October 21, 2019

Via Electronic Mail (rule-comments@sec.gov)

Vanessa Countryman
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release No. 34-86168; File No. SR-CboeEDGA-2019-012

Dear Ms. Countryman:

The Healthy Markets Association[1] appreciates the opportunity to supplement our comments[2] to the above-referenced proposal to introduce "Liquidity Provider Protection" on EDGA.[3] In particular, we submit this letter in response to the questions raised by the Commission staff's Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Introduce a Liquidity Provider Protection Delay Mechanism on EDGA.[4]

While we recognize that an intentional time delay may, in some circumstances, provide investors with opportunities to mitigate their risks and costs, as we explained in our prior letter, the information provided in the EDGA Delay Proposal

- is inadequate to establish its compliance with the Exchange Act and Commission rules,

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[1] The Healthy Markets Association is an investor-focused not-for-profit coalition working to educate market participants and promote data-driven reforms to market structure challenges. Our members, who range from a few billion to hundreds of billions of dollars in assets under management, have come together behind one basic principle: Informed investors and policymakers are essential for healthy capital markets. To learn more about Healthy Markets or our members, please see our website at http://healthymarkets.org.

[2] Letter from Tyler Gellasch, Healthy Markets Association, to Vanessa Countryman, SEC, July 16, 2019, *available at* https://www.sec.gov/comments/sr-cboeedga-2019-012/srcboeedga2019012-5815372-187487.pdf.

[3] *Notice of Filing of a Proposed Rule Change to Introduce a Liquidity Provider Protection on EDGA*, SEC, Exch. Act Rel. No. 34-86168; Jun. 20, 2019, *available at* https://www.sec.gov/rules/sro/cboeedga/2019/34-86168.pdf ("EDGA Delay Proposal" or the "Filing").

[4] *Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Introduce a Liquidity Provider Protection Delay Mechanism on EDGA*, SEC, Exch. Act Rel. No. 87096, Sept. 24, 2019, *available at* https://www.sec.gov/rules/sro/cboeedga/2019/34-87096.pdf ("OIP").

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- is inconsistent with existing rules and interpretations of the Commission, and
- raises significant, complex policy concerns (including the protection of investors) that must be carefully addressed.

We therefore urge the Commission to deny the EDGA Delay Proposal.

Further, because the Commission staff has previously offered significantly flawed analysis and conclusions related to the application of certain elements of Regulation NMS a previously considered time delay proposal, we urge the Commission to clarify its position and reaffirm the importance of accurate and firm quotations in the markets.

Below, we offer responses to the eleven enumerated questions posed in the OIP.

1. ***Do commenters agree with the Exchange's assertion that the proposal would reduce cross-market latency arbitrage and improve market quality by enabling liquidity providers to maintain tighter spreads for longer durations and with greater size? Why or why not? How should enhancements to market quality be measured?***

No. But the opinions of commenters on this point are also irrelevant. To be approved, the Exchange must first establish how its proposed change complies with the Exchange Act's obligations.

The Exchange has offered no evidence to establish how it would -- as a factual matter -- "reduce cross-market latency arbitrage." What is the exact taxonomy of the "cross-market latency arbitrage" that it seeks to address? Exactly how would the systems change contemplated by the Exchange address that? To what extent would market participants utilize the time advantage contemplated by the EDGA Delay Proposal? None of these basic facts are established.

On the other hand, even in its support letter for the proposal, XTX Markets

> acknowledges, however, that there is a scenario in which institutional investors could see a decline in fill rates, but that scenario simply highlights a difference in how institutional investors should trade EDGA and what to avoid.
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> …
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> while accessing liquidity on EDGA under LP2 may require a different approach, evidence suggests that market participants can adapt their routing strategies...[5]

Thus, even XTX Markets, a strong supporter of the proposal has asserted that an institutional investor would need to change how it interacts with the markets. But XTX

[5] Letter from Eric Swanson, XTX Markets LLC, to Vanessa Countryman, SEC, July 31, 2019, available at https://www.sec.gov/comments/sr-cboeedga-2019-012/srcboeedga2019012-5898688-188828.pdf.

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Markets conveniently doesn't explain why it has come to that conclusion. The uncomfortable reality is that the asymmetric delay introduced by this one Exchange would create significant risks for information leakage and adverse selection on other trading venues.

