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January 22, 2019

Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-0609

Re: File No. SR-IEX-2018-23; Investors Exchange LLC; Notice of Filing of Proposed Rule Change to Modify the Resting Price of Discretionary Peg Orders

Dear Mr. Fields:

The FIA Principal Traders Group (“FIA PTG”)<sup>1</sup> appreciates the opportunity to comment on the above-captioned proposal (“Proposal”). The Investors Exchange LLC (“IEX” or “Exchange”) currently offers two types of non-displayed pegged orders, Discretionary and Primary, for which the working price of an order relative to its peg may be automatically adjusted by the IEX matching engine when receiving a signal from IEX’s crumbling quote indicator (“CQI”). According to IEX, this indicator is designed to predict imminent changes in the national best bid and offer (“NBBO”).

For an IEX Discretionary Peg Order, the price of the order rests at either the NBB for buys or the NBO for sells, but may become more aggressive and price up to the midpoint of the NBBO. Based on information provided in other IEX rule filings, the CQI signal is active for only very brief times during the day. As such, the effect of the IEX Discretionary Peg Order is to price as aggressively as the midpoint most of the time, but fall back to match the price of the NBB (or NBO) when the IEX CQI signal predicts the order may be executed and the NBBO may subsequently change.

The IEX Primary Peg Order operates in a similar fashion except that the resting price starts one tick below the NBB for buys (or one tick above the NBO for sells) with discretion to become more aggressive and price match up to the NBB or NBO. As in the case of IEX Discretionary Peg Order,

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<sup>1</sup> FIA PTG is an association of firms, many of whom are broker-dealers, who trade their own capital on exchanges in futures, options and equities markets worldwide. FIA PTG members engage in manual, automated and hybrid methods of trading, and they are active in a wide variety of asset classes, including equities, fixed income, foreign exchange and commodities. FIA PTG member firms serve as a critical source of liquidity, allowing those who use the markets, including individual investors, to manage their risks and invest effectively. The presence of competitive professional traders contributing to price discovery and the provision of liquidity is a hallmark of well-functioning markets. FIA PTG advocates for open access to markets, transparency and data-driven policy and has previously made recommendations about a variety of equity market structure issues, including Regulation NMS (See <https://ptg.fia.org/keywords/equity-market-structure>).

the Primary Peg Order generally operates at the more aggressive price, and falls back to its resting price only when the CQI signal is active.

IEX is now proposing to modify the resting price of its Discretionary Peg Order type to be one tick below the NBB for buys (or one tick above the NBO for sells) but still maintain the Order's discretion to price as aggressively as the midpoint. FIA PTG is concerned with this novel application of discretionary pricing as it would allow, for example, a buy order with a resting price that is *below* other fully displayed (and protected) NBB orders, to "jump over" those orders and price more aggressively up to the midpoint when the CQI signal indicates it is "safe" to do so. But when the CQI signal is active, the IEX matching engine would reprice the order back below the price of all displayed NBB orders to *avoid execution*, even though all other displayed, protected, NBB orders would be executed.

At present, when the CQI signal is active a Discretionary Peg Order may still be filled (along with any displayed NBB/NBO orders) by incoming contra-side orders. The "discretion" afforded by the CQI signal effects the price of the execution, not whether or not the order is executed. As IEX explains in its filing, the purpose of its proposed change is so that the Discretionary Peg Order can avoid being executed at all whenever the CQI signal is active.

In determining whether to approve this proposal FIA PTG encourages the Commission to consider the impact and overall fairness of this mechanism to any displayed protected quotes on IEX, which may represent market maker liquidity or customer orders. Market spreads are influenced by a number of factors including estimates of the adverse selection of contra-side orders. Today, the advantage a Discretionary Peg Order has over displayed orders, in that it can price more aggressively during "favorable" market conditions, is partly counterbalanced by that fact that even when the CQI signal is active, Discretionary Peg Orders will still be executed (though at the less aggressive price matching the NBB or NBO).

With this proposed change IEX would be eliminating this counterbalance – Discretionary Peg Orders would execute only when the IEX matching engine predicted favorable conditions for that order, but never when the model predicted an imminent price change in the NBBO. Only displayed orders would be executed, and therefore be impacted by any negative adverse selection. There would seem to be a conflict between the proposed change and the promotion of price discovery through the display of protected quotes that are the hallmark of our national market system.

In considering these conflicts we recommend the Commission establish standards or guidelines for the use of discretionary price mechanisms, as well as the ability of matching engines to automatically adjust order prices based on predictive signals. For example, if a Discretionary Order can effectively jump over a single price level, can it jump over two price levels? Or 10 price levels? What if the Discretionary Peg Order resting price was 20 ticks below the NBB but still had the ability to price as aggressively as the midpoint? Should approval or disapproval be based on the nature of the signal, or its duration? As noted, the CQI signal is only active for small periods of time during normal market hours. What about a signal that was active most of the time and only turned off, allowing an order to price more aggressively, under ideal circumstances?

Taking this one step further, one could imagine IEX, or any other exchange, reversing the sign of a CQI-like signal such that instead of a buy order becoming less aggressive when a price decline was predicted, it became more aggressive when a price increase was predicted. If the current

proposal is adopted and it is deemed acceptable for a Discretionary Peg Order to programmatically avoid execution under perceived unfavorable market conditions, then it would seem that, by symmetry, the opposite would also be permitted – an unexecuted buy order resting at the NBB (or lower) should be able to fully cross the spread and execute at the NBO when the CQI signal indicates the NBBO is about to increase. Of course, if the NBO were populated with Primary Peg Orders, the matching engine would be repricing these to avoid executions as well, leading to some very counterproductive behavior.

As demonstrated by these examples, approval of the IEX proposal without any principles or guidelines could open the door to some very complex order types in which matching engines are able to price and re-price orders based on any complex series of predictive signals for any purpose, including those that may create inherent conflicts between orders.

Prior to IEX becoming an exchange there was considerable discussion about IEX's proposed use of a 350-microsecond speed bump, and the Staff provided detailed interpretive guidance related to the protected-quote status of displayed orders at exchanges implementing such delays. However, there was much less discussion about the specifics of the order types that would ultimately be relying on these speed bumps. We encourage the Commission to perform a similar analysis of signal-based order types, and seek specific public input on this topic, before approving IEX's proposed modification to its Discretionary Peg Order type.

Finally, in addition to rejecting the Proposal, FIA PTG encourages the Commission to address the spiraling complexity in our national market system. Rather than addressing the problems with the foundation of our market structure, exchanges have continued to add complex work-arounds including complicated order types and speed bumps. We strongly support any action by the Commission to address the fundamental issues in equity market structure, including those in our recent white paper,<sup>2</sup> without further delay.

If you have any questions about these comments, or if we can provide further information, please contact Joanna Mallers ([jmallers@fia.org](mailto:jmallers@fia.org)).

Respectfully,

FIA Principal Traders Group



Joanna Mallers  
Secretary

cc: Walter J. Clayton, Chairman  
Robert J. Jackson, Jr., Commissioner  
Hester M. Peirce, Commissioner  
Elad L. Roisman, Commissioner  
Brett W. Redfearn, Director of the Division of Trading and Markets

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<sup>2</sup> [Reg NMS: A Retrospective Review & Practical Reforms for Improvement](#)