural person with respect to price (except in the case of a market order that is changed to a marketable limit order) or side of market, and that does not originate from a trading algorithm or any other computerized methodology. Retail Orders could either be Discretionary Peg or Midpoint Peg orders<sup>4</sup> with a time-in-force of Immediate-or-Cancel (“IOC”) or Fill-or-Kill (“FOK”). Second, IEX proposes to amend Rule 11.190 to add the defined term “Retail Liquidity Provider order,” which would be defined as a Discretionary Peg order that is only eligible to execute against incoming Retail Orders through the execution process described in proposed new IEX Rule 11.232(e). Finally, under proposed IEX Rule 11.232(a), IEX would define the term “Retail Member Organization” as an IEX Member (or division thereof) that has been approved by the Exchange to submit Retail Orders.

B. Retail Member Organizations

Under proposed Rule 11.232(b), any IEX Member (or a division thereof) could qualify as

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<sup>4</sup> Both Discretionary Peg and Midpoint Peg orders are non-displayed trading interest on the Exchange. See IEX Rule 11.190(a)(9) and (10).

an RMO if it conducts a retail business or handles retail orders on behalf of another broker-dealer. An IEX Member would be required to submit: (1) an application form; (2) supporting documentation sufficient to demonstrate the retail nature and characteristics of the applicant's order flow, such as sample marketing literature, website screenshots, or other publicly disclosed material describing the Member's retail order flow; and (3) an attestation, in a form prescribed by the Exchange, that substantially all orders submitted as Retail Orders would meet the qualifications under the Retail Program.

If approved as a RMO, the IEX Member would be required to have written policies and procedures reasonably designed to assure that it will only designate orders as Retail Orders if all requirements of a Retail Order are met. Such written policies and procedures must require the IEX Member to: (i) exercise due diligence before entering a Retail Order to assure that entry as a Retail Order is in compliance with the requirements the Retail Program; and (ii) monitor whether orders entered as Retail Orders meet the applicable requirements under the Retail Program. If a RMO does not itself conduct a retail business – but routes Retail Orders on behalf of another broker-dealer – the RMO's supervisory procedures must be reasonably designed to assure that the orders it receives from such other broker-dealer that are designated as Retail Orders meet the definition of a Retail Order. Additionally, the RMO must: (i) obtain an annual written representation, in a form acceptable to the Exchange, from each other broker-dealer that sends the RMO orders to be designated as Retail Orders that entry of such orders as Retail Orders will be in compliance with the requirements of the Retail Program; and (ii) monitor whether Retail Order flow routed on behalf of such other broker-dealers meets the applicable requirements of

the Retail Program.<sup>5</sup> The Exchange also proposes rules setting forth procedures for addressing a RMO's failure to comply with the Retail Program requirements.<sup>6</sup>

C. Priority and Allocation

Proposed IEX Rule 11.232(e) sets forth the rules governing priority and order allocation for the Retail Program. Specifically, Retail Liquidity Provider orders in the same security would be ranked and allocated according first to price and then to time of entry into the IEX System. Upon entry into the IEX System, a Retail Order would seek to execute against resting contra-side orders in price/time priority in accordance with current IEX Rule 11.230 (Order Execution) and also subject to the following provisions set forth in new IEX Rule 11.232(e):

- A Retail Order to buy (sell) will execute upon entry against sell (buy) orders resting on the IEX Order Book in the following order:
  1. displayed sell (buy) orders at the National Best Offer (National Best Bid) during a locked or crossed market;
  2. non-displayed orders priced to trade at the Midpoint Price; followed by
  3. Retail Liquidity Provider orders priced to trade at the Midpoint Price.<sup>7</sup>

Thus, RLP orders would have last priority when interacting with an incoming Retail Order. As noted earlier, Retail Orders are either IOC or FOK. Therefore, any Retail Orders not executed

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<sup>5</sup> The Exchange represents that FINRA, on behalf of the Exchange, will review an RMO's compliance with these requirements through an exam-based review of the RMO's internal controls. See id., at 32239 n.17.

<sup>6</sup> New IEX Rules 11.232(b), (c), and (d) would set forth the procedures governing the Exchange's review of an RMO application, how the Exchange would reject an RMO application or disqualify a Member that has already been approved as an RMO, and how a Member could appeal a rejected RMO application or disqualification. See Notice, supra note 3, at 32239-40.

