

June 1, 2015

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-05-15; Exemption for Certain Exchange Members

Dear Mr. Fields:

The Chicago Stock Exchange, Inc. (the “Exchange” or “CHX”) respectfully submits this comment letter in connection with the Securities and Exchange Commission’s (the “SEC” or “Commission”) solicitation of comments to the above-referenced proposal to amend Rule 15b9-1 (“Rule”) under the Securities Exchange Act of 1934 (“Act”), which exempts certain brokers or dealers from membership in a registered national securities association (“non-member”), pursuant to Section 15(b)(8) of the Act (“proposed amendment”).¹ Specifically, the proposed amendment would replace the current gross income allowance in the Rule with a narrower exemption from Association membership for a broker or dealer that carries no customer accounts and effects transactions on a national securities exchange.² The proposed amendment would also create an exemption for a dealer that effects transactions off the exchange of which it is a member solely for the purpose of hedging risks of its floor-based activity, or a broker or dealer that effects transactions off the exchange resulting from orders that are routed by a national securities exchange of which it is a member, to prevent trade-throughs consistent with the provisions of Rule 611 of Regulation NMS.³

The Exchange agrees with the Commission that the Rule should be amended to better align the scope of its exemption, in light of today’s market activity, with Section 15(b)(8) of the Act and the Commission’s original purpose in adopting Rule 15b9-1.⁴ However, the Exchange believes that limiting the exemption, as described above, would result in an imprudent concentration of regulatory oversight responsibility with one self-regulatory organization (“SRO”) (*i.e.*, the Financial Industry Regulatory Authority, Inc. (“FINRA”)), which may achieve the Commission’s goal of efficient oversight of the off-exchange trading activity of non-members, but will do so at the certain cost of regulatory resiliency and innovation. The Exchange also believes that, in light of the ongoing trend away from floor-based equities trading activity, the proposed exemptions should

¹ See Exchange Act Release No. 74581 (March 25, 2015), 80 FR 18035 (April 2, 2015) (“Release”).

² See id.

³ See id.; see also 17 CFR 242.611.

⁴ See supra note 1.

be expanded to better reflect the bona fide hedging and exchange-based routing activities extant in today's markets.

The Exchange believes that the proposed amendment raises serious single point of failure concerns and would discourage innovation in regulatory surveillance and oversight practices, which are particularly dangerous in light of today's ever-changing markets. No single market operates in isolation. Seemingly innocuous or routine activity on one market may inform another market of illicit trading activity on its own market (e.g., spoofing on one market to impact the NBBO and pricing of orders on another market). The Exchange believes that effective regulation of such cross-market activity requires multiple reviews of the same data from the unique vantage points of the respective SROs. In fact, this practice is already a key part of the current well-established regulatory framework, premised upon cooperation between the SROs and statutorily delegated regulatory authority, pursuant to Section 17(d) of the Act. Thus, regulating off-exchange activity necessarily requires regulatory redundancy.

The Exchange further believes that the proposed amendment is unnecessarily broad in light of the upcoming deployment of the Consolidated Audit Trail ("CAT"), which will provide all SROs with the necessary data to effectively surveil the cross-market trading activity of all market participants. All SROs have contributed significant resources in developing CAT. As such, the Exchange absolutely intends to derive the maximum value from CAT once it is implemented.

The Exchange recognizes, however, that enhancements must be made to the current regulatory framework to address the jurisdictional concerns raised by the Commission.⁵ The Exchange believes that these concerns can be effectively addressed through the adoption and enforcement of more robust SRO rules concerning the cross-market trading activity of its members, so as to harmonize with the relevant FINRA rules. Accordingly, the Exchange believes that, through a combination of the CAT data, more robust SRO rules concerning cross-market trading activity and the current well-established regulatory framework, all SROs could be well-positioned to provide the best solution to the Commission's concern regarding regulation of the off-exchange activity of non-members.