So while the problem is undefined, and way in which that problem is solved by the proposal unexplained, even XTX Markets recognizes that the entire marketplace would have to change their practices marketwide so as to respond to the new risks to institutional investors that would be introduced by the EDGA Delay Proposal.

2. ***According to several commenters, EDGA liquidity would be "illusory" because the Exchange's liquidity providers could update their quotations while incoming orders are delayed. Do commenters believe that the proposed rule change would lead to quote fading? Why or why not? Do commenters believe that the proposed rule change would impact fill rates? Would the "illusory" liquidity be a significant portion of the Exchange's overall liquidity?***

As we stated in our prior letter, the purported purpose of EDGA Delay Proposal would be to provide market participants with resting orders on the Exchange an opportunity to cancel their orders prior to execution, but subsequent to the receipt of an otherwise matching order. We should not need to speculate what percentage of the time those market participants will elect to take advantage of that clear, unfair advantage. Further, even a seemingly small percentage change in fill rates at this one venue may still lead to information leakage and other risks that could have profound trading cost consequences for other market participants across other trading venues.

3. ***Some commenters assert that the proposal is not unfairly discriminatory under the Exchange Act because the proposal addresses a particular behavior as opposed to specific class or type of market participants. Is this assertion accurate? Why or why not?***

No. The methodology that an Exchange elects to distribute an unfair advantage has no bearing on whether that advantage is fair or not. The EDGA Delay Proposal is expressly intended to permit the ultra-sophisticated traders who have resting orders on the Exchange to avoid (or increase) trade executions at what they now think are "stale" prices (based on price changes in financial products in different asset classes that are traded on a different exchange and regulated by different regulators).[6]

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[6] Filing, at 7 (noting that it is "designed to protect orders that add liquidity to the EDGA Book by giving Users the opportunity to adjust their quotes [during the four millisecond delay] based on market signals before trading at a stale price."). However, despite the lengthy delay, it still does not appear to exceed the stated transmission time from Illinois to New Jersey. Thus, we are somewhat puzzled as to how this proposal could achieve its stated objective. We also note that while most beneficiaries are likely to be sophisticated market makers, some institutional investors using passive trading strategies could -- at least theoretically -- improve their overall execution quality by avoiding transacting at stale prices on the Exchange. However, the Exchange offers no details regarding for example, the percentage of its order

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In this instance, those who are effectively willing to cross the spread and execute a trade are even further penalized, and suddenly introduced to additional risks and cost--the risk that the market participant with the resting order will back away from the trade and use that information against him or her elsewhere. That information leakage may prove costly to the investor seeking to take liquidity on EDGA, without a single transaction being consummated on EDGA.

4. ***Will the proposal increase the risk of adverse selection for liquidity takers and market participants that are unable to react to market signals in order to adjust their quotes within four milliseconds?***

Yes.

5. ***Is an intentional delay of four milliseconds necessary to minimize the effectiveness of latency arbitrage strategies? Will the delay negate the advantages that trading firms using the latest microwave connections have over liquidity providers using traditional fiber connections? Should the delay be shorter or longer to accomplish this goal? Is four milliseconds an appropriate duration for a delay? Is such delay consistent with the Act? Why or why not?***

We don't know the answer to this set of questions. The proposed four millisecond time delay appears to be "[b]ased on the geographical latencies currently experienced between the Chicago Mercantile Exchange ("CME") data center in Aurora, IL and the Exchange's primary data center in Secaucus, NJ."[7]

What happens when technology evolves and the time required to transmit data changes? Or the exchange decides that it cares more about the time between London and Secaucus? Will the exchange propose to again modify the time delay?

We believe strongly that the Exchange Act and Commission Rules are not, and should not be, directly tied to current geographies and technologies. Giving one set of market participants time to make a decision to avoid executions against validly submitted orders, whether for 4 milliseconds or 10 minutes, is still an unfair advantage.

Again, we note that some institutional investors using passive orders may utilize sufficiently time-sensitive systems to also take advantage of the proposed delay. Further, we understand that some market participants may nevertheless seek to interact in a marketplace where such an opportunity exists, however, we do not see how that venue could remain compliant with the obligations of an exchange pursuant to the Exchange Act. It may, however, satisfy the obligations of an ATS.

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passive order flow from agency brokers who are likely to be able to change their trading behavior based upon new information during the 4 millisecond time horizon.

