

March 15, 2019

Via Electronic Delivery

Mr. Christopher J. Kirkpatrick
Secretary of the Commission
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: ICE Futures Rule 4.26 Order Execution (New Passive Order Protection Functionality); Submission No. 19-119

Dear Mr. Kirkpatrick –

We are currently serving as elected CTA/CPO Representatives on the National Futures Association (NFA) Board of Directors. We represent a constituency of over 3,000 registered NFA members, and with the limitations discussed below, are writing in support of the ICE Proposal for Passive Order Protection¹.

Each of us and our firms has an extensive background in the futures industry and trade execution, going back to the era of the trading pits before the introduction of electronic markets. We have experienced the market's evolution firsthand, and on behalf of our customers are keenly sensitive to issues of fairness in the filling of orders.

The promise of electronic markets is to provide a level playing field in which all orders compete equally for the best fills. In the days of open outcry the floor traders clearly had an opportunity to profit from customer orders, and were well paid for executing them. In today's world, the co-located computer has taken the place of the floor, with the exchanges, for a price, providing lower latency access to markets, which we contend inherently puts other market participants at a disadvantage.

Trading has evolved to become more of a speed contest than a price competition, as increasing resources are devoted to reducing latency to gain a time advantage. See [“Stop the high-frequency traders arms race”, Financial Times, December 27, 2012,](#) “a one millisecond advantage over a competitor will beat that competitor 100 per cent of the time”, and “Flash Boys: A Wall Street Revolt,” Michael Lewis, W.W. Norton and Company, 2014.

Several ‘fixes’, including “speed bumps” and “frequent batch auctions”, some of which have already been deployed globally in various forms^{2 3 4}, are designed to create a level playing field

¹ The views expressed in this letter are our own and not those of NFA.

² IEX, a US based stock exchange founded in 2012, has implemented a ‘speed bump’ that pauses inbound orders for 350 microseconds before relaying them to the exchange for execution. Similarly, NYSE introduced a ‘speed bump’ on NYSE American, in July 2017.

where all orders compete equally. We are in favor of the proposed speed bump because if ICE is correct in assessing the impact, it would enable resting orders to compete fairly against incoming orders. Given the way a Central Limit Order Book functions in terms of order sequencing and filling, if there is a new piece of market moving news, under the status quo a new order would likely be able to trade against a resting order before the resting order could be modified or canceled.⁵

We concur with the comments of then SEC Chair Mary Jo White in her June 5, 2014 speech “Enhancing our Equity Market Structure”:

We must consider, for example, whether the increasingly expensive search for speed has passed the point of diminishing returns. I am personally wary of prescriptive regulation that attempts to identify an optimal trading speed, but I am receptive to more flexible, competitive solutions that could be adopted by trading venues. These could include frequent batch auctions or other mechanisms designed to minimize speed advantages. ... A key question is whether trading venues have sufficient opportunity and flexibility to innovate successfully with initiatives that seek to deemphasize speed as a key to trading success in order to further serve the interests of investors. If not, we must reconsider the SEC rules and market practices that stand in the way.

In [“Will the Market Fix the Market? A Theory of Stock Exchange Competition and Innovation,” Budish, Lee and Shim, February 27, 2019](#), the authors contend that if an exchange adopts a new design that eliminates latency arbitrage advantages, it will potentially win more market share, and if this pans out, the other exchanges are likely to compete by adopting a similar approach. If the authors are correct, the role of regulators will be to encourage this activity without having to impose solutions, as the exchanges themselves level the playing field through a competitive process.

We recognize that a number of market participants profit from the current structure and that they are opposed to the proposed speed bump, which would likely deprive them of a time advantage that they are currently exploiting⁶. Claimed objections relate to the increased likelihood of “spoofing”, “reduced liquidity”, and that the asymmetric delay will provide a “last look”. We think these claims are unfounded for the following reasons:

- Spoofing is not typically done through resting orders so is not likely to increase, and in addition is already subject to criminal sanctions which act as a material deterrent.

³ CBOE operates a MiFID II compliant periodic auction book for European equities.

