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VIA E-MAIL

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C., 20549-1090

Re: Securities Exchange Act Release No. 80041 (February 14, 2017), 82 FR 11252 (February 21, 2017) (SR-CHX-2017-04) (the "CHX Proposal")

Dear Mr. Fields:

NYSE Group ("NYSE") appreciates the opportunity to submit a comment letter on the above-referenced rule proposal filed by the Chicago Stock Exchange, Inc. ("CHX"). NYSE previously commented on a prior CHX proposal, which CHX has since withdrawn, that proposed an asymmetrical intentional delay for arriving, marketable orders.[1] CHX is now proposing to adopt a different form of an asymmetrical intentional delay, referred to as the CHX Liquidity Enhancing Access Delay ("LEAD"), which would subject all new incoming orders, cancel, and cancel/replace messages to a 350-microsecond intentional access delay. However, this delay would not be applied to specified new incoming order and cancel messages submitted by a qualified CHX market maker ("LEAD MM"). CHX claims its proposed asymmetrical delay would be better suited for protecting resting displayed orders against latency arbitrage strategies than the intentional delay that the Commission recently approved for Investors Exchange LLC ("IEX").[2]

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1 See Securities Exchange Act Release Nos. 78860 (Sept. 16, 2016), 81 FR 65442 (Sept. 22, 2016) (SR-CHX-2016-16) (Notice of filing) (the "CHX LTAD Proposal"); 79984 (February 7, 2017), 82 FR 10521 (February 13, 2017) (SR-CHX-2016-16) (Notice of withdrawal of CHX LTAD Proposal). In the CHX LTAD Proposal, CHX would have allowed resting displayed orders to be re-priced or cancelled, while arriving, marketable orders would have been systemically delayed from being processed. NYSE objected to the CHX LTAD Proposal on the grounds that it would result in CHX members' non-compliance with the Quote Rule as set forth in Rule 602 of Regulation NMS ("Rule 602"), 17 CFR 242.602, and CHX's non-compliance with the Order Protection Rule as set forth in Rule 611 of Regulation NMS ("Rule 611"), 17 CFR 242.611. See Letter from Elizabeth K. King, General Counsel & Secretary, New York Stock Exchange, to Brent J. Fields, Secretary, Securities and Exchange Commission, dated October 14, 2016, available here: https://www.sec.gov/comments/sr-chx-2016-16/chx201616-10.pdf ("LTAD Comment Letter").

2 See Securities Exchange Act Release No. 78101 (June 17, 2016), 81 FR 41141 (June 23, 2016) ("IEX Approval Order").

NYSE believes that the concerns that NYSE identified in the LTAD Comment Letter have not been addressed in the latest CHX Proposal. At its core, the proposed CHX LEAD program would still provide for an asymmetrical delay that advantages certain displayed quotes relative to liquidity seeking orders. In this regard, the CHX Proposal stands in contrast to the delay mechanism design approved by the Commission that advantages only non-displayed orders.

The NYSE believes that the latest iteration of the CHX Proposal to adopt an asymmetrical, intentional delay that would systematically allow displayed orders to be re-priced or cancelled before they can be accessed is inconsistent with the purposes of the Quote Rule as set forth in Rule 602 and would violated the Order Protection Rule as set forth in Rule 611. Therefore, the CHX Proposal is not consistent with the Securities Exchange Act of 1934 (the "Act").

I. <u>Background</u>

CHX has withdrawn its LTAD proposal and now proposes a new "CHX Liquidity Enhancing Access Delay" or "LEAD" that CHX claims is designed to enhance displayed liquidity and price discovery by minimizing the effectiveness of latency arbitrage strategies. As proposed, all new incoming orders that could immediately execute against one or more resting orders on the CHX book and requests to cancel or cancel and replace an order would be intentionally delayed for 350 microseconds before such delayed messages would be executed against resting orders. However, the following orders would not be subject to the intentional delay: (i) non-marketable orders that would be posted to the CHX book and have been entered by a qualified LEAD MM and (ii) a cancel message relating to a resting order that originated from a LEAD MM. To qualify as a LEAD MM and receive these benefits, a market maker must meet the following minimum performance standards: (i) maintain a single round-lot two-sided quote at a designated percentage away from the national best bid or offer ("NBBO") that is half of the market-wide quoting requirement for that security (i.e., 4% instead of 8%, 14% instead of 28%, and 15% instead of 30%); (ii) maintain a monthly average NBBO quoting percentage of 10% in assigned securities; (iii) the LEAD MM's executed shares in an assigned security must average at least 2% of all executed shares in that security; and (iv) at least 80% of such executed shares must result from resting orders from the LEAD MM.

