CITADEL | Securities

March 15, 2019

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

Re: ICE Futures U.S. Proposed Asymmetric Delay (Industry Filing IF 19-001)

Dear Mr. Kirkpatrick:

Citadel Securities[1] appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") on the proposal by ICE Futures U.S., Inc. ("ICE") to implement an asymmetric delay for certain futures contracts (the "Asymmetric Delay").[2]

According to the proposal, ICE will apply a delay to incoming liquidity taking orders, thereby effectively providing a select group of highly sophisticated liquidity providers with a "last look" that enables them to back away from their otherwise firm, displayed quotations. While ICE indicates that the Asymmetric Delay will be initially limited to gold daily and silver daily contracts, the proposed rule change provides ICE with the ability to implement a similar delay for any or all contracts on the exchange, and would create a precedent that could dramatically and adversely impact the entire U.S. futures market.

We urge the Commission to disapprove the ICE proposal. ICE has failed to demonstrate how creating an unprecedented structural advantage for a select group of liquidity providers is consistent with the Commodity Exchange Act ("CEA") and Commission regulations. Below, we detail why asymmetric delays impair market quality, resiliency, efficiency, and fairness. We then describe how the ICE proposal is inconsistent with the CEA and Commission regulations, not only as a result of unfairly discriminating against certain market participants, but also for failing to protect the price discovery process, to promote fair and equitable trading, and to prevent manipulative activity.

[1] Citadel Securities is a leading global market maker across a broad array of fixed income and equity securities. In partnering with us, our clients, including asset managers, banks, broker-dealers, hedge funds, government agencies and public pension programs, are better positioned to meet their investment goals.

[2] ICE Futures U.S. Submission No. 19-119, Amendments to Rule 4.26 Order Execution (Feb. 1, 2019), available at https://www.cftc.gov/sites/default/files/2019-02/ICEFuturessPassiveOrder020119.pdf?mod=article_inline ("ICE Filing").

I. The Asymmetric Delay Impairs Market Quality, Resiliency, Efficiency and Fairness

The Asymmetric Delay applies only to liquidity taking orders, effectively giving liquidity providers a "last look" structural advantage that allows them to selectively decide whether to honor firm, displayed quotations based on current market conditions. Awarding liquidity providers this type of structural advantage impairs market quality, resiliency, efficiency, and fairness in several ways:

- **Denying investors access to firm and reliable prices**. The ability of market participants to access firm, displayed quotations is a cornerstone of open, fair and transparent markets. The Asymmetric Delay enables liquidity providers to cancel or modify displayed quotations if they detect the market has moved to their disadvantage while liquidity taking orders are delayed (and not afforded the same opportunity). This means that market participants attempting to trade against firm, displayed quotations may find them no longer available once the delay has expired. As investors are denied reliable access to publicly displayed quotations, their confidence in the accuracy and transparency of market prices will be undermined, negatively impacting market liquidity.

- **Introducing inequitable "last look" functionality that has been denounced in other markets**. The Asymmetric Delay effectively provides liquidity providers with a "last look" to selectively decide whether to honor firm, displayed quotations based on current market conditions. Importantly, a liquidity provider need not know the specific terms of an actual incoming order in order to benefit from this new "last look" functionality. Instead, the liquidity provider need only assess current market data in real-time to determine whether the market has moved unfavorably while potential incoming orders are being delayed. In practice, this "last look" allows liquidity providers to honor their quotations only when it is in their ultimate economic interest, and to otherwise back away from their quotations at the expense of other market participants.

- **Creating the illusion of greater liquidity that is inaccessible when needed most**. Allowing liquidity providers to selectively cancel their quotations while incoming orders are delayed creates an illusion of greater liquidity than actually is accessible. This dynamic will be most pronounced during periods of market volatility, when liquidity providers will most likely take advantage of the ability to cancel or modify resting quotations. The Asymmetric Delay will, therefore, increase the risk of short-term price dislocations and only exacerbate concerns about market resiliency and liquidity during periods of market volatility.

- **Advantaging highly sophisticated liquidity providers at the expense of ordinary investors**. Only a select group of liquidity providers can take advantage of the 3 millisecond delay that is proposed to be applied to liquidity taking orders. The Asymmetric Delay is designed specifically for those liquidity providers, to the detriment of the rest of the market.

