CITADEL | Securities

December 8, 2017

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

**Re: CHX Liquidity Enhancing Access Delay: Statement in Support of Commission Review**

Dear Mr. Aleman:

Citadel Securities[1] appreciates the opportunity to file an additional statement as the Securities and Exchange Commission (the "Commission") reviews the delegated action of the Division of Trading and Markets to approve the proposal by the Chicago Stock Exchange, Inc. ("CHX") to implement an asymmetric access delay (the "Access Delay"). This Access Delay would apply to all CHX participants except for a new category of "LEAD Market Makers" ("LEAD MMs").[2]

A diverse group of market participants raised concerns regarding the proposed Access Delay,[3] in particular the intent to specifically benefit a select group of liquidity providers. Despite these concerns and the unprecedented nature of the Access Delay, the Division of Trading and Markets approved the proposal as consistent with both (a) the Securities Exchange Act of 1934 ("Exchange Act") and (b) CHX's protected quotation status.[4] As a supplement to our previous comments on the proposal,[5] we highlight three areas of the staff's approval order that merit further review by the Commission.

[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 Securities accounts for approximately 20 percent of U.S. listed equity volume, 21 percent of U.S. listed equity option volume, and more than 37 percent of all retail U.S. listed equity volume.

[2] 82 Fed. Reg. 11252 (Feb. 21, 2017), available at: https://www.gpo.gov/fdsys/pkg/FR-2017-02-21/pdf/2017-03296.pdf (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] *See* Comment File for SR-CHX-2017-04 at https://www.sec.gov/comments/sr-chx-2017-04/chx201704.htm.

[4] Exchange Act Release No. 34-81913 (Oct. 19, 2017), available at: https://www.sec.gov/rules/sro/chx/2017/34-81913.pdf (the "Approval Order").

[5] Please see our two previous comment letters on the CHX Proposal.

## I. The Staff Guidance that Underpins the Approval Order Should be Re-Evaluated to Ensure Consistency with the Commission's Interpretive Guidance on Automated Quotations

The Commission stated in its Automated Quotations Interpretive Guidance[6] that the evaluation of whether or not an access delay is *de minimis* should focus on whether the proposed delay impairs fair and efficient access to an exchange's quotations, and noted that "[g]enerally, the Commission would be concerned about access delays that were imposed only on certain market participants."[7] The Commission specifically rejected the notion of automatically classifying delays of less than one millisecond as *de minimis*, stating that "establishing a bright line *de minimis* threshold is not appropriate at this time."[8] However, staff then issued guidance establishing a bright line *de minimis* threshold of one millisecond, which it pledged to re-evaluate from time to time.[9]

In the approval order for the CHX Proposal, staff relied solely on its own bright line *de minimis* test (without any re-evaluation) to hold that the Access Delay is consistent with CHX's protected quotation status, stating that "[a]ccordingly, because the 350 microsecond delay imposed by the LEAD is less than a millisecond, it is de minimis."[10] Staff has not assessed whether the Access Delay would impair fair and efficient access to CHX's quotations.

Given the novel issues raised by the asymmetric nature of the proposed Access Delay, we believe that the CHX Proposal should prompt the re-evaluation of the bright line *de minimis* threshold put forward by staff in its guidance. The CHX Proposal allows a select group of liquidity providers to completely bypass the delay, making it fundamentally different from the IEX delay and impairing the fair and efficient access of other market participants (including both liquidity takers and liquidity providers that are not LEAD MMs) to CHX quotations. Even CHX has acknowledged that the asymmetric nature of the Access Delay provides a material benefit to LEAD MMs that impacts "the current risk/reward dynamic for liquidity provision."[11] Providing such a material benefit to a select group of market participants is clearly not *de minimis* under the type of qualitative assessment contemplated by the Commission's Interpretative Guidance, regardless of the length of the delay.

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[6] 81 Fed. Reg. 40785 (June 23, 2016), available at: https://www.gpo.gov/fdsys/pkg/FR-2016-06-23/pdf/2016-14876.pdf ("Interpretive Guidance").

[7] *Id*. at 40792 (FN 75) and 40793.

[8] *Id.* at 40792.

[9] Staff Guidance on Automated Quotations under Regulation NMS (June 17, 2016), available at: https://www.sec.gov/divisions/marketreg/automated-quotations-under-regulation-nms.htm.

[10] Approval Order at page 51.

[11] Letter to Eduardo A. Aleman, Assistant Secretary, Commission, from James G. Ongena, Executive Vice President and General Counsel, CHX (March 24, 2017) at page 7, available at: https://www.sec.gov/comments/sr-chx-2017-04/chx201704-1668613-149115.pdf.

## II. The Approval Order Did Not Adequately Examine Key Assertions Made by CHX

As noted above, the approval order also found the Access Delay to be consistent with Exchange Act requirements, including Section 6(b)(5), which prohibits unfair discrimination, and Section 6(b)(8), which prohibits burdens on competition that are not necessary or appropriate. In reaching these conclusions, the approval order appears to borrow heavily from assertions made by CHX without any independent analysis regarding the justification for the proposal or its expected impact on market participants.

