

COMMENT LETTER

October 21, 2019

ICI Letter Opposing Cboe EDGA Exchange Proposed Liquidity Provider Protection Delay Mechanism (pdf)

October 21, 2019 Ms. Vanessa Countryman Secretary U.S. Securities and Exchange Commission 100 F Street NE Washington DC 20549-1090 Re: File No. SR-CboeEDGA-2019-012 Dear Ms. Countryman: The Investment Company Institute¹ is writing to express opposition to the proposal by Chicago Board Options EDGA Exchange, Inc. (“EDGA” or the “Exchange”) to establish the Liquidity Provider Protection delay mechanism (the “Access Delay”), which intentionally would delay all liquidity taking orders by at least four milliseconds in order to allow liquidity providers time to adjust their quotations in response to new market data.² We strongly oppose the Proposal because, among other things, it: (i) would unfairly discriminate against liquidity takers as well as liquidity providers that are unable to update their quotes within four milliseconds; (ii) would introduce intractable complexity to the duty of best execution and the market structure generally; and (iii) is inconsistent with a fair and efficient national market system under Section 11A of the Securities Exchange Act of 1934 (“Exchange Act”). For these reasons, as described below, we believe the Proposal is inconsistent with the Exchange Act and the Commission therefore should disapprove it. First, by asymmetrically applying the Access Delay only to orders that take liquidity, the Proposal would unfairly discriminate against market participants that are primarily liquidity takers, which 1 The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s members manage total assets of US\$23.4 trillion in the United States, serving more than 100 million US shareholders, and US\$7.1 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC. 2 Securities Exchange Act Release No. 86168, 84 FR 30282 (June 26, 2019) (the “Proposal”). Ms. Ms. Vanessa Countryman October 21, 2019 Page 2 include most retail and institutional investors.³ These investors would no longer be able to rely on a displayed quotation on EDGA because liquidity providers could modify or remove that quotation during the period of the Access Delay.⁴ The Exchange argues that this discrimination is justified to encourage market makers and “any of a wide range of other market participants entering resting limit orders” to provide liquidity by preventing those resting orders from “being picked off by opportunistic traders.”⁵ That purported rationale, however, fails to acknowledge that only one category of liquidity providers could benefit

from the Access Delay: fast liquidity providers that are capable of modifying their quotations on EDGA within four milliseconds following a change in market prices. In fact, any investor submitting a limit order that joins the best bid or offer on EDGA but which is unable to cancel or modify its order within four milliseconds would face the risk of an adverse execution against the opportunistic traders. The Access Delay, therefore, favors only sophisticated, low-latency market makers at the expense of liquidity takers, who would lose efficient and reliable access to displayed liquidity on the Exchange, and slower liquidity providers.⁶ We further believe that this unfair discriminatory structure would impose an undue burden on competition on liquidity takers and slower liquidity providers and does not further the protection of investors or the public interest.⁷ Second, the Proposal could significantly complicate the duty of best execution and would exacerbate market complexity more broadly. The Exchange states that while market participants would not be required to access liquidity on EDGA under Regulation NMS because EDGA quotations would not be protected, market participants “would be permitted to send orders for execution on EDGA” consistent with the duty. 3 Section 6(b)(5) of the Exchange Act requires that the rules of an exchange not be “designed to permit unfair discrimination between customers, issuers, brokers, or dealers.” 15 U.S.C. 78f(b)(5). 4 The Access Delay also may increase incidents of trade throughs on the Exchange. For example, when an investor sends a marketable sell order to EDGA, the best bid made ticks up on another market during the Access Delay. To the extent the EDGA liquidity provider does not update its quotation to match the new best bid during the Access Delay, there is no better priced hidden liquidity inside the spread on EDGA; and the order is not routable to the trading center with the new best bid; and therefore the execution following the conclusion of the Access Delay would trade through the superior bid available on the away exchange. 5 Proposal at 30289-30290. 6 Moreover, under the Proposal, the low-latency market makers capable of benefitting from the Access Delay, at the expense of slower liquidity providers and liquidity takers, would be under no obligation to improve market quality. The Commission has stated that “while exchanges may legitimately confer special benefits on market participants willing to accept substantial responsibilities to contribute to market quality, such benefits must not be disproportionate to the services provided.” Exchange Act Release No. 67437, 77 FR 42525, 42527 (SR- NYSEAmex-2011-86) (disapproving a proposed rule change that would allow certain market makers to access certain order information unavailable to other market participants). 7 See 15 U.S.C. 78f(b)(5) and (8) (requiring, among other things, that the rules of an exchange be designed to protect investors and the public interest and to not impose any burden on competition not necessary or appropriate in furtherance of the Exchange Act). Ms. Ms. Vanessa Countryman October 21, 2019 Page 3 of best execution.⁸ This framing of the duty of best execution may suggest that broker-dealers have the option to consider or ignore EDGA quotations even where EDGA quotations are better than the best protected quotations. It is difficult to imagine a scenario where a broker-dealer could ignore a better priced EDGA quotation to fill (or partially fill) an order without potentially inviting claims that it may be violating its duty of best execution. Even if a broker-dealer consistently found that it is unable to reliably access EDGA quotations because liquidity providers modify their quotes during the Access Delay, it nevertheless could face regulatory scrutiny, including from the Exchange itself, as to why it did not route or attempt to route to a better priced EDGA quotation. The Proposal would exacerbate market complexity generally by establishing a harmful precedent. Other exchanges may similarly adopt manual quotations and access delays of varying lengths, which will undermine the efficacy of the Order Protection Rule and further complicate a broker-dealer’s best execution analysis.⁹ As additional exchanges adopt access delays of varying lengths, broker-dealers would have to account for each separate delay in determining which quotations are immediately accessible, further complicating routing decisions. Broker-dealers also would