Overall, the Asymmetric Delay is based on the false premise that liquidity providers must be given a structural advantage over liquidity takers in order to "level the playing field."[3] This ignores the inherent risks and rewards associated with providing liquidity through resting orders. By displaying a quote, a liquidity provider is choosing to invite liquidity takers to execute against it, thereby hoping to earn the spread between its bid and offer quotations. However, at the same time, there is a risk that the market moves against the liquidity provider and an unfavorable execution occurs before the displayed quotation can be cancelled or modified. The Asymmetric Delay seeks to eliminate the risk side of this equation for liquidity providers, in essence ensuring that all executions will be favorable from their perspective. This would dramatically alter current market dynamics and disadvantage all other market participants.

II. The Asymmetric Delay Is Inconsistent with the Commodity Exchange Act

A. The Asymmetric Delay Unfairly Discriminates Against Other Market Participants

A DCM is required to provide market participants with "impartial access to its markets and services."[4] However, the Asymmetric Delay gives a select group of highly sophisticated liquidity providers preferred access to ICE's markets in a manner that is inconsistent with this requirement.

The Asymmetric Delay is discriminatory on its face, as it will be applied only to certain orders and exchange participants (i.e. liquidity takers). As a result, liquidity providers are given a structural advantage that allows them to selectively decide whether to honor firm, displayed quotations based on current market conditions while incoming orders are delayed. ICE acknowledges that this is the clear intent of the Asymmetric Delay, stating that the delay will provide liquidity providers with "time to react to external market conditions (e.g. a price change in the related market)."[5]

This structural advantage results in at least three forms of unfair discrimination that benefit a select group of highly sophisticated liquidity providers on ICE. First, these liquidity providers are advantaged compared to liquidity takers when interacting on ICE, as they can opt to honor their quotations only when it is in their economic interest to do so, unlike other exchange participants. Second, since only these liquidity providers have the technological capabilities to utilize the Asymmetric Delay, they are advantaged compared to other market participants submitting resting orders on the exchange. Third, these liquidity providers on ICE will be advantaged compared to liquidity providers operating in other markets. Specifically, the liquidity providers on ICE will be able to leverage the price discovery being provided by liquidity providers in other markets by using the associated data regarding quotations and executions to adjust their displayed quotations on ICE to avoid unfavorable executions.

All of these forms of unfair discrimination may negatively impact market liquidity and price discovery. Liquidity takers are denied access to firm and reliable prices, while other market participants may be discouraged from submitting resting orders if they are unable to effectively utilize the delay. Separately, price discovery on other markets may degrade due to those liquidity

[3] ICE Filing at page 1.

[4] Commission Regulation §38.151(b).

[5] ICE Filing at page 1.

providers being placed at a disadvantage compared to the liquidity providers operating on ICE. As a result, we urge the Commission to avoid creating the problematic precedent that it is acceptable for a limited group of exchange participants to be granted a structural advantage that provides preferential access when interacting in the U.S. futures market.

We note that the Asymmetric Delay is fundamentally different than exchange incentive or fee discount programs. Incentive programs for market makers typically include defined obligations, such as minimum quoting criteria, in order to ensure that the program is balanced and does not create an unfair advantage for specific market participants. In contrast, ICE does not propose requiring liquidity providers to satisfy any obligations in order to utilize the Asymmetric Delay. Fee discount programs are typically based on objective criteria, such as trading volume, and are available to all exchange participants. In contrast, there is no way for a liquidity taker to utilize the Asymmetric Delay as a liquidity provider does.

B. The Asymmetric Delay Does Not Protect the Price Discovery Process and Fails to Promote Fair and Equitable Trading

DCMs are required to provide a "competitive, open, and efficient market" and a "mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade."[6] In addition, DCMs are required to "promote fair and equitable trading."[7] The Asymmetric Delay is inconsistent with these statutory requirements.

As detailed above, the Asymmetric Delay frustrates the ability of market participants to access firm, displayed quotations on ICE's centralized market, as liquidity providers are able to cancel or modify displayed quotations if they detect the market has moved to their disadvantage while liquidity taking orders navigate the delay. This undermines confidence in the accuracy of displayed prices, and can create the illusion of greater liquidity than actually is accessible, particularly during periods of market volatility. As a result, the Asymmetric Delay negatively impacts the price discovery process on ICE's centralized market.

In addition, providing a select group of highly sophisticated liquidity providers with a structural advantage that allows them to avoid unfavorable executions fails to promote fair, equitable, and efficient trading. The stated intent of the Asymmetric Delay is to give these liquidity providers a "window to modify their Exchange orders where there is a price change in a related market."[8] No other exchange participant is provided with a similar opportunity. The Asymmetric Delay is specifically designed to alter the current competitive balance between liquidity providers and liquidity takers by giving a select group of exchange participants an unfair, inequitable, and inefficient structural advantage that overrides free market competition.

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[6] 7 U.S.C. § 7(d)(9).

[7] 7 U.S.C. § 7(d)(12).

