

ARGUMENT SCHEDULED FOR OCTOBER 11, 2019
Nos. 19-1042(L), 19-1043, 19-1046, 19-1049, 19-1053, 19-1054

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

NEW YORK STOCK EXCHANGE LLC, ET AL.,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of a Rule
of the Securities and Exchange Commission

Brief of Amicus Curiae Investors Exchange LLC
in Support of Respondent

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INITIAL BRIEF: August 1, 2019

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES**A. Parties and Amici**

All parties and amici appearing before the Securities and Exchange Commission and this Court are listed in Respondent's brief apart from Investors Exchange LLC, appearing as amicus in this brief.

B. Ruling Under Review

Respondent's brief accurately references the ruling at issue.

C. Related Cases

These consolidated cases have not previously been before this Court or any other court. All related cases are identified in Respondent's brief.

/s/Hyland Hunt

Hyland Hunt

CORPORATE DISCLOSURE STATEMENT

Under Rule 26.1 of the Federal Rules of Appellate Procedure and D.C. Circuit Rule 26.1, amicus curiae Investors Exchange LLC submits the following corporate disclosure statement:

Investors Exchange LLC is a registered national securities exchange. It is wholly owned by IEX Group, Inc., a privately-held company. No publicly-traded company holds 10% or more of IEX Group, Inc. stock.

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GLOSSARY

ATS	Alternative Trading System
IEX	Investors Exchange LLC
NMS	National Market System
SEC	Securities and Exchange Commission
Transaction Fee Pilot or Pilot	Transaction Fee Pilot for NMS Stocks, Final Rule, 84 Fed. Reg. 5,202 (Feb. 20, 2019)

INTEREST OF AMICUS CURIAE¹

Investors Exchange LLC (“IEX”) is a registered national securities exchange, founded in 2012 on the belief that the current stock market ecosystem does not sufficiently prioritize the interests of long-term investors, like pension funds and mutual funds.² IEX has implemented several design and pricing choices to level the playing field for long-term investors, resulting in a model that differs significantly from the model adopted by incumbent exchanges like those operated by Petitioners. Like Petitioners, IEX seeks to attract liquidity to its exchange to facilitate equity trading. Unlike Petitioners, however, IEX does not offer rebates, because of abundant evidence that rebates create harmful and expensive complexities in the U.S. stock market and IEX’s conclusion that a transaction fee model based on rebates is an unsustainable practice in the long term.

As a company with experience as both an alternative trading system and a national securities exchange, IEX can provide a unique perspective on why the Commission’s decision to study the effect of rebates on the markets was not only reasonable but was also a necessary response to widespread dissatisfaction of market

¹ No counsel for a party authored this brief in whole or in part, and no person other than amicus curiae, its members, or its counsel contributed money that was intended to fund this brief’s preparation or submission. *See* Fed. R. App. P. 29(a)(4)(E). IEX filed its notice of its intent to participate as amicus curiae on July 30, 2019. All parties have consented to the filing of this brief.

² The story behind the founding of IEX Group was chronicled in Michael Lewis’ 2014 book *Flash Boys: A Wall Street Revolt*.

participants with exchange transaction pricing and, especially, the payment of rebates. IEX's firsthand experience confirms the Commission's determinations that evaluating the impacts of exchange access fees and rebates is necessary, and that the Transaction Fee Pilot is essential to gather the type of data needed. IEX's experience also demonstrates that the Pilot will help, not harm, the market.

INTRODUCTION AND SUMMARY OF ARGUMENT

As a market operator, IEX understands the role that the modern payment and fee model, and particularly the rebate system, plays in the U.S. stock market, and like many other informed market participants, believes that rebates harm investors and impair market structure, fair competition, price transparency, and best execution—and therefore they should be prohibited. But that is not the standard the Securities and Exchange Commission needed to meet to adopt the Pilot. The Commission needed only to determine that it had a reasonable basis to study the effects of rebates and fees on the market, and to show that the Pilot was a reasonable way to gather data for that purpose. The Commission easily exceeded that standard.

While the U.S. stock market is one of the most successful markets in the world, its structure is fundamentally impaired by “rebates”—payments made by exchanges to broker-dealers to incentivize different types of orders. Because of rebates, traders are faced with conflicts of interest, the true costs of trading are obscured, and the market is made unnecessarily complex through complicated order types and

fragmentation that the rebate system helps to foster. These concerns have been consistently raised by numerous market participants, including IEX, members of the SEC's Equity Market Structure Advisory Committee, numerous agency brokers trading for customers, and dozens of institutional investors. Misgivings about the negative effects of rebates are longstanding and backed by empirical research and over twenty years of experience with the rebate system. Far from being an essential component of a properly functioning equity market, as Petitioners claim, the use of rebates is a unique evolution in the U.S stock markets that benefits only a few market participants, including Petitioners and specialized trading firms like their amici, at the expense of everyone else.

