Council of Institutional Investors®
The voice of corporate governance

Via Email

February 11, 2020

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: IEX Proposal for D-Limit Order Type; File No. SR-IEX-2019-15

Dear Madam Secretary:

The Council of Institutional Investors (CII) is pleased to submit this comment letter in support of the proposal by Investors Exchange LLC (IEX) to introduce a new Discretionary Limit (D-Limit) order type. We urge the Securities and Exchange Commission (SEC or Commission) to approve the IEX D-Limit proposal.[1]

CII is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management.[2]

We believe D-Limit is well-tailored to increase diversity and depth of displayed liquidity by protecting investors from getting "picked off" by fast traders at key moments. D-Limit would leverage the IEX Crumbling Quote Indicator (CQI), which identifies brief moments in time when the quote is about to change, and resting orders are vulnerable to adverse selection. D-Limit orders would be automatically re-priced in brief moments when the CQI is "on," a targeted and narrow way to address this vulnerability.

Our support for D-Limit is rooted in our interest in market innovation that actually protects the interests of long-term investors, including our members and their beneficiaries. We believe that this comment by AJO is particularly on-target:

[1] IEX, Notice of Filing of Proposed Rule Change to Add a New Discretionary Limit Order Type, SEC Release No. 34-87814; File No. SR-IEX-2019-15, Dec. 20, 2019, at https://www.sec.gov/rules/sro/iex/2019/34-87798.pdf.
[2] For more information about the Council of Institutional Investors (CII), including its board and members, please visit CII's website at http://www.cii.org.

> We are generally opposed to, or at least skeptical of, the introduction of new exchange order types for two basic reasons. First, we believe they introduce further complexity to an already severely fragmented U.S. equity marketplace. Second, we find that most of the order types introduced by the for-profit exchanges are created with the sole purpose of benefitting a particular type of market participant, often to the detriment of other market participants. Rarely do we come across a proposed order type or exchange mechanism that is truly accessible to all market participants and that aims to benefit all users who choose to employ it. We believe that D-Limit is unique in this regard, and we commend IEX's continued effort to create a level playing field in our equity markets.[3]

Long-term investors are at real and substantial risk from speed advantages of a small number of trading firms that specialize in "latency arbitrage," which imposes a multi-billion-dollar tax on institutional investors. A recent study sponsored by the Financial Conduct Authority suggested that this activity is endemic, and results in substantial losses to all liquidity providers.[4] One result is limited willingness of long-term investors, as well as market makers, to display quotes. As Themis Trading put it in a comment letter, "an environment has been created that is more toxic than it needs to be for the display of institutional orders."[5]

The D-Limit order type provides an innovative, non-discriminatory method to protect interests of all participants. We believe it would encourage increased displayed liquidity, benefiting the U.S. equity markets. And D-Limit seeks to attract displayed liquidity without paying rebates, which we view as creating potential conflicts of interest between investors and brokers.

We would like to emphasize one point: **D-Limit quotes clearly should qualify as protected quotes**. We believe it makes no sense to define as "protected" only quotes that provide investors no protection against speed trading strategies. The SEC made clear when it adopted Rule 611 that the point of the Order Protection Rule – the regulatory purpose – *was to protect investors* and to encourage display of orders:

> By strengthening price protection in the NMS for quotations that can be accessed fairly and efficiently, *Rule 611 is designed to promote market efficiency and further the interests of both investors who submit displayed limit orders and investors who submit marketable orders. Price protection encourages the display of limit orders*

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[3] Letter from Sean Paylor, AJO, Feb. 10, 2020, at https://www.sec.gov/comments/sr-iex-2019-15/sriex201915-6791509-208328.pdf.

[4] See Matteo Aquilina, Eric Budish and Peter O'Neill, *Quantifying the High-Frequency Trading 'Arms Race': A Simple New Methodology and Estimates*, Financial Conduct Authority Occasional Paper 50, January 2020 ("We find that latency-arbitrage races are very frequent (one per minute for FTSE 100 stocks), extremely fast (the modal race lasts 5-10 millionths of a second), and account for a large portion of overall trading volume (about 20%). Race participation is concentrated, with the top-3 firms accounting for over half of all race wins and losses. Our main estimates suggest that eliminating latency arbitrage would reduce the cost of trading by 17% and that the total sums at stake are on the order of $5 billion annually in global equity markets"), at https://www.fca.org.uk/publication/occasional-papers/occasional-paper-50.pdf.

[5] Letter from Sal Arnuk and Joseph Saluzzi, Themis Trading LLC, Feb. 6, 2020, at https://www.sec.gov/comments/sr-iex-2019-15/sriex201915-6782019-208160.pdf.

> by increasing the likelihood that they will receive an execution in a timely manner and helping preserve investors' expectations that their orders will be executed when they represent the best displayed quotation. Limit orders typically establish the best prices for an NMS stock. Greater use of limit orders will increase price discovery and market depth and liquidity, thereby improving the quality of execution for the large orders of institutional investors.[6]

We disagree in this regard with comments by the Securities Industry and Financial Markets Association (SIFMA).[7] SIFMA indicated that while its members have varying views, SIFMA is concerned that repricing of D-Limit orders without them being subject to the IEX "speed bump" would make those quotes "inaccessible." SIFMA suggested that IEX offer the D-Limit order type as "un-protected." However, as T. Rowe Price pointed out in its comment letter, the ability of brokers to take liquidity will be unaffected because orders will be repriced only in short, discrete moments that are targeted by a small number of latency arbitrage firms.[8] Brokers placing orders for investors are looking for liquidity based on fundamental factors. They are not seeking quick profits during the few seconds of the day when arbitrage strategies are most active.

The D-Limit order type would be a narrowly tailored means to protect investors and other liquidity providers that they clearly need and do not have now. We strongly support the IEX proposal.

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CII appreciates the opportunity to submit comments on this important matter and is available to provide any additional information the Commission requests.

Sincerely,

Kenneth A. Bertsch
Executive Director

Jeffrey P. Mahoney
General Counsel

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[6] 70 FR at 37505 (*emphasis added*).
[7] Letter from Ellen Greene, SIFMA, Feb. 3, 2020, at https://www.sec.gov/comments/sr-iex-2019-15/sriex201915-6775258-208127.pdf.
[8] Letter from Mehmet Kinak and Jonathan D. Siegel, T. Rowe Price, Feb. 5, 2020 ("Institutional liquidity takers will still be able to access a displayed quote on IEX…. institutional orders on IEX typically occur before IEX's systems predict a quote change is imminent - consequently, these orders will be able to access the liquidity they see before the CQI changes to 'on.' Rather, D-Limit seeks to limit reactive strategies used by a small subset of proprietary trading firms that invest in high speed infrastructure to predict price changes, leverage small latency advantages, and opportunistically trade against stale quotes"), at https://www.sec.gov/comments/sr-iex-2019-15/sriex201915-6772531-208082.pdf.