[8] ICE Filing at page 2.

C. The Asymmetric Delay May Be Susceptible to Manipulation

DCMs may only list contracts that "are not readily susceptible to manipulation."[9] In addition, DCMs have the responsibility to prevent manipulation and price distortion on their markets.[10] However, implementing an Asymmetric Delay may cause the relevant contracts to become more susceptible to manipulation (such as spoofing), as liquidity providers will have the opportunity to deliberately post quotations that they have no intention of honoring and that are instead solely designed to move market prices. This concern may be most pronounced during periods of market volatility, when liquidity providers will most likely take advantage of the ability to cancel or modify resting quotations.

ICE has failed to detail how the exchange will monitor and prevent this type of activity from occurring as a result of the Asymmetric Delay, including how it will distinguish between *bona fide* cancellations and disruptive trading activity. In addition, monitoring and surveillance is not an adequate cure for improper market structure design. The Commission should closely analyze the potential impact of the Asymmetric Delay and whether it may result in the relevant contracts being more susceptible to manipulation.

III. ICE Has Failed to Justify the Asymmetric Delay

DCMs are required to explain how a proposed rule change is consistent with the CEA and Commission regulations.[11] In this case, ICE has failed to meet its burden.

The ICE rule filing provides little detail regarding a number of important topics, including:

- the anticipated impact of the Asymmetric Delay on market quality, resiliency, efficiency, and fairness, with supporting data and academic research;[12]
- why the length of the delay was set at 3 milliseconds, with supporting data;
- how ICE would determine whether to implement the Asymmetric Delay for other contracts; and

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[9] 7 U.S.C. § 7(d)(3).

[10] 7 U.S.C. § 7(d)(4).

[11] 17 C.F.R. § 40.6(a)(7)(v).

[12] We note that academic research in the equities markets suggests that asymmetric speed bumps tend to result in wider spreads and worse market quality, and primarily benefit the most sophisticated liquidity providers. *See* Haoming Chen et al., "The value of a Millisecond: Harnessing Information in Fast, Fragmented Markets" (Nov. 18, 2017), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2860359. We also note the concerns raised by a wide variety of market participants with respect to an asymmetric speed bump proposed by the Chicago Stock Exchange, which was later withdrawn (https://www.sec.gov/comments/sr-chx-2017-04/chx201704-4118079-171622.pdf). *See, e.g.*, Recommendation of the SEC Investor Advocate (Feb. 28, 2018), available at: https://www.sec.gov/comments/sr-chx-2017-04/chx201704-3169295-161957.pdf and Comment Letter from Healthy Markets Association (Mar. 17, 2017), available at: https://www.sec.gov/comments/sr-chx-2017-04/chx201704-1648304-148475.pdf.

- an analysis of consistency with relevant statutory requirements, including DCM core principles 2, 3, 4, 9, and 12, and Commission regulation §38.151.

Importantly, the ICE rule filing also fails to identify the existence of a market-wide problem in the U.S. futures market that would warrant an exchange taking the unprecedented step of implementing an asymmetric delay. Instead, ICE appears to be narrowly focused on gaining market share in contracts where the "price discovery takes place in a related market."[13] However, the Asymmetric Delay will establish a precedent that may result in a proliferation of asymmetric delays throughout the U.S. futures market. In this regard, we note that the ICE rule filing is not limited to Gold Daily and Silver Daily contracts, and instead allows ICE to implement the Asymmetric Delay to any contract "as determined by the Exchange from time to time in its discretion."[14]

We urge the Commission to carefully consider the ramifications of concluding that the Asymmetric Delay is consistent with the CEA, despite the lack of an identified market-wide problem. A proliferation of asymmetric delays could negatively impact market quality, resiliency, efficiency, and fairness throughout the U.S. futures market, and negatively impact related markets that rely on the price discovery provided by futures, such as the U.S. Treasury market, physical commodities markets, and OTC derivatives markets.

Granting a select group of liquidity providers the ability to back away from firm, displayed quotations is an unprecedented structural advantage that would dramatically and adversely impact current market dynamics and the competitive balance between liquidity providers and liquidity takers in the U.S. futures market. In our view, for the reasons set forth above, Commission disapproval of the ICE proposal is necessary in order to prevent substantial harm to the markets and market participants.

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For the reasons detailed above, we urge the Commission to disapprove the ICE rule filing. Please feel free to call the undersigned at (646) 403-8200 with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger
Managing Director
Global Head of Government & Regulatory Policy

[13] ICE Filing at page 2.

[14] ICE Filing at Exhibit A. ICE also has the discretion to modify the length of the delay in its discretion.