The Commission opted to proceed cautiously and to collect more data before forming a definitive view on whether rebates have a negative net impact on investors and the market. But it hardly threw up its hands over a record in equipoise. Much less did the SEC knowingly decide to cause harm, as Petitioners would have it. Instead, the Commission determined that the evidence showing that rebates create potential distortions in routing behavior, market structure, and execution quality was sufficient to justify a market-wide pilot to investigate these concerns. That conclusion is sound and amply supported by the record. Besides potential harm created by broker conflicts of interest, substantial evidence was presented to the

Commission that rebates distort market structure by obscuring the true costs of trading, adding complexity, and fostering market fragmentation.

Nor is there any reason to fear that the Pilot itself will harm the market, as Petitioners and their amici claim. To be clear, the Commission was not required to reach a definitive conclusion that the Pilot will benefit each and every aspect of the market in order to adopt it. But any particular harms suffered—if they occur at all—are more than likely to be overshadowed by the benefits to the market as a whole from reducing transaction fees and limiting rebates, even temporarily. What’s more, the claims by Petitioners’ amici of certain investor harm are overblown, based on inapt comparisons to a different pilot, and quite simply wrong. IEX firmly believes the Pilot will improve market structure, and it is not alone in this view. It is one of dozens of entities—including investors representing trillions of dollars in the stock market—that wrote to support the Pilot because it will improve the U.S. stock market and benefit investors, both in the short term while the Pilot is in effect, and in the long term when the Commission can take final action based on the results of the study.

Conducting the Pilot is the only way for the Commission to obtain the data it needs to make long-term decisions about reforming rebates. Given the competitive environment between exchanges, no natural experiment will produce this data; an external constraint applied equally to all exchanges is essential. Nor could any of

Petitioners' proposed alternatives supply this essential data; most of them would focus exclusively on conflicts of interest and not provide any data on market structure or quality, and others would impair the validity of the data. Further, there is no conclusive way to judge the effect of rebate conflicts without removing the source of the conflict. Limiting the Pilot to exchanges, and excluding alternative trading systems, was likewise eminently reasonable. The two types of trading venues operate under entirely different rules and have highly divergent fee practices.

As the only stock exchange that has never offered any rebates—precisely because of their distortive effects on the market—IEX welcomes the Pilot as a necessary and important step toward establishing a structure for the U.S. stock market that better serves the interests of long-term investors and the broader investing public.

ARGUMENT

I. The Transaction Fee Pilot Will Improve The Stock Market Because Rebates Distort Market Structure.

A. The Maker-Taker System Is a Controversial Development.

1. Market liquidity generally refers to the ability of buyers and sellers of securities to transact efficiently; in a market with greater liquidity, transactions can occur more quickly and with lower transaction costs. Limit orders to buy or sell shares can “make” liquidity on an exchange—*i.e.*, add to share volume (depth)—when they “cannot be filled immediately when they arrive because no market

participant is willing to trade at the price of the order.” JA_[Transaction Fee Pilot for NMS Stocks, Proposed Rule, 83 Fed. Reg. 13,008, 13,041 (Mar. 26, 2018)]. A marketable order to buy or sell that can be immediately executed, on the other hand, reduces the volume of shares available for sale or purchase, and thereby “takes” liquidity. *Id.* For example, assume the prevailing market bid price—*i.e.*, the highest price at which buyers are willing to buy—is \$8.75 per share, and buyers are seeking 100 shares at that price. A limit order to sell 100 shares at \$9.00 (or more) will not be executed and makes liquidity by resting on an exchange’s order book and becoming available to trade with other orders at that price. *Id.* An order to sell 100 shares at \$8.50, in contrast, would be executed immediately and would take liquidity at the resting bid price of \$8.75. *Id.*

Most exchanges—representing about 90 percent of on-exchange trading volume at the time the Pilot was adopted, JA_[Transaction Fee Pilot for NMS Stocks, Final Rule, 84 Fed. Reg. 5,202, 5,254, Table 1 (Feb. 20, 2019)]—offer rebates either to members that “make” liquidity by placing orders to buy or sell shares on the exchange, or to members that “take” liquidity. JA_[*Id.* at 5,202]. In the “maker-taker” model, which is most common, an exchange pays the maker of liquidity a rebate after a trade is executed. *Id.* Typically, a rebate is a fraction of a cent, with the standard rebate hovering around \$0.0030 per share, or 30 cents per 100 shares. *See, e.g.,* Chester S. Spatt, *Is Equity Market Exchange Structure Anti-Competitive?*,