[7] Filing, at 6. That said, using the data transmission periods offered by the Exchange, we still don't quite understand how the mechanism would achieve the explicitly stated objective.

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6. ***Is the proposal tailored in a manner such that its potential benefits outweigh the potential or likelihood of harm or unintended consequences to the national market system?***

No.

7. ***Should the Exchange's unprotected, manual quote be allowed to lock or cross manual quotations disseminated by another manual market? Why or why not?***

No. One of the great advancements of the past 15 years in the markets was the decreased incidents of locked and crossed markets. As we stated previously:

> it seems likely that the incidence of locked and crossed markets will likely increase significantly. While the Exchange cites to a "study" of a single day's worth of trading in a handful of securities, the Exchange does not explain why that is even remotely relevant.[8] For example, the EDGA Delay Proposal does not explain whether, or to what extent, the special treatment sought by the Exchange could impact those findings. We are deeply concerned about the EDGA Delay Proposal's lack of discussion regarding trading during locked and crossed markets. There are significant concerns with trading during a locked/crossed market, and the risk of investors receiving less than best execution becomes significant. None of those are addressed.
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> The overlap of the variations is complex. By not being recognized as an automated market, not being subject to Rule 611, changing how other exchanges will interact with the now manual exchange pursuant to SEC Rule 610, but still being included within the NBBO, it seems highly likely that locked and crossed markets would become more prevalent. Of course, again, reducing locked and crossed markets was one of the key objectives in the adoption of Regulation NMS.[9]

8. ***What impact, if any, would the dissemination of an unprotected, manual quote have on the national market system? Should EDGA's unprotected, manual quote be disseminated by the SIP? If so, should the SIP disseminate a modifier to indicate that EDGA's quote is manual? Should***

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[8] See Filing, at 17,n.24.

[9] See Ivy Schmerkin, *Battle over Locked and Crossed Markets*, Information Week: Wall Street and Technology, (Apr. 15, 2003), *available at* http://www.wallstreetandtech.com/exchanges/nasdaqandrsquos-battle-over-locked-crossed-markets/d/d-id/1255842.html.

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the EDGA quote be used to calculate the NBBO? Should the EDGA quote be used to calculate midpoint values?

As we have stated previously, we believe a manual quotation should not be disseminated by the SIP. If, however, the Commission were to approve the inclusion of the EDGA manual quotation in the SIP, that quotation should be clearly separately indicated as manual. Further, if the Commission were to consider approving such a program, it should consider limiting the scope to thinly traded securities and making it a pilot program.

As we have previously stated, the inclusion of the EDGA quotation would likely prove to be extremely misleading for market participants particularly under the current Rule 605 regime, and lead to skewed calculations not to mention investor confusion. It is not difficult to believe that market makers on EDGA may be willing to offer more aggressive pricing than than on other exchanges--in large part due to the fact that they would have the opportunity to avoid a money-losing execution on EDGA, but would not have the same opportunity on other exchanges. However, as mentioned previously, those quotes on EDGA would be far less accessible than those of other exchanges. Further, by including the EDGA manual quotation in these market-wide calculations that are relied upon not just to route orders, but also as references for executions on other venues, the impact would be felt by market participants who do not seek to interact on EDGA.

If the purpose of the NBBO and midpoint calculations is to provide accurate assessments of the market based on accessible quotations, then the EDGA manual quotations must be excluded or Rule 605 data must first be updated to reflect the current scenario presented.

9. ***How will the dissemination of EDGA's unprotected, manual quote impact a broker-dealer's obligation to obtain best execution?***

While some commenters may argue that a market participant could simply ignore the "unprotected, manual quote" on EDGA, this result is impossible.

First, if the EDGA quotation is included in the SIP and related market-wide statistics, then market participants are going to be directly and indirectly impacted by the quotation irrespective of whether they seek to interact on EDGA.

Second, given the specific temporal advantage that EDGA is seeking to provide to those with resting orders, it is highly likely that EDGA will often "look" like it is offering the best prices in the marketplace. This creates significant challenges for current transaction cost analysis tools. The prices offered on EDGA are likely to be materially more difficult to access than those offered by other exchanges (at least at first, as it would be the only exchange permitting those with resting orders to opt out of a trade).