<sup>7</sup> In the Notice, the Exchange provides examples illustrating how these priority rules would operate. See id., at 32240.

pursuant to the above execution priority would be cancelled.

D. Conforming Changes

Finally, the Exchange proposed to delete current IEX Rule 11.340(d)(4), which, in relevant part, states that the Exchange does not operate a retail liquidity program.<sup>8</sup>

E. Comparison to Other Retail Programs

In the Notice,<sup>9</sup> the Exchange discusses how its Retail Program compares to, among others, the retail programs of the New York Stock Exchange (“NYSE”) and Nasdaq BX (“BX”), which the Commission recently approved to become permanent during the pilot periods for each respective program.<sup>10</sup> IEX highlights the substantive differences between several features of its program and the programs of other exchanges.<sup>11</sup> Among other things, for example, the Exchange explains that the price improvement offered by its Retail Program would be a Midpoint Price execution instead of a minimum \$0.001 above the NBBO or exchange best bid and offer. IEX also notes that any of its Members would be eligible to submit an RLP order, whereas use of a similar order type on NYSE is restricted, and that RLP orders on IEX would not have higher execution priority over non-RLP orders.<sup>12</sup>

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<sup>8</sup> IEX Rule 11.340 governs the Tick Size Pilot Plan and currently is not in effect due to the expiration of the Tick Size Pilot.

<sup>9</sup> See id., at 32240-42.

<sup>10</sup> See Securities Exchange Act Release Nos. 85160 (February 15, 2019), 84 FR 5754 (February 22, 2019) (SR-NYSE-2018-28) (approving NYSE Retail Liquidity Program on a permanent basis); 86194 (June 25, 2019), 84 FR 31385 (July 1, 2019) (SR-BX-2019-011) (approving Nasdaq BX Retail Price Improvement Program on a permanent basis). The Commission notes that at the time that this proposed rule change was filed, the Nasdaq BX Retail Price Improvement Program had not yet been approved on a permanent basis.

<sup>11</sup> See Notice, *supra* note 3, at 32240-42.

<sup>12</sup> See id., at 32240.

### III. Discussion and Commission Findings

After careful review, the Commission finds that the Exchange's proposal to establish the Retail Program is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>13</sup> In particular, the Commission finds that the proposed rule change is consistent with Sections 6(b)(5)<sup>14</sup> and 6(b)(8)<sup>15</sup> of the Exchange Act. 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.

Under IEX's proposed Retail Program, IEX will operate a process by which Members could qualify to become RMOs, thereby permissioning them to submit certain liquidity-taking Retail Orders to IEX for execution, generally, at the Midpoint Price. Any Member could submit liquidity-providing RLP orders, which will be Discretionary Peg orders that are only eligible to execute against the designated Retail Orders. Retail Orders would be able to execute against the proposed RLP orders as well as certain other orders on the Exchange's order book as specified in proposed IEX Rule 1.232(e).

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<sup>13</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

<sup>15</sup> 15 U.S.C. 78f(b)(8).

The Commission notes that the Exchange’s proposed Retail Program is substantively different in several respects than the retail liquidity programs operated by certain other national securities exchanges and, thus, does not present all of the same issues raised by those programs. The Commission notes that IEX provided a fulsome discussion of the distinctions between its proposed Retail Program and the programs operated by other exchanges. In particular, IEX described its proposed Retail Program as “leverage[ing] IEX’s existing market structure” and discussed how IEX will: (1) allow executions at Midpoint Prices instead of any subpenny price; (2) not disseminate when an RLP order is on the book, which could serve as an incentive to only route Retail Orders to IEX when the presence of an RLP order is disseminated; (3) have no impact on order book priority and give RLP orders lower priority than other liquidity providing orders priced to trade at the midpoint; and (4) operate within existing tick size trading increments.<sup>16</sup>

The proposal includes qualification and application rules for RMOs, an appeal process for disapproved RMOs, requirements for RMOs to include written policies and procedures to ensure that Retail Orders are bona fide, required annual attestations from RMOs with respect to Retail Orders, and a process for disqualification of RMOs with appeal procedures. The Commission believes that the proposal with respect to RMOs is consistent with the Exchange Act as it is reasonably designed to ensure that RMOs submit only bona fide Retail Orders to the program and, thus, helps ensure that the program is operated in the interests of investor protection and consistent with the public interest. All IEX Members would have an opportunity to become a RMO if desired, and the Commission believes that the proposal sets forth a fair and reasonable process to become and remain a RMO.

