Goldman
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February 26, 2020

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

Re: IEX Proposed Rule Change to Add a New Discretionary Limit Order Type;
     SEC Release No. 34-87814; File No. SR-IEX-2019-15 (December 20, 2019)

Dear Ms. Countryman:

      Goldman, Sachs & Co. ("Goldman Sachs") appreciates the opportunity to provide the Securities and Exchange Commission ("SEC" or "Commission") with its comments on the proposed rule change by Investors Exchange, LLC ("IEX") relating to a new discretionary limit order type ("D-Limit Order"). Goldman Sachs has consistently supported proposals that foster liquidity provision and market integrity and safety.[1] In that regard, we support IEX's innovative efforts to encourage displayed liquidity and enhance the price discovery process. Furthermore, as is discussed below, the D-Limit Order seeks to address practices that have developed with the evolving complexities of our market, namely latency arbitrage.

      As described more fully in the IEX rule filing, the D-Limit Order leverages IEX's Crumbling Quote Indicator ("CQI"). In those instances where the CQI predicts that the National Best Bid and Offer ("NBBO") is about to change, the D-Limit Order is repriced to one minimum price variation ("MPV") outside of the NBB or NBO.[2] During this comment process, considerations about the D-Limit Order's consistency with the requirements of Regulation NMS Rule 611 (the Order Protection Rule) and Rule 602 (the Firm Quote Rule) as well as Section 6 of the Securities Exchange Act of 1934 (the "Exchange Act") have been raised. For the reasons stated below, we believe that D-Limit Orders are consistent with these fundamental rules and underlying principles and will be a mechanism that provides benefits to our capital markets.

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[1] *See Letter from Paul Russo regarding Investors' Exchange, LLC, Application for Registration as a National Securities Exchange under Section 6 of the Securities Exchange Act*, Exchange Act Release No. 34-75925, File No. 10-222 (January 12, 2016); *Letter from Greg Tusar and Matthew Lavicka regarding Concept Release on Equity Market Structure*; Exchange Act Release No. 34-61358, File No. S-7-02-10 (June 25, 2010).

[2] As explained in IEX's rule filing, the CQI uses a proprietary mathematical calculation using a transparent formula codified in IEX Rule 11.190. Exchange Act Release No. 87814, 84 FR 71997, 71998 ("IEX Rule filing").

<u>D-Limit Orders Quotations Are Protected Quotations under the Order Protection Rule</u>

The SEC has already analyzed IEX's "speed bump" in the context of its Application for Registration as a National Securities Exchange under Section 6 of the Exchange Act and concluded that IEX is an automated trading center and that its quotes are entitled to protection under Rule 611.[3] The introduction of the D-Limit Order does not alter that analysis. There is no delay embedded within D-Limit Orders.[4] Rather, a D-Limit Order, by design, updates its displayed price based on the operation of IEX's CQI. This price update may occur before an incoming order is recognized and processed by the IEX matching engine. These circumstances can occur with *any* protected quotation. A displayed price may no longer be available for a number of reasons, including: (1) it may have already been executed against; (2) it may have been cancelled before being executed against; or (3) the order may be pegged to the NBBO and the NBBO may update. In each of these scenarios, there is no doubt that the displayed order is considered accessible and protected if representing the best bid or offer on an exchange. D-Limit Orders are no different. They are as accessible as any other quote.

<u>D-Limit Orders Are Consistent with the Requirements of the Firm Quote Rule</u>

The D-Limit Order falls within the exception found in Rule 602(b)(3), which provides, in relevant part, that:

> "[n]o responsible broker or dealer shall be obligated to execute a transaction for any subject security . . . if before the order sought to be executed is presented, such responsible broker or dealer has communicated to its exchange or association . . . a revised bid or offer."

In our view, a reasonable interpretation of Rule 602(b)(3) is that an order is "presented" when recognized and processed by the system's matching engine.[5] In the case of IEX, an order

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[3] *See In the Matter of the Application of Investors' Exchange, LLC for Registration as a National Securities Exchange* Exchange Act Release No. 34-78101(June 17, 2016) ("Because the delay imposed by IEX's POP/coil is well within geographic and technological latencies experienced today that do not impair fair and efficient access to an exchange's quotations or otherwise frustrate the objectives of Rule 611, the Commission believes that such intentional delay will not frustrate the purposes of Rule 611 by impairing fair and efficient access to IEX's quotations . . . thus IEX can maintain a protected quotation SEC order granting IEX's exchange registration"); *See also Commission Interpretation Regarding Automated Quotations Under Regulation NMS*, Exchange Act Release No. 34-78102, File No. S7-03-16 (June 17, 2016) ("[A] de minimis delay, even if it involves an 'intentional device' that delays access to an exchange's quotation, is compatible with the exchange having an 'automated quotation' under Rule 600(b)(3) and thus a 'protected quotation' under Rule 611.").