Market participants do not typically treat exchanges as offering effectively inaccessible quotes. Accordingly, a market participant's failure to seek to access a better priced -- but inaccessible -- manual quote on EDGA could lead to misleading transaction cost

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analysis. A traditional analysis would likely suggest strongly that the market participant seek to access that "unprotected" quote. Of course, this impact is magnified significantly if the EDGA quotation is included in the SIP and related market-wide statistics.

Third, as the Commission has heard many times over the years, most sophisticated market participants feel obligated to access liquidity wherever it can be found--regardless of the regulatory status of the venue or quotation. For example, many asset managers will be very disappointed with their brokers' performance if their brokers' were to limit their trading to just protected quotes on exchanges, and ignored all other sources of liquidity.

Fourth, regardless of the ultimate position taken by the SEC on the filing, in order to correctly analyze the impact such a proposal would have on the markets, it is incumbent upon staff to first modernize the Rule 605 framework. In particular, noting that the average trade size on EDGA is historically under 100 shares[10], modernizing Rule 605 to include odd lot trades coupled with more relevant 605 speed metrics would be paramount.

As a result of these factors and others, we believe that market participants will nevertheless feel obligated by their best execution responsibilities to seek to access the "unprotected" quotation.

Finally, we note that we would be concerned if brokers' best execution obligations did not press them to seek to access EDGA's liquidity, in the same way that we believe a broker may not be compliant with its best execution responsibilities today if it was not (subject to customer input) seeking to access other significant sources of unprotected liquidity.

10. ***What would be the impact, if any, on the national market system if other national securities exchanges, with a larger percentage of overall trading volume, adopted a similar proposal? In particular, how would the proposal affect market quality?***

While we appreciate the staff's interest in these important big picture questions, they would seek for us to offer mere conjecture. As previously stated, the inclusion of the manual quotations in the SIP would have a dramatic, and distortive impact on market-wide statistics, which would impact all market participants. However, beyond that point, we simply do not yet have adequate information upon which to make informed speculation.

And even if we were to start making some speculations about this particular proposal, why would we confine ourselves to just the facts of the instant proposal in the current marketplace? As we have seen with the introduction of other time delay proposals

[10] For example, EDGA's average trade size for the month of September 2019 was 91 shares. Cboe, CBOE Historical Market Volume, *available at* http://markets.cboe.com/us/equities/market_statistics/historical_market_volume/ (last viewed Oct. 21, 2019).

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following the approval of IEX, we would expect market participants to use this EDGA Delay Proposal as justification for other, similar proposals. How would those not-yet-invented proposals impact the marketplace? For example, what if another exchange family were to introduce a time delay proposal that was based on latencies between the London and the US? Or what if another exchange sought to increase the time delay to half a second? Or what if the time delay was provided to only qualified market makers (using whatever criteria)?

By permitting some market participants fade quotes that would be included in the SIP and market-wide statistics, the Commission would be essentially jumping into a sled atop a very steep slope. However, we don't yet know how fast down the slope we will go, or what other obstacles may lay ahead.

We do however urge the staff to move forward with modernizing Rule 605 data with all due speed.

11. ***What are commenters' views on how the proposal would affect trading activity, in general, and liquidity providers, in particular, on other markets? Would the LP2 delay mechanism impose systemic risks and create informational disparities across the national market system? Would the proposal provide EDGA liquidity providers with the option to leverage or free ride price discovery that occurs at other trading venues?***

As previously stated, it is likely that the approval of the EDGA Delay Proposal would likely lead to decreased fill rates, misleading market-wide statistics, and altered execution prices across not just exchanges, but off-exchange trading venues.

Conclusion

The EDGA Delay Proposal provides insufficient information for the Commission to conclude that EDGA has established that it would:

- "perfect the mechanism of a free and open market and a national market system,"[11]
- "protect investors and the public interest,"[12]
- "not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers";[13] and
- "not impose any burden on competition not necessary or appropriate in furtherance of the purposes of" the Act.[14]

[11] 15 U.S.C.§ 78f(b)(5).
[12] 15 U.S.C.§ 78f(b)(5).
[13] 15 U.S.C.§ 78f(b)(5).
[14] 15 U.S.C.§ 78f(b)(8).

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Accordingly, despite the fact that the unique proposal could potentially offer some value to some market participants, it should be denied.

Thank you for your consideration. Should you have any questions or would like to discuss these matters further, please contact Chris Nagy at (402) 312-7918 or me at (202) 909-6138.

Sincerely,

Tyler Gellasch
Executive Director