Tables 1, 2, 4, 5 (July 22, 2019), <https://tinyurl.com/yyathh3c> (listing rebates at Nasdaq and NYSE Arca). By contrast, the “taker” of liquidity is charged a fee, usually equal to the highest permissible “take fee” set by regulation at \$0.0030 per share. JA_[84 Fed. Reg. at 5,258, Table 2]. A so-called “inverted” or “taker-maker” exchange is one that pays a rebate to the “taker” of liquidity, and charges a fee to the “maker” of liquidity. JA_[*Id.* at 5,202]. A final alternative, which IEX has chosen, is a flat fee model, charging flat fees per order (whether they make or take liquidity), other than some order types that are executed for free. *See id.*; JA_[*id.* at 5,258, Table 2]. There are no rebates under this model. *See* JA_[*id.* at 5,258, Table 2]; IEX, Investors Exchange Fee Schedule, <https://tinyurl.com/y2o9vczp>.

For decades, the flat fee model was the prevailing one. The maker-taker system did not emerge until the late 1990s when an electronic trading venue began offering rebates as a way to attract order flow away from traditional exchanges. JA_[83 Fed. Reg. at 13,040 & n.227]. Subsequently, exchanges followed suit, offering rebates to attract order flow. *Id.* Today, most on-exchange trading is executed on a maker-taker (or taker-maker) exchange; as of the date the Commission

finalized the Pilot, seven were maker-taker, four were inverted, and two had flat fees.³ JA_[84 Fed. Reg. at 5,202].

2. Exchanges that pay rebates have created a series of complex “rebate tiers” under which traders can earn different rebates based on multiple factors such as stock price, order type, type of market participant, and listing exchange. *See* Royal Bank of Canada, Comment Letter, 6 (Oct. 16, 2018) (“Royal Bank of Canada Comment”). Many tiers also include a trading firm’s average daily volume as a factor, so market participants are rewarded for sending a larger proportion of their trading activity to a particular exchange. JA_[84 Fed. Reg. at 5,221 n.245]; Royal Bank of Canada Comment at 6. Often, rebate tier pricing is applied retroactively, after the month when the relevant trading took place, meaning that participants may not be certain of pricing at the time they are trading. Royal Bank of Canada Comment at 8 (“[Rebate tier] variables ... are typically calculated monthly and therefore remain unknown in real time and even at the end of most trading days.”).

Given this complex tiered system, defining the range of potential rebates at a given exchange is virtually impossible. One market participant provided evidence to the Commission that there are at least 1,023 separate pricing “paths” available to

³ Apart from IEX, only the NYSE American exchange, owned by Petitioner NYSE, has a flat fee model. JA_[84 Fed. Reg. at 5,254, Table 1] (indicating NYSE American’s market share was 0.32% at the time the Pilot was adopted).

traders, dependent upon 3,762 pricing variables. *Id.* at 8. And the precise contours of rebate offerings are constantly being changed by Petitioner exchanges. In the past five years, maker-taker exchanges have made a total of 437 changes to their fee schedules. JA_[84 Fed. Reg. at 5,258 (Table 2)]. In other words, the rebate incentive structure used by exchanges to attract order flow is recent, complex, and dynamic.⁴

3. Rebates are not the only methods of encouraging liquidity. Many exchanges provide other economic incentives to market makers if the market makers meet certain objective criteria to improve market quality. For example, IEX has the “IEX Enhanced Market Maker” Program, which offers a discount on all trades to certain members if the members meet certain quote performance standards. IEX, IEX Enhanced Market Maker Program, <https://tinyurl.com/y43zvcc9>. The Pilot allows exchanges to continue to offer this type of economic incentive to market makers that satisfy objective market quality metrics—even on securities in the no-rebate test group—for principal trading activity. JA_[84 Fed. Reg. at 5,222-23].

4. Using rebates as a method to incentivize market makers has been controversial for as long as it has been commonplace. To be sure, rebates benefit

⁴ This shift to a maker-taker system is often identified as being closely related to the establishment of a \$0.0030 regulatory cap on take fees under Regulation NMS in 2005. *See* 70 Fed. Reg. 37,496, 37,545 (June 29, 2005); JA_[84 Fed. Reg. at 5,238-5,239]. As IEX explained to the Commission, technological advances since 2005 have reduced many costs in equities trading, but the “cap” established by Regulation NMS “has become a standard rate that is used in effect to subsidize the payment of rebates.” IEX, Comment Letter, 3 (May 30, 2018).

certain market participants. Maker-taker exchanges use rebates to attract order flow, which in turn creates valuable market data that can be sold by those exchanges at a significant mark-up. *See, e.g.*, Larry Harris, Comment Letter, 6 (June 15, 2018) (“Harris Comment”) (former SEC Chief Economist explaining how exchanges can “participate in the profits” from rebates through the sale of expensive market data).⁵ And a small, discrete group of traders, like Petitioners’ amici, have structured their business models around capturing rebates as a source of profit separate from any profit made from well-timed trades. *Id.* at 4-6 (explaining how certain proprietary traders can “execute parasitic strategies” based on the maker-taker structure). But for everyone else, there has been ever-increasing concern, raised repeatedly to the Commission, that rebates harm investors and the market.