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<sup>16</sup> See Notice, supra note 3, at 32241.

The Exchange asserts that while the Retail Program would differentiate among its Members, it believes that such differentiation is not unfairly discriminatory because the Retail Program is designed to promote a competitive process for retail executions on a registered exchange while providing retail investors with the potential to receive meaningful price improvement.<sup>17</sup> The Exchange notes that, under the respective retail programs of NYSE, BX, and others, there is existing precedent for differentiation and limited segmentation of incoming retail order flow and liquidity providing order flow that seeks to execute against such incoming retail flow.<sup>18</sup> IEX also asserts that, as with the NYSE and BX programs, its Retail Program is designed to provide an additional competitive alternative for retail orders by offering certain incentives for broker-dealers to bring more of their retail order flow onto a public exchange.<sup>19</sup>

The Commission believes that proposals involving segmentation of order flow on a national securities exchange – even if such order flow is retail or offers price improvement to retail orders– must be carefully evaluated. In this instance, the Commission believes that the Retail Program is reasonably designed, within the Exchange’s existing market structure, to attract retail order flow to a registered national securities exchange, while offering the opportunity for retail investors to potentially benefit from midpoint executions.<sup>20</sup>

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<sup>17</sup> See Notice, supra note 3, at 32242.

<sup>18</sup> See supra notes 9-12 and accompanying text.

<sup>19</sup> See Notice, supra note 3, at 32242.

<sup>20</sup> The Commission has previously recognized that market participants and some exchanges distinguish between individual retail investors, whose orders are considered desirable by liquidity providers because such retail investors are presumed on average to be less informed about short-term price movements, and professional traders, whose orders are presumed on average to be more informed about short term price movements. The Commission has also recognized that, because of this distinction, some liquidity providers may be more inclined to offer price improvement to retail orders. See Securities Exchange Act Release Nos. 73702 (November 28, 2014), 79 FR 72049

The Commission also believes that providing RLP orders lower execution priority against Retail orders than other orders priced to trade at the Midpoint Price is not designed to permit unfair discrimination or impose an unnecessary or inappropriate burden on competition. The Commission notes that the RLP order type would be available to all IEX Members, and Members seeking to interact with retail order flow on IEX also would be able to submit non-RLP orders for Midpoint Price executions, which would be given higher priority than RLP orders. Given the restrictions on RLP orders (i.e., they would only interact with incoming Retail Orders), it is appropriate that RLP orders would not impact order book priority and not enjoy a competitive advantage, in the form of enhanced priority or execution opportunities, over other resting orders, but rather would yield priority to them. Further, IEX will allow any Member to submit RLP orders, which provides fair and broad access to this new order type and should promote competition by removing barriers to its use on the Exchange.

Further, the Exchange explains that requiring a Retail Order to be either a Discretionary Peg order or Midpoint Peg order with a time-in-force of IOC or FOK is designed to maximize the opportunity for such orders to be executed on IEX with Midpoint Price improvement.<sup>21</sup> This approach provides for potentially meaningful price improvement while utilizing order types that operate within the current minimum trading increment rules. To the extent it is successful, the proposal could facilitate and promote competition between exchanges and the over-the-counter market and potentially bring more retail order flow to a public exchange. As such, the proposal is designed to remove impediments to and perfect the mechanism of a free and open market and a national market system, and further the investor protection and public interest objectives of

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(December 4, 2014) (SR-BX-2014-048) (approving the BX Retail Price Improvement Program on a pilot basis).

<sup>21</sup> See Notice, supra note 3, at 32243.

Section 6(b) of the Act.

Accordingly, the Commission finds the design of the Retail Program within the current market structure to be consistent with the Act, including the requirements of Section 6(b)(5) and Section 6(b)(8) of the Act.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,<sup>22</sup> that the proposed rule change (SR-IEX-2019-05), be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>23</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>22</sup> 15 U.S.C. 78s(b)(2).

<sup>23</sup> 17 CFR 200.30-3(a)(12).