need to separately account for the national best bid or offer and the best protected bid or offer to ensure compliance with both their duty of best execution and the Order Protection Rule.¹⁰ If the Proposal is approved, exchanges subsequently might propose specific order types that are exempt from these asymmetric access delays adding further complexity to the market structure. As a general matter, increases in market complexity benefit the most sophisticated market participants to the detriment of less sophisticated investors, and raise costs for everyone. Third, the Proposal is inconsistent with a fair and efficient national market system under Section 11A.¹¹ A fundamental principle of the national market system is that immediate access to quotations facilitates the efficient pricing, display, and execution of orders. It is primarily for this reason that the Commission stated when adopting Regulation NMS that “a trading center’s systems should provide the fastest response possible without any programmed delay.”¹² The Proposal would retreat from intermarket price protection and efficient access to the Exchange’s quotations by allowing low- latency liquidity providers to modify their displayed quotations. The Commission has recognized that the ability of investors to timely access firm, displayed quotations is a cornerstone of open, fair, and transparent markets.¹³ 8 Proposal at 30290. The Exchange notes that the decision to route an order to EDGA may depend on the prices and sizes posted on the Exchange as well as other factors such as the likelihood of execution. 9 17 CFR 242.611. 10 This may necessitate separate dissemination of the best protected bid and offer and the national best bid and offer, particularly if other exchanges similarly adopt “manual” quotations that are electronically accessible. 11 15 U.S.C. 78k-1. 12 Exchange Act Release No. 51808, 70 FR 37495, 37519 (June 29, 2005). 13 Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD, the Nasdaq Market, and Nasdaq Market Makers, Exchange Act Release No. 37542, at 32 (August 8, 1996) (“[f]ailure to honor quotations deprives investors of the liquidity that market makers advertise they will provide and injures the credibility of the market as a whole.”). Ms. Vanessa Countryman October 21, 2019 Page 4 In sum, we believe that the Proposal’s potential benefits solely would inure to a few low-latency liquidity providers, The direct harm to liquidity takers and slower liquidity providers as well as the disruptions and complexity that the Proposal would introduce to the market greatly outweigh those potential benefits. For these reasons, we strongly urge the Commission to disapprove the Proposal. We appreciate the opportunity to comment. If you have any questions, please contact me at (202) 218-3563. Regards, /s/ Dorothy Donohue Deputy General Counsel