One obvious concern is that rebates can lead to conflicts of interest for brokers acting as agents for investors: an agency broker may opt to seek out rebates (which they typically keep and do not pass on to the client) instead of searching for the best

⁵ Because of this link between order flow and market data, the rebate system helps to support the ability of exchanges to charge ever-higher rents for proprietary market data and direct connectivity. *See* IEX, *The Cost of Exchange Services: Disclosing the Cost of Offering Market Data and Connectivity as a National Securities Exchange* (Jan. 2019), <https://tinyurl.com/y6oav9sd> (finding that fees for market data feeds were as high as 15 times the cost of IEX to produce an equivalent data set). Two of Petitioners here are also fighting the Commission’s recent actions finding those exchanges did not justify certain market data fees, in a dispute pending in separate litigation before this Court. *See The Nasdaq Stock Market LLC and NYSE Arca, Inc. v. SEC*, Nos. 18-1292, 18-1293 (D.C. Cir.).

trade for a client. JA_[84 Fed. Reg. at 5,204]. In 2014, Senator Carl Levin wrote to the Commission urging it to act to address the conflicts created by the maker-taker system. Letter from Senator Carl Levin to Mary Jo White, SEC (July 9, 2014), <https://tinyurl.com/yyxawrvk>. And in 2016, Senators Mark Warner and Mike Crapo praised the then-Commission Chair for recognizing the need for “reforms to mitigate potential broker conflict and ... to enhance transparency.” Letter from Senator Mark Warner & Senator Mike Crapo to Mary Jo White, SEC (Apr. 22, 2016) (“Warner-Crapo Letter”); John McCrank, *Senators back study of contested stock exchange pricing model*, Reuters (Apr. 22, 2016), <https://tinyurl.com/y2jwq66u>.

Even some Petitioners have previously questioned the legality and benefits of the maker-taker system. See Christine Stebbins, *ICE CEO Sprecher wants regulators to look at ‘maker-taker’ trading*, Reuters (Jan. 26, 2014), <https://tinyurl.com/yypwgzo5> (describing efforts by Jeffrey Sprecher, Chairman of Petitioner NYSE and CEO of its parent corporation, to encourage regulators to review maker-taker system because “it hurts everybody in the market”); Bradley Hope & Scott Patterson, *NYSE Plan Would Revamp Trading*, Wall St. J. (Dec. 17, 2014), <https://tinyurl.com/y6edbpum> (quoting Sprecher as having “consistently said” that the maker-taker system “should be ‘illegal’”); see also SEC Br. 9-10.⁶

⁶ Additionally, the former CEO of the electronic trading venue that pioneered rebates declared in 2014 that “[t]he reasons we came out with maker-taker pricing

So it should come as no surprise that the Commission and industry participants have been discussing the need to investigate and address the harm caused by rebates for years. In 2014, then-Commissioner Luis Aguilar proposed a pilot program to temporarily ban maker-taker rebates for certain securities. See Luis Aguilar, *Taking an Informed Approach to Issues Facing the Mutual Fund Industry* (Apr. 2, 2014), <https://tinyurl.com/y2pwjppqo>. And in 2016, the Equity Market Structure Advisory Committee, a panel of market structure experts established to advise the Commission, specifically recommended a pilot program to “better understand, within the context of our current market structure, the effect of access fees on liquidity provision, liquidity taking and order routing with the ultimate goal of improving market quality.” Equity Market Structure Advisory Committee, *Recommendation for an Access Fee Pilot* (July 8, 2016), <https://tinyurl.com/y2pr9nhz>. Senators responsible for SEC oversight agreed that a “sound pilot study of maker-taker pricing can further the goal of ... needed reforms that are based on sound data and that are consistent with the SEC's mandate to promote fair, orderly, and transparent markets.” Warner-Crapo Letter, *supra*.

When, after years of discussion, 61 meetings with industry members, and about 150 public comments, the Commission ultimately adopted a pilot, it did so

... no longer exist” at a congressional roundtable to address market structure. Everett Rosenfeld, *Wall Street elite call for maker-taker changes*, CNBC (Jul. 28, 2014), <https://tinyurl.com/yy2utyfb>.

with the strong support of a majority of commenters—including virtually universal support by investors and entities representing their interests. *See* JA_[84 Fed. Reg. at 5,214] (most commenters thought pilot necessary); SEC, Comments on Proposed Rule: Transaction Fee Pilot for NMS Stocks, <https://tinyurl.com/y3ycy5pa>.

