CITADEL | Securities

June 16, 2017

Mr. Eduardo A. Aleman
Assistant Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090

Re: Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt the CHX Liquidity Enhancing Access Delay (Release No. 34-80740; File No. SR-CHX-2017-04)

Dear Mr. Aleman:

Citadel Securities ("Citadel")[1] appreciates the opportunity to further comment on the proposal by the Chicago Stock Exchange, Inc. ("CHX") to create an asymmetric access delay (the "Access Delay") that would apply to all CHX participants except for a new category of "LEAD Market Makers" ("LEAD MMs").[2] Citadel welcomes the Securities and Exchange Commission's (the "Commission") decision to institute proceedings to determine whether the proposed rule change should be approved or disapproved in light of the significant legal and policy concerns raised.[3]

As stated in our earlier comment letter,[4] CHX's proposed Access Delay would allow a select group of liquidity providers to back away from their quotations, giving them an unfair advantage compared to other market participants and unduly burdening market competition. CHX has failed to demonstrate how the asymmetric application of the proposed Access Delay is consistent with the Securities Exchange Act of 1934 ("Exchange Act"), including Sections 6(b)(5) and 6(b)(8).[5] Below, we address CHX's rebuttals to the concerns raised by a wide range of market participants about the CHX Proposal,[6] as well as certain of the Commission's questions in the Order Instituting Proceedings.

---

[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. On an average day, Citadel accounts for approximately 15 percent of U.S. listed equity volume, 19 percent of U.S. listed equity option volume, and more than 35 percent of all retail U.S. listed equity volume.

[2] Exchange Act Release No. 80041, 82 FR 11252 (February 21, 2017) (the "CHX Proposal"). Specifically, the Access Delay would not apply to a LEAD MM's (a) new orders and modifications to resting orders (as long as they can be immediately ranked on the CHX book without executing against resting orders), and (b) cancellations of resting orders. *See* CHX Proposal at 11254.

[3] Exchange Act Release No. 80740, 82 FR 24412 (May 26, 2017) ("Order Instituting Proceedings").

[4] Letter to Eduardo A. Aleman, Assistant Secretary, Commission, from Stephen John Berger, Managing Director, Government & Regulatory Policy, Citadel, dated March 14, 2017.

[5] Sections 6(b)(5) and 6(b)(8) require, among others, that the rules of an exchange are not designed to permit unfair discrimination and do not impose any undue burden on competition.

[6] *See* Comment File for SR-CHX-2017-04 at https://www.sec.gov/comments/sr-chx-2017-04/chx201704.htm.

I. CHX Has Failed to Demonstrate that the Proposed Access Delay is Consistent with the Exchange Act

Rule 700(b)(3) of the Commission's rules of practice provides that the "burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations thereunder [. . .] is on the self-regulatory organization that proposed the rule change." CHX has failed to satisfy this burden.

First, CHX has failed to demonstrate the existence of a market-wide problem that would warrant an exchange taking the unprecedented step of implementing an asymmetric access delay. Instead, CHX attempts to justify its proposal by pointing to its *own* declining market share in a *single* security, the SPY.[7] Notably, CHX fails to provide, among others, (a) market-wide trading data showing any issues with trading the SPY, (b) an explanation of why similar market share declines did not occur for other securities listed on CHX, and (c) an explanation of other metrics that could be relevant in analyzing how the SPY is traded on CHX, such as the higher cancel-to-trade ratios and lower trade-to-order ratios on CHX compared to other exchanges.[8] Given that SPY is one of the most liquid securities in the U.S., CHX fails to explain why its exchange is different from all others such that it needs to grant an unprecedented structural advantage to certain of its market makers. The burden lies on CHX to furnish more robust data and analysis in order to determine whether CHX is merely attempting to recapture lost market share from other exchanges or whether there is really a fundamental flaw with current market structure that merits attention.

Second, CHX has failed to provide the necessary data to allow market participants and the Commission to evaluate the purportedly heightened quoting and trading obligations for LEAD MMs (the "LEAD Obligations"),[9] which is necessary in order to determine whether the CHX Proposal is consistent with the Exchange Act. CHX points to the LEAD Obligations to justify the discrimination that is inherent in its proposal to provide LEAD MMs with a structural advantage compared to all other market participants.[10] However, CHX does not provide any data regarding the materiality of the LEAD Obligations and how they can be reasonably expected to improve market quality. It appears possible that many, if not all, of the liquidity providers on CHX that would be expected to become LEAD MMs already meet these "enhanced" quoting and trading obligations today, thereby decreasing their significance.

---

[7] *See* CHX Proposal at 11253.

[8] *See* Letters from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel Securities, dated October 13, 2016 ("Citadel Letter 1") and dated January 17, 2017 ("Citadel Letter 2"). Citadel incorporates these letters by reference here.

[9] A LEAD MM would be required to: (1) maintain a monthly average of quotations at the national best bid or offer ("NBBO") of at least 10%; (2) ensure that the LEAD MM's executions in the assigned security comprise an equally-weighted daily average of at least 2% of all executions in that security on CHX over the course of a month; and (3) ensure that at least 80% of these executions are against a quotation originating from the LEAD MM's trading account. CHX would also reduce by 50% the percentage away from the NBBO that a LEAD MM can quote. *See* Proposed CHX Article 16, Rule 4(f).