CHX claims that it has proposed LEAD to address recent declines in CHX trading volume in the SPDR S&P 500 trust exchange-traded fund ("SPY"), which CHX attributes to latency arbitrage activity in that symbol. CHX further claims that the best way to offset latency arbitrage is to allow liquidity providers who have committed to "heightened quoting and trading requirements" a "small head start" to the cancellation of stale quotes.

II. <u>LEAD is Inconsistent with Regulation NMS</u>

A. The Quote Rule

The Quote Rule, first adopted in 1978 and amended in 1996, is a foundational element of the reliability and availability of quotation information in the U.S. securities markets. The Quote Rule requires a national securities exchange to establish procedures for collecting, processing, and making available to vendors the best bid, best offer, and aggregate quotation sizes for NMS securities that are communicated on that exchange by an exchange member to another member.[3] In addition, the Quote Rule establishes requirements for broker-dealers. Specifically, when a broker-dealer is a member of an exchange and communicates bids or offers in NMS securities to other members of that exchange, that broker-dealer is obligated under the Quote Rule to communicate its best bids, best offers, and quotation sizes to the exchange and to be "firm" for those published quotes. To be "firm" for its published quotations under the Quote Rule means a broker-dealer has an obligation "to execute any order . . . at a price at least as favorable . . . as [its] published bid or published offer . . . in an amount up its published quotation size.[4] The Quote Rule provides specific exceptions to a broker-dealer's obligation to be firm for its published quotes, including that "before the order sought to be executed is presented, . . . [the] broker or dealer has communicated to its exchange . . . a revised bid or offer."[5]

CHX's proposed LEAD would systematically delay LEAD MMs' ability to execute orders at their published quotations. Specifically, CHX is proposing that, after a LEAD MM's quote has been published, CHX would intentionally and predictably delay orders seeking to trade with that quote for 350 microseconds. In this way, by publishing quotations on CHX, a LEAD MM could predictably minimize its obligations under the Quote Rule, and CHX would be enabling this practice by its LEAD MMs.

CHX claims that the proposed LEAD would not cause LEAD MMs to violate the Quote Rule because an order delayed in the LEAD mechanism would not have been presented to a LEAD MM. While such an interpretation is technically accurate, the Exchange believes that an exchange-provided systematized delay for a subset of members is inconsistent with the purposes of the Quote Rule and Section 6(b)(5) of the Exchange Act, which, among other things, requires exchange rules to be designed to promote just and equitable principles of trade and not be designed to permit unfair discrimination between customers, issuers and brokers or dealers.

B. LEAD Would Violate the Order Protection Rule

Regulation NMS requires that a trading center displaying an automated quotation provide "immediate-or-cancel" ("IOC") functionality for an incoming order to execute immediately and automatically against the displayed quotation up to its full size, and for any unexecuted portion of such incoming order to be cancelled immediately and automatically without being routed elsewhere.[6] Accordingly, to qualify as an automated trading center, "the trading center must

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3 17 CFR 242.602. The Quote Rule was previously codified in Rule 11Ac1-1 under the Act. See Securities Exchange Act Release Nos. 14415 (January 26, 1978), 43 FR 4332 (February 1, 1978) and 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996). The Quote Rule similarly requires a national securities association (i.e., FINRA) to establish procedures for collecting bids, offers and quotation sizes with respect to NMS securities from its members when those members communicate bids and offers to a broker-dealer or customer.

4 17 CFR 242.602(b)(2).

5 17 CFR 242.602(b)(3)(ii). In addition, the Quote Rule does not require a broker-dealer to be "firm" for its published quotation if, "[a]t the time the order sought to be executed is presented, such . . . broker or dealer is in the process of effecting a transaction. . . ." Id.