Thus, as an alternative to the proposed amendment, the Exchange respectfully requests that the Commission amend the Rule to permit non-members to maintain membership or become members of a national securities exchange, in lieu of becoming a member of a national securities association, provided that the national securities exchange -1- maintains rules that adequately address oversight of, and jurisdiction over, off-exchange trading activity of its members and -2- has developed surveillance technology and specialized regulatory personnel to surveil, supervise and enforce such off-exchange activity.⁶ The Exchange believes that the latter will be largely addressed by CAT data, which the individual SROs would leverage by utilizing its surveillance to

⁵ See supra note 1.

⁶ In the Release, the Commission recognized that "while today an exchange may not be able to effectively regulate off-exchange activity, it may be able to acquire the resources and expertise to do so." See Release at footnote 81.

review the relevant cross-market activity, which would, in turn, promote innovation in surveilling such activity. In light of the importance of the CAT data to the Exchange's proposal, the Exchange also requests that any amendment to the Rule become operative sometime after the relevant CAT data becomes available to the SROs. To this end, the Exchange is prepared to adopt and enforce more robust rules, pursuant to Rule 19b-4 under the Act, governing cross-market trading activity of its Participants. The Exchange submits that with the upcoming deployment of CAT and its adoption of more robust trading practices rules that harmonize with the relevant FINRA rules, combined with an investment in additional regulatory resources and its experience and expertise in running its existing, established and comprehensive market surveillance program, the Exchange, consistent with its obligations as a national securities exchange, will be able to effectively surveil and enforce rules regarding the off-exchange activity of its Participants.

The Exchange further believes that the proposed Rule 15b9-1(c) exemptions regarding off-exchange activities to hedge floor-based activities and exchange-based Rule 611 of Regulation NMS compliant routing should be expanded to permit non-members to engage in a larger number of legitimate and necessary hedging and routing activities without being required to become a member of a national securities association.

Specifically, the Exchange recommends that the proposed "floor-based" limitation to exempt off-exchange hedging activity should be removed as it does not accurately reflect the scope of bona fide hedging activity utilized in today's markets. For example, a non-member that wishes to execute an off-exchange transaction to reduce or liquidate an existing position should be permitted to execute such a transaction without becoming a member of a national securities association, because such reduction or liquidation constitutes bona fide hedging activity to an existing position, irrespective of where or how the position was acquired.

The Exchange also recommends that the exemption regarding exchange-based routing of orders should be expanded to include all exchange-based routing activity, including, but not limited to, routing effected for Regulation NMS-compliance and best execution purposes. This is because the proposed exemption does not contemplate the full array of legitimate and necessary exchange-based routing activity effected in today's markets. For example, the Exchange currently permits routable incoming odd lot orders to be routed away to execute against better priced Protected Quotations of external markets, instead of executed within the CHX Matching System at an inferior price, even though odd lots could permissibly trade through Protected Quotations of external markets.⁷ The proposed exemption does not seem to contemplate such routing for best execution purposes. Another example would be routing of orders in compliance with the proposed "trade-at" prohibition of the upcoming Tick Size Pilot Program,⁸ which would not be effected for Rule 611 compliance purposes. Moreover, given that all exchange-based routing functionalities must be approved by the Commission, pursuant to Rule 19b-4 under the Act, the Exchange

⁷ See CHX Article 19, Rule 3(a)(2); see also 17 CFR 242.611; see also "Responses to Frequency Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS," Question 7.03, April 4, 2008, <http://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm#sec7>.

⁸ See Exchange Act Release No. 74892 (May 6, 2015), 80 FR 27513 (May 13, 2015).

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believes that any exchange-based routing would be consistent with the purposes of the Act (e.g., Section 6(b) of the Act), and thus, expanding the exemption to include all exchange-based routing would be appropriate.

As a final note, the Exchange believes that it would be beneficial to all markets participants if the proposed amendments were to be included in the ongoing public colloquy between members of the new Equity Market Structure Advisory Committee, as the proposed amendments will undoubtedly have a significant impact on market structure going forward.

CHX welcomes further dialogue and coordination with Commission staff and other market participants regarding the Exchange's proposals described herein.

Sincerely,

A handwritten signature in blue ink, appearing to read "J. Ongena".

James Ongena
Senior Vice President and General Counsel