B. The Commission Reasonably Concluded that Potential Market Distortion from Rebates Made It Necessary to Investigate Them.

In adopting the Pilot, the Commission took only a first cautious step toward addressing the long-expressed concerns regarding rebates: gathering essential data to document the extent and nature of market distortions created by the maker-taker system. Petitioners fault (Br. 24-29) the Commission for concluding it needed more data to study this controversial system, rather than reaching a certain conclusion that rebates were harmful before acting. But Petitioners' proposed standard creates a Catch-22 where the Commission must already have conclusive evidence in order to collect the very evidence it needs to form conclusions. IEX agrees with the SEC that Petitioners' proposed standard is contrary to this Court's precedents, and that neither the Exchange Act nor the Administrative Procedure Act require the Commission to conclusively demonstrate that the status quo causes certain harm before instituting a pilot to analyze how a market practice is impairing market structure or harming investors. *See* SEC Br. 28-30.

IEX writes separately to emphasize that this is not a case where the likelihood of market harm—and thus the need to gather data to consider further action—was

speculative or unfounded. On the contrary, the Commission rightly “agree[d]” with commenters that “existing evidence suggest[s] the distortive effect of practices in the market tied to rebates or access fees,” and that a pilot program was needed to “provide sufficient information to inform potential future rulemaking.” JA_[84 Fed. Reg. at 5,238].

That judgment was amply supported by the record. The majority of commenters—including entities representing trillions of dollars invested in the market—supported the Pilot. JA_[*Id.* at 5,214]; IEX, Comment Letter, Appendix (June 27, 2018) (“IEX Comment II”) (listing more than 60 institutional investors that signed letters in support of the Pilot). With good reason. As the Commission recognized, there is substantial evidence that rebates present a conflict of interest for some traders, incentivizing traders to route orders based on rebates, rather than seeking the best price or fastest trade. JA_[84 Fed. Reg. at 5,204-5,205]. Such evidence of potential distortions to order routing, and the resulting harm to investors, is alone sufficient to sustain the Commission’s judgment that the issue requires further study. *See* Br. for Investment Company Inst. & Council of Institutional Investors, Section I.A. But conflicts of interest are far from the only problems created by rebates. As the Commission acknowledged, the record strongly suggests—even if it does not yet establish—that rebates also distort market structure, diminishing transparency, increasing complexity, and limiting competition.

1. One significant harm, documented by several commenters and that the Commission reasonably concluded warranted further study, is market opacity. *See* JA_[84 Fed. Reg. at 5,204 & n.22]. Given the hundreds of different pricing variations for fees and rebates—and the fact that rebates are often determined well after a trade, Royal Bank of Canada Comment at 8—investors, other market participants, regulators, and academics cannot easily determine differences in execution costs on different exchanges. And because the maker-taker model subsidizes high rebates by charging high take fees that far exceed the exchange’s costs to execute trades, it increases the divergence between displayed prices (which do not reflect fees) and actual prices. *See* JA_[Goldman Sachs, Comment Letter, 2-3 (May 24, 2018)]. As IEX’s own experience demonstrates, when there is no need to subsidize rebates, transaction fees can be much lower, and investors can better trust that the displayed price more accurately reflects the true costs of execution.

2. The SEC was also presented with substantial evidence that the increased market complexity spurred by rebates advantages sophisticated market participants at the expense of other investors. JA_[84 Fed. Reg. at 5,205 & n.24]. One of the ways this occurs is that rebate-paying exchanges have developed special order types designed to advantage only sophisticated, rebate-sensitive participants. For example, Petitioners each offer a “post-only” or “add liquidity only” order type to members. *See* NYSE, Add Liquidity Only Order (Oct. 15, 2014), <https://tinyurl.com/y64odm5f>;

Nasdaq, Post-Only Order (2017), <https://tinyurl.com/y6godru5>; CBOE, Partial Post Only at Limit Order (2018), <https://tinyurl.com/y3ufnjvw>. Such rebate-tailored orders allow a member to enter an order to trade while specifying that it wishes only to make liquidity (by placing a resting order on an exchange), and will not take liquidity (by trading against an existing order on an exchange). JA_[84 Fed. Reg. at 5,233] (describing “post-only orders” as “limit orders that include instructions to never remove liquidity,” which “may be more reflective of a rebate-sensitive market participant”).

As a result, a post-only order to buy a stock at \$10.00 will not trade against a resting order to sell the stock at \$10.00. Instead the post-only order will be canceled or temporarily repriced at a lower price. On its face, this seems counterproductive, as it significantly reduces the chance that orders will trade at their specified limit prices—thus impairing market efficiency. But an advantage of this maneuver for *some* market participants—if not for the investors with the limit orders that are not traded against—is that it ensures the “post-only” trader will always receive a rebate if the order is eventually executed.