6 See 17 CFR 242.600(b)(3) (defining the term "automated quotation") and 17 CFR 242.600(b)(57) (defining the terms "protected bid or protected offer," together, a "protected quotation," to mean an automated quotation that is the best bid or best offer of a national securities exchange).

have implemented such systems, procedures, and rules as are necessary to render it capable of displaying quotations that meet the action, response, and updating requirements set forth in the definition of an automated quotation."[7]

The Commission determined that in the context of the Order Protection Rule, the term "immediate" does not preclude a programmed delay that is *de minimis*, provided that such delay "does not impair fair and efficient access to an exchange's protected quotation."[8] With IEX, the intentional delay approved by the Commission is applicable to both the entry of new orders and requests to cancel or modify resting displayed orders; the only orders that can update without delay are resting non-displayed orders. As the Commission noted in the IEX Approval Order, "[n]on-displayed orders are not reflected in an exchange's quotations, and Rule 611 applies order protection to publicly displayed quotes only. Accordingly, an access delay that does not allow the repricing of displayed orders does not impact an exchange's displayed quotation, and cannot be said to lead to 'maybe' quotations."[9]

In contrast to IEX, CHX is proposing an intentional delay that would allow for "maybe" quotations. The operation of the proposed LEAD delay would impair the fair and efficient access to CHX's protected quotations by allowing LEAD MMs to adjust protected quotations after CHX has received an order to trade with such displayed orders. In this scenario, even a delay that could be considered *de minimis* in other contexts should not be permitted under the Order Protection Rule.

Accordingly, the NYSE believes the Commission must disapprove CHX's proposal as inconsistent with the Order Protection Rule. The NYSE respectfully urges the Commission to further clarify its Rule 611 Interpretation to explicitly preclude exchanges from applying any form of programmed delay, *de minimis* or otherwise, that would provide an opportunity for displayed orders to be re-priced or cancelled after an exchange has received orders seeking to trade with that displayed liquidity.[10]

C. Benefit to LEAD MM Disproportionate to Proposed Obligations

The Commission has recognized that the participation of market makers in exchange markets may benefit public customers by promoting more liquid and efficient trading, and that an exchange may legitimately confer benefits on market participants willing to accept *substantial* responsibilities to contribute to market quality. The Commission therefore has stated that it carefully reviews proposals that seek to offer special advantages to market makers to ensure that the rewards are not disproportionate to the services provided.[11] NYSE believes that the

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7 See Securities Exchange Act Release No. 51808, 70 FR 37496, 37520 (June 29, 2005).

8 See Rule 611 Intepretation, supra note 5 at 40789.

9 See IEX Approval Order, supra note 1 at 41156, n. 216.

10 In the Rule 611 Interpretation, the Commission noted that the *de minimis* interpretation does not obviate the requirement that proposed access delays be reviewed for consistency with the Act and Regulation NMS. See supra note 5 at 40790.

11 See Securities Exchange Act Release No. 58845 (October 24, 2008), 73 FR 64379, 64388 (October 29, 2008) (SR-NYSE-2008-46) (Approval Order of NYSE's New Market Model).

proposed benefit that would be conferred on LEAD MMs and no other class of participants – the ability to cancel resting orders without delay – is disproportionate to the proposed obligations specified in the minimum performance standards expected of LEAD MMs to qualify for this benefit. Specifically, the NYSE believes that the proposed minimum performance standards would not meaningfully change the amount of accessible displayed liquidity on CHX, yet LEAD MMs would be the only market participant with the ability to cancel resting orders.

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The NYSE objected to the IEX application in part due to the complexity that would result if one market is approved to add an intentional delay. However, by approving IEX and issuing the Rule 611 Interpretation, the Commission has signaled that other exchanges should similarly be permitted to add an intentional delay consistent with Regulation NMS and the Act. Because CHX's proposed LEAD would be inconsistent with the Quote Rule, would result in CHX's non-compliance with the Order Protection Rule, and would confer benefits on LEAD MMs that would be disproportionate to the obligations, the CHX Proposal should be disapproved.

Sincerely,

Elizabeth K. King

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cc: Hon. Michael Piwowar, Acting Chairman
Hon. Kara Stein, Commissioner
Heather Seidel, Acting Director of Trading and Markets
David Shillman, Associate Director of Trading and Markets