[4] Like other IEX order types, D-Limit Orders must traverse the IEX "speed bump" on initial entry. Thereafter, in contrast to other IEX order types or messages, D-Limit Orders will automatically update their price one MVP away from the NBB or NBO when the CQI is engaged.

[5] Rule 602 does not define the term "presented," nor do the relevant proposing and adopting releases shed much light on its interpretation. *See* Securities Exchange Act Release No. 12670 (July 29, 1976), 41 FR 32856 (August 5, 1976); Securities Exchange Act Release No. 13626 (June 14, 1977), 42 FR 32418 (June 24, 1977); Securities Exchange Act Release No. 14415 (January 26, 1978), 43 FR 4342 (February 1, 1978). However, prior cases involving the Firm Quote Rule have focused on situations where the broker/dealer was aware of the incoming order and subsequently "backed away" from their published quote. *See, e.g., Credit Suisse*, Release No. 77003 (Jan. 31, 2016). With respect to automated trading centers and relevant quotations, it would stand to reason that

is presented after it traverses IEX's speed bump, is queued for processing, and is directed through the order queue to the matching engine for execution.[6] Any updates to the price of the D-Limit Order price affecting an incoming order would occur prior to this sequence, communicated in the form of a standing instruction to adjust one MPV away from the NBB or NBO when the CQI indicates a crumbling quote. In this regard, D-Limit Orders are no different from the operation of peg order types, which adjust based on changes in the NBB or NBO prior to the presentation of an incoming order. In the case of both order types, they operate in a manner consistent with the Firm Quote Rule because any changes to the IEX bid or offer based upon the operation of the CQI will be made prior to the presentation of an incoming order to the IEX matching engine.

D-Limit Orders Are Consistent with the Goals of the National Market System and Section 6(b) of the Exchange Act

A core goal of the national market system is to perfect the mechanism of a free and open market and a national market system. In adopting the 1975 amendments to the Exchange Act and creating the principles of the national market system, Congress stated:

> The objective is to enhance competition and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations of practices and services. Neither the markets themselves nor the broker-dealer participant in these markets should be forced into a single mold. Market centers should compete and evolve according to their own natural genius and all actions to compel uniformity must be measured and justified as necessary to accomplish the salient purposes of the Securities Exchange Act, assure the maintenance of fair and orderly markets and to provide price protection for the orders of investors.[7]

Adverse selection stemming from latency arbitrage can have a negative effect on the national market system because liquidity providers may be more inclined to provide less liquidity at wider spreads. The D-Limit Order provides a potential solution to this problem. The Commission has long recognized the importance of displayed limit orders in the national market system, and IEX's rule proposal has the potential to encourage the public display of limit orders.[8] In fact, in adopting Regulation NMS, the Commission stated "displayed limit orders are a critically important element of efficient price discovery that deserve greater protection against trade-throughs."[9] Similarly, here, we believe that the benefits derived by providing this limited protection for displayed liquidity will advance the goals of the national market system. Further, D-Limit Orders will be available for use by all market participants,

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such an "awareness" of the order would not occur until the order is recognized and processed by the matching engine.

[6] *See* 84 FR at 41154-41155.

[7] H.R. Rep. 94-123, 94th Cong., 1st Sess. 51 (1975)

[8] *See, e.g., Order Execution Obligations*, Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290.

[9] *See* Exchange Act Release No. 34-51808 (June 9, 2005), 70 FR 37496, 37517 (June 29, 2005).

helping mitigate practices that hinder liquidity provision thereby furthering the goals of Section 6 of the Exchange Act.

<u>D-Limit Orders Can be Fairly Assessed in the Context of a Broker's Best Execution Obligations</u>

Today, best execution is a fairly complex assessment, requiring the consideration of a multitude of exchanges, ATSs, and dark pools, each with its own array of order types. The addition of the D-Limit Order does not increase that complexity; it simply adds another consideration that must be factored into order routing strategies. In fact, the D-Limit Order could lead to improvements in execution quality by encouraging greater displayed liquidity without the consequences of exposure to latency arbitrage. While Goldman Sachs would be supportive of further Commission guidance on best execution, we do not believe that the introduction of D-Limit Orders, in and of itself, adds complexity that would burden broker-dealers' existing best execution obligations.

<u>Conclusion</u>

We again express our support for IEX's D-Limit Order proposal. We believe that the D-Limit Order will afford a needed level of protection against latency arbitrage practices, thereby encouraging greater liquidity and improved price discovery. We believe that exchanges should be encouraged to provide solutions to complex market structure issues, as this fosters not only competition but the growth and enhancement of the national market system.

Goldman Sachs greatly appreciates the Commission's consideration of the important issues raised in this rule filing and would be pleased to discuss our comments in greater detail. Please feel free to contact the undersigned with any questions

Sincerely,

Philip Berlinski
Co-Chief Operating Officer
Equities, Global Markets
Goldman Sachs & Co. LLC

cc: Jay Clayton, SEC Chairman
        Robert J. Jackson Jr., SEC Commissioner
        Hester M. Peirce, SEC Commissioner
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