3. What’s more, rebates impair market structure because they distort competition between markets and between brokers, especially due to volume-based rebate tiers. As for competition between exchanges, rebates make order flow “sticky” because rebate rates generally increase when traders send more volume to a

particular exchange. *See* Harris Comment at 6. Not unlike a frequent flyer's airline allegiance, rebates encourage a trader with substantial volume at one exchange to send more orders to that same exchange. *Id.* This "stickiness" means that routing decisions can be influenced more by rebates than by the likelihood of execution or potential for price improvement. *Id.*

Exchanges, in turn, must compete for order flow based on rebates, instead of competing on any number of other attributes that would drive improved market quality as a whole, such as offering the best prices, largest sizes, or fastest fills. Although not making a finding that this sort of distortion occurs, the SEC recognized that it could be happening. *See* JA_[84 Fed. Reg. at 5,286] (noting the Pilot "could alter competition between exchanges by causing market participants to focus less on differences in fees and rebates and more on other metrics, such as execution quality").

With respect to inter-broker competition, volume-based rebates stifle innovation by making it much harder for small and mid-size brokers to compete with the largest firms. The highest-volume trading firms are much more likely to meet rebate tier requirements that are based on a trader's share of market-wide average daily volume. *See* Royal Bank of Canada Comment at 7. Qualifying for high-volume rebate tiers is a major benefit that effectively enables the highest-volume firms to maintain a low "all-in" cost of trading (summing up transaction rebates, transaction fees and market data fees). Petitioners Nasdaq and CBOE have both revealed that

five of their top brokers receive checks from the exchanges at the end of the month, even after factoring in the high costs of paying for market data, connectivity, and other costs. *See* Statement of Ordovery & Bamberger ¶ 27, in Nasdaq, Comment Letter, SEC Market Data Roundtable (Feb. 13, 2019), <https://tinyurl.com/y4c5s68q>; Statement of Chris Concannon, CBOE, SEC Market Data Roundtable Tr. 74:20-75:2 (Oct. 25, 2018), <https://tinyurl.com/yxtzozam>. Because they tend not to qualify for volume-based rebates, firms with lower trading volume have substantially higher costs on a per trade basis, and thus end up subsidizing firms with higher trading volume. *See* Clearpool, Comment Letter, 3 (Oct. 23, 2018).

These are just some of the ways that rebates impair market structure, all documented in the comment record. *See* JA_ [84 Fed. Reg. at 5,204-5,205]. Coupled with the evidence suggesting that rebates likely harm investors by distorting order routing, the record amply supports the Commission's determination that further study is necessary.

C. By Limiting Rebates, the Pilot Will Benefit Market Structure.

In adopting the Pilot, the Commission engaged in a thorough cost-benefit analysis, as well as an extensive analysis of the Pilot's effects on efficiency, competition, and capital formation. *See* SEC Br. 15-20. And the Commission reached some definitive conclusions—for example, that the Pilot would not have a substantial impact on capital formation. JA_ [84 Fed. Reg. at 5,288]. But the lack of

data precluded the SEC from making precise predictive judgments about the effects of the Pilot on efficiency and competition. *See* JA_[*id.* at 5,280-5,288]. With reason. Obtaining the data needed to make conclusive judgments is the whole point of the Pilot. *See* SEC Br. 31.

Even without being able to pin down the effects of the Pilot with precision, however, the Commission could comfortably predict that the Pilot's benefits—including the major benefit of obtaining essential information to guide future regulatory decisions, JA_[84 Fed. Reg. at 5,259]—outweighed any potential costs. This careful analysis of the Pilot's effects, coupled with a reasonable judgment that “more good than harm will come of” it, satisfies the Commission's obligation of reasoned decision-making. *Maryland People's Counsel v. FERC*, 761 F.2d 768, 779 (D.C. Cir. 1985). In IEX's view, however, the record supports an even sunnier conclusion about the Pilot's benefits. Certainly, the doomsday predictions of Petitioners and their amici (Br. for GTS Securities, LLC, et al. 4-15) are unfounded.

There is plenty of evidence in the record to show that by limiting rebates, the Pilot will have beneficial effects on market structure while in effect. *See* JA_[84 Fed. Reg. at 5,266-67] (discussing potential benefits in terms of lower transaction costs and improved market quality); JA_[*id.* at 5,280-5,281] (describing how the Pilot could “improve the efficiency of capital allocation by lowering execution costs,” and improve price efficiency because “quoted spreads also may more closely reflect the

net cost of trading and could temporarily increase price transparency”). For all the reasons that the Commission reasonably concluded that it was essential to study the effect of rebates, barring them (for some stocks) during the Pilot is likely to produce beneficial effects while the Pilot is underway.