[10] *See* Letter to Eduardo A. Aleman, Assistant Secretary, Commission, from James G. Ongena, Executive Vice President and General Counsel, CHX (March 24, 2017) at page 6, available at: https://www.sec.gov/comments/sr-chx-2017-04/chx201704-1668613-149115.pdf ("CHX Letter").

Even in response to questions from market participants regarding the materiality of the LEAD Obligations, CHX failed to provide any objective data.[11] Instead, CHX selectively compared the LEAD Obligations to certain market maker obligations imposed by NYSE and Bats, while asserting that any additional market maker obligations that may be imposed by those exchanges "would not be appropriate" to include in the CHX Proposal.[12] This selective comparison does not assist market participants or the Commission in evaluating whether the LEAD Obligations are substantial and proportionate to the benefits conferred to LEAD MMs.[13] This evaluation is critical given the unprecedented benefit proposed for LEAD MMs of being able to utilize their structural advantage to back away from displayed quotations, as discussed further below.

II. The CHX Proposal Unfairly Discriminates in Favor of LEAD MMs and Constitutes an Undue Burden on Competition

The CHX Proposal provides LEAD MMs with a small amount of additional time to cancel or modify a resting quotation while incoming order flow is delayed. This structural advantage provides LEAD MMs with a window of time to analyze current market data and then to selectively adjust their quotations to avoid interacting with certain incoming orders. As a result, the asymmetric application of the Access Delay unfairly discriminates in favor of LEAD MMs to the detriment of other market participants, including liquidity providers that are not LEAD MMs as well as any market participant seeking to have its order filled on CHX.

CHX admits that the proposed Access Delay will materially benefit LEAD MMs, acknowledging that "LEAD will impact the current risk/reward dynamic for liquidity provision" and will "bring the risk of providing displayed liquidity back to levels commensurate with its rewards."[14] However, other liquidity providers on CHX that are not LEAD MMs will not be able to take advantage of this benefit. Therefore, these liquidity providers will be subject to greater risks than LEAD MMs when providing displayed liquidity, as they will not be able to cancel or modify their quotations as quickly as a LEAD MM. This would likely expose these other liquidity providers to adverse selection compared to LEAD MMs, which in turn will raise the costs for non-LEAD MMs to continue to provide liquidity.

The ability of LEAD MMs to analyze and respond to current market data in order to cancel or modify a resting quotation also unfairly discriminates against liquidity takers, such as institutional and retail investors. LEAD MMs will be able to utilize their structural advantage at any time, irrespective of the type of entity that sends an incoming order that is delayed. As noted above, CHX acknowledges that the Access Delay will lower the risks associated with providing liquidity for LEAD MMs. This means that the current competitive balance between liquidity providers and

---

[11] *See* CHX Letter at page 6.

[12] *Id.*

[13] Exchange Act Release No. 67437, 77 FR 42525, 42527 (July 19, 2012) (SR-NYSEAmex-2011-86) (noting that "while exchanges may legitimately confer special benefits on market participants willing to accept substantial responsibilities to contribute to market quality, such benefits must not be disproportionate to the services provided").

[14] CHX Letter at page 7.

liquidity takers will be fundamentally altered. Liquidity takers may find it more difficult to successfully access the liquidity displayed on CHX, particularly during times of market volatility when LEAD MMs are most likely to attempt to cancel or modify displayed quotations before they are able to be accessed by incoming order flow.

We urge the Commission to find that the CHX Proposal is inconsistent with Sections 6(b)(5) and 6(b)(8) of the Exchange Act, as it provides LEAD MMs with a structural advantage that effectively allows them to back away from displayed quotations, unduly burdening market competition and unfairly discriminating against both other liquidity providers that do not have the same advantage and liquidity takers that will find it more difficult to access displayed liquidity on CHX.

III. The Access Delay Is Not *De Minimis* under the Commission's Interpretive Guidance

The Access Delay is also inconsistent with the Commission's Automated Quotations Interpretive Guidance[15] and the requirements for protected quotation status under Regulation NMS. Despite CHX's attempts to equate its proposed Access Delay with the intentional delay imposed by IEX,[16] the CHX Proposal is fundamentally different.

The asymmetrical application of the proposed Access Delay is explicitly designed to alter the competitive balance between liquidity providers and liquidity takers that exists on CHX today, a fact that CHX has acknowledged.[17] This Access Delay is thus plainly not *de minimis*, as it creates a new competitive balance between both (a) LEAD MMs and other liquidity providers that are not able to benefit from the structural advantage, and (b) LEAD MMs and liquidity takers seeking to access displayed liquidity on CHX. As LEAD MMs seek to cancel or modify resting quotations, other market participants may be impaired in their ability to fairly and efficiently access displayed quotations on CHX.

* * * * * * * * * *

We appreciate the opportunity to provide additional comments on the CHX Proposal. Please feel free to call the undersigned at ([redacted] with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger
Managing Director, Government & Regulatory Policy

---

[15] Securities Exchange Act Release No. 78102, 81 FR 40785 (June 23, 2016).

[16] *See* CHX Letter at page 14.

[17] *See* CHX Letter at page 7.