⁴ [Eric Budish](#), a PhD Economist and Professor of Economics at the University of Chicago Booth School of Business, along with associates, has written extensively on market structure and design. See: [The Quarterly Journal of Economics Vol. 130 November 2015 Issue 4 The High-Frequency Trading Arms Race: Frequent Batch Auctions as a Market Design Response](#).

⁵ [See Comment Letter on Chicago Stock Exchange Proposal for an asymmetric speed bump, submitted by Eric Budish, October 13, 2016](#).

⁶ When evaluating the comment letters you receive, we would encourage you to determine whether the sender profits from the current structure, and then decide what weight to give their input.

- The proposal may in fact increase liquidity (the intent of ICE) by improving the state of the resting orders v the incoming orders, thereby fostering the placing of more resting orders and the creation of a deeper market.
- An asymmetric speed bump will not provide an unfair last look because the liquidity provider will not see that someone wants to trade against their resting order before canceling it. Rather, the liquidity provider will have the opportunity to cancel a stale quote at the same time another market participant is trying to pick off the stale quote. This will arise where both parties react to the same external information e.g. a price change on a related market. If the liquidity provider is unaware of the new information and therefore doesn't know/think that their order is stale, the liquidity provider will leave the resting order as is and the incoming order will be filled. It is only when both parties try to act at essentially the same time that the speed bump should affect outcomes.

While we think the above three objections are unfounded, we do share the concerns raised by SEC Investor Advocate Rick Fleming with regard to the proposed CHX asymmetric speed bump⁷. However, the CHX proposal was withdrawn, and in the absence of more data we do not think it is possible to assess the extent to which the Investor Advocate's concerns apply to the ICE proposal, or to predict with any certainty the impact of the ICE proposal. From our perspective there are problems with the current market structure that clearly provide a speed advantage to some participants, and there may well be problems with the ICE proposal. On balance, the ICE proposal, even if flawed, will generate useful data in understanding market structure and answering the questions that have been raised.

Accordingly, we are in favor of the Commission granting approval, limited to gold and silver futures for a specified period of time, with the requirement that ICE monitor the effect of the speed bump with reference to pre-agreed metrics to establish whether or not it improves market conditions, or leads to trade practice abuses. The data gathered through the monitoring will allow the Commission and ICE to make an informed decision whether the speed bump is a useful innovation in the evolution of the markets that may have broader application.

In the US, CME Group is the primary futures market for gold and silver, with ICE secondary thereby providing an arbitrage opportunity. Competition among exchanges is intense, and from our perspective the ICE proposal is an innovative way to enable orders placed with it to compete on price as opposed to time at CME. This is the way market structure should evolve – it is good public policy and furthers the purpose of the CFTC “to promote responsible and fair competition” among exchanges⁸.

Respectfully submitted,

⁷ See <https://www.sec.gov/comments/sr-chx-2017-04/chx201704-3169295-161957.pdf> We think that concerns raised based on the Toronto Stock Exchange (TSX) asymmetric speed bump are not relevant because it was random. See “The Value of a Millisecond” https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2860359

⁸ See Commodity Exchange Act, Chapter 1, Commodity Exchanges, Sec. 5(b), Purpose.

Douglas Bry, Senior Strategist
Welton Investment Partners
Eastwood Building
San Carlos Between 5th and 6th
PO Box 6147
Carmel, CA 93921
303-478-6608
dbry@welton.com

Ernest Jaffarian, CEO & CIO
Efficient Capital Management, LLC
4355 Weaver Parkway, Suite 200
Warrenville, IL 60555
630.657.6801
jaffarian@efficientcapital.com

Martin Lueck, Director of Research
Aspect Capital Limited
10 Portman Square | London W1H 6AZ
Tel: +44 20 7170 9700
martin.lueck@aspectcapital.com

CC: The Hon. J. Christopher Giancarlo, Chairman
The Hon. Brian D. Quintenz, Commissioner
The Hon. Rostin Behnam, Commissioner
The Hon. Dawn DeBerry Stump, Commissioner
The Hon. Dan M. Berkovitz, Commissioner
Mr. Mike Gill, Chief of Staff to the Chairman
Mr. Amir Zaidi, Director, Division of Market Oversight