The main argument put forth by Petitioners and their amici to the contrary is that lower rebates will force market-makers to derive their profits from a larger spread between the prices at which they buy and sell shares, and investors will be harmed when bid-ask spreads increase. *See* Br. for GTS Securities, LLC, et al. 4-15; Petrs. Br. 9.

This argument ignores a number of realities about the markets. First, there is no reason to believe there will be a substantial increase in bid-ask spreads, even for the stocks in the no-rebate test group. The average rebate is just a fraction of the average spread. Rebates typically equal about \$0.0030 per share—that is, one third of one cent. The average spreads for issuers who commented on the Pilot ranged from \$0.07 to \$0.95. Themis Trading, Comment Letter, 1-2 (Aug. 16, 2018), (disclosing spreads of issuers who had commented on Pilot). One-third of one cent is a de minimis percentage of these larger spreads. For the most active stocks, on the other hand, the spreads are already so narrow that prohibiting rebates is not likely to affect them. The Pilot is highly unlikely to widen bid-ask spreads for those stocks because the natural spread (even in the absence of rebates) is already narrower than

the minimum tick size (*i.e.*, the mandatory difference between prices), which is one penny. JA_[84 Fed. Reg. at 5,276].

Second, there is a market maker exception in the Pilot that allows exchanges to continue to offer economic incentives to market makers to encourage them to provide liquidity to markets by meeting objective metrics. JA_[*Id.* at 5,222-5,223]; p. 9, *supra*. These incentives provide market makers with specific incentives to promote liquidity (without the harms of a rebate-based system), thus reducing the likelihood of any substantial narrowing of bid-ask spreads.

Third, investors in the market are the true drivers of liquidity. A market maker chasing rebates is the definition of a fair-weather friend for an issuer, because in times of real volatility, a rebate worth one third of a cent will not provide sufficient incentive to take investment risk. When Petitioner Nasdaq conducted its own limited study in reducing access fees and rebates in 2015, it found that while liquidity provided by “fee sensitive electronic market makers” decreased, other firms representing buy side and retail investors stepped up to fill that role, and increased the degree to which they provided liquidity. Eric Stockland & Stan Feldman, *Cracks in the Pillar*, 4-6, in IEX, Comment Letter (Aug. 8, 2018).⁷

⁷ Petitioners’ amici claim (Br. 10-12) that the recent Tick Size Pilot proves that wider spreads harm investors. But there is no comparison between a pilot that mandated larger spreads, in some instances requiring them to be at least five cents, and a pilot that would study much smaller changes in fees and rebates (e.g., a third of a cent), that may or may not widen spreads by a small amount.

Finally, even if even if some spreads widen, quoted spreads are not perfect, or even very good, proxies for market efficiency and market quality. Wider spreads can actually improve liquidity if more brokers are encouraged to make offers because of the greater rewards. Harris Comment at 8. And quoted spreads do not motivate traders. Mehmet Kinak, Global Head of Trading and Market Structure at T. Rowe Price, testified recently at a meeting of the SEC's Investor Advisory Committee that he does not execute trades on the basis of the quoted spread. Video, Meeting of Investment Advisory Committee 2:09-2:10 (Mar. 28, 2019), <https://tinyurl.com/y3babs2o>. Ultimately, markets function best when investors are able to buy and sell stock based on their analysis of the value of that investment—whether the underlying asset is currently undervalued or overvalued—without prices being obscured or distorted by rebates.

At the end of the day, Petitioners and their amici are trying to make a case for investor harm that investors themselves don't endorse. Dozens of entities representing institutional investors, including the country's most sophisticated firms like Vanguard and T. Rowe Price, supported the Pilot. *See* IEX Comment II, Appendix. Those companies are best positioned to evaluate their own interests.

II. The Data Generated By The Pilot Is Essential And Cannot Be Obtained Another Way.

The Pilot will collect vital data about the U.S. stock market, enabling the Commission to decide whether and how to make evidence-based regulatory changes.

It is an important—and temporary!—plan for the Commission to adjust certain rules for certain stocks for a year or two to see how market participants actually respond to a new environment. The Commission cannot gather the data it needs without this sort of study, and none of the alternatives proposed by Petitioners can achieve the same ends. Nor will the data emerge in the absence of Commission action. As the SEC recognized, the necessary data cannot be gathered, and the market will not evolve, without the Commission’s imposition of external rules that apply to all exchanges, because competitive pressures “serve as a barrier to market-led reforms in this area.” JA_ [84 Fed. Reg. at 5,214]. IEX’s experience as a flat-fee exchange in a maker-taker world confirms that rebates cannot be reformed—or even effectively studied—without an external constraint imposed by the Commission.

A. The Alternatives Proposed by Petitioners Are Insufficient and Would Not Address the Market Structure Effects of Rebates.

None of the alternatives suggested by Petitioners could gather the sort of useful data that is needed right now. Petitioners argue (Br. 52-56) that the Commission could have achieved the goals of the Pilot by: (i) gathering more existing routing data from broker-dealers; (ii) requiring increased disclosure of routing data by broker-dealers; (iii) strengthening and better articulating broker-dealers’ duty of best execution; and (iv) allowing issuers to opt out of having their stock included in the Pilot.

But these proposed alternatives would not analyze how the entire stock market system ecosystem is affected by rebates. The first three proposed alternatives address solely the potential conflict of interests created by the maker-taker system, but do not address the critical issues of market structure—and none of them have the benefit of actually removing the conflict. *See* JA_[84 Fed. Reg. at 5,203] (noting the pilot is necessary to study the effect of rebates not only on “order routing behavior,” but also “market structure”). Further, those alternatives address the inherent conflicts imperfectly, at best. The Commission reasonably determined that the best way to establish (or disprove) a causal link between rebates and routing behavior was to remove rebates for a group of test stocks. JA_[*Id.* at 5,253]. Attempting to divine how rebates affect routing behavior by gathering more data in a rebate-driven system is much less effective than comparing how market participants actually behave in the absence of rebates.

The last alternative—to allow issuers to opt out—would distort the results of the Pilot. If some issuers opted out, it would add additional complexity to the data analysis, introducing selection bias and potentially confusing the issue of how the rebate limitations affected the market. JA_[*Id.* at 5,213]; SEC Br. 52-53. The plain insufficiency of Petitioners’ alternatives show that Petitioners’ real objection is to the Commission taking any action to limit rebates, even for a test period. By attempting to impede the Commission from the only realistic way of obtaining

essential data, while simultaneously insisting that the Commission cannot act without more certainty, Petitioners are effectively arguing that the Commission is powerless to respond in any meaningful way to longstanding investor and industry concerns about the harms caused by rebates. There is no basis in logic or law for such a constrained view of the Commission's authority.

B. The Pilot Does Not Need to Include Alternative Trading Systems.

Contrary to Petitioners' argument (Br. 48-52), the Commission is not "discriminating" against exchanges by excluding alternative trading systems ("ATs") from the Pilot; it is accurately recognizing the different regulatory environment in which ATs operate.

As a former ATs, IEX understands well how different the regulatory regimes are for exchanges, as compared to ATs. ATs are not governed by the NMS rules regarding trades and quotes. JA_[84 Fed. Reg. at 5,205-5,206]. They operate very differently from exchanges, with "bespoke" fee arrangements negotiated separately between each market participant and trading venue. JA_[*Id.* at 5,206]. Recently the Commission enacted a new set of rules for ATs, requiring increased disclosures to allow market participants to better assess potential conflicts of interests and risks of information leakage arising from ATs. *See* Regulation of NMS Stock Alternative Trading Systems, 83 Fed. Reg. 38,768 (Aug. 7, 2018). But the regulatory structure is still nothing like the much more stringent rules governing exchange operations.

Exchanges and ATSS are far from similarly situated with respect to rebates, and there is nothing in the purpose of the Pilot that compelled the Commission to include ATSS within the scope.

* * * * *

Investors and others have clamored for Commission action on rebates for years, given the substantial evidence that rebates create conflicts of interest and impair market structure. IEX believes so strongly that rebates harm the market that it has declined to offer them, even though doing so makes it much harder for IEX to compete within the confines of the current system. The SEC's decision to take a first, measured step towards addressing this problem is thoroughly considered, reasonable, and essential to repairing the damage done to markets by the evolution of fee-and-rebate structures that benefit only a few market participants at the expense of everyone else.

CONCLUSION

The petition for review should be denied.

Respectfully submitted,

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August 1, 2019

CERTIFICATE REGARDING SEPARATE BRIEF

Pursuant to D.C. Circuit Rule 29(d), I certify that a separate amicus brief is necessary because of the unique perspective offered by amicus as the only exchange that does not pay rebates, and as a former alternative trading system.

/s/ Hyland Hunt

Hyland Hunt

August 1, 2019

CERTIFICATE OF COMPLIANCE

This amicus curiae brief is in 14-point Times New Roman proportional font and contains 6,331 words as counted by Microsoft word, excluding the items that may be excluded. The brief thus complies with the type-face, style, and volume limitations set forth in Rule 29(a)(5) and 32(a)(5)–(7)(B) of the Federal Rules of Appellate Procedure.

/s/ Hyland Hunt

Hyland Hunt

August 1, 2019

CERTIFICATE OF SERVICE

I hereby certify that, on August 1, 2019, I served the foregoing amicus curiae brief upon all counsel of record by filing a copy of the document with the Clerk through the Court's electronic docketing system.

/s/ Hyland Hunt

Hyland Hunt