Under the CHX Proposal, LEAD MMs are permitted to bypass the Access Delay to cancel or modify a resting quotation based on their analysis of current market data and anticipated incoming order flow, effectively allowing them to back away from displayed quotations. This unfairly discriminates against both liquidity takers attempting to access these displayed quotations and other liquidity providers that do not have the advantages of LEAD MMs, and unduly burdens market competition since displayed quotations on CHX will no longer be comparable to quotations on other exchanges. In our view, a more thorough review of the assertions made by CHX would assist in demonstrating the CHX Proposal's inconsistency with Exchange Act requirements. We provide two examples below.

### *A. The Justification for the Proposal*

According to CHX, the Access Delay is designed to offset a structural bias in the market that "imposes a tax on liquidity provision."[12] However, the only evidence provided of such a market-wide structural bias was the declining market share of CHX in a single security, the SPY.[13] When evaluating the proposed Access Delay, it is therefore critical to understand how the SPY is traded on CHX. Unfortunately, the approval order fails to examine important questions raised by commenters, such as:

- Were there notable market-wide trends in the SPY or did only CHX experience a decline in volume?[14]
- How is the SPY typically traded on CHX?[15]
- What specifically happened in January 2016 that caused a decline in volume in the SPY on CHX? Why were other securities traded on CHX unaffected?

[12] CHX Proposal at 11253.

[13] *Id*.

[14] We provided a data analysis showing relatively constant daily trading volumes in the SPY. *See* Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel Securities, dated October 13, 2016 at pages 11-12 and 16, available at: https://www.sec.gov/comments/sr-chx-2016-16/chx201616-7.pdf [incorporated by reference into the Letter from Stephen John Berger, Managing Director, Government & Regulatory Policy, Citadel Securities, dated March 14, 2017, available at: https://www.sec.gov/comments/sr-chx-2017-04/chx201704-1641469-145366.pdf].

[15] *See id.*, at pages 9 and 15 for a data analysis showing that the cancel-to-trade ratio for orders in the SPY was significantly higher on CHX compared to all other exchanges. In addition, the trade-to-order ratio on CHX was, with the exception of PHLX, significantly lower compared to all other exchanges.

A decline in the market share of a single exchange in a single security should be insufficient to justify the unprecedented Access Delay. In our view, staff should be independently determining whether there is a market-wide problem that warrants attention or whether CHX-specific factors are motivating the proposal. This type of analysis is critical in evaluating whether the CHX Proposal is consistent with the Exchange Act.

*B. The Materiality of the LEAD MM Obligations*

CHX also asserts that the benefits provided to LEAD MMs under the Access Delay are proportionate to the purportedly heightened quoting and trading obligations that are imposed.[16] Specifically, LEAD MMs would be required to: (a) maintain a monthly average of quotations at the national best bid or offer ("NBBO") of at least 10%; (b) 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 (c) ensure that at least 80% of these executions are against a quotation originating from the LEAD MM's trading account.[17]

However, the approval order fails to provide any independent analysis of the materiality of these requirements. Maintaining quotations at the NBBO for at least 10% of a calendar month and taking part in at least 2% of qualified executions appear to be low thresholds for active liquidity providers. In fact, data provided by CHX shows that for securities traded in its Chicago datacenter, such as the SPY, the vast majority of all trading account/security combinations satisfied these requirements in February 2017.[18] In addition, according to CHX, the most active liquidity providers in the SPY "would have easily passed all three tests" in January 2016, before the decline in volume in the SPY on CHX occurred.[19] Any independent analysis by the staff should also take into account the quoting and trading activity of market makers on other exchanges. It would appear difficult to consider the requirements for LEAD MMs as heightened quoting and trading obligations if they are already commonly satisfied by market makers on other exchanges without the benefit of an asymmetric access delay.

As noted above, the CHX Proposal would enable LEAD MMs to completely bypass the Access Delay to cancel or modify a resting quotation based on their analysis of current market data and anticipated incoming order flow. This ability to back away from a displayed quotation in response to an external market event is an unprecedented benefit that has not been granted by other exchanges to their market makers. As a result, for purposes of Exchange Act requirements, it is crucial that this benefit be accurately weighed against the obligations imposed on LEAD MMs. We urge the Commission to perform a more rigorous analysis of the materiality of the LEAD MM obligations, including assessing whether liquidity providers on other exchanges would easily satisfy the proposed requirements.

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[16] See Approval Order at pages 27-28.

[17] CHX Proposal at 11255.

[18] Letter to Eduardo A. Aleman, Assistant Secretary, Commission, from James G. Ongena, Executive Vice President and General Counsel, CHX (June 30, 2017) at page 8, available at: https://www.sec.gov/comments/sr-chx-2017-04/chx201704-1834258-154593.pdf.

[19] *Id.*

**III. Approving the Access Delay on a Pilot Basis Does Not Address the Concerns**

The approval order permitted CHX to implement the Access Delay on a pilot basis for 24 months. However, approval was not conditioned on any specific questions being answered or addressed during the pilot period and staff's rationale for approving the Access Delay would appear to equally apply to a proposal to implement a similar delay on a permanent basis (i.e. it was not based on the proposal being a pilot). Therefore, to the extent the CHX Proposal is approved, other venues would likely file similar proposals that are not time-limited on a pilot basis. As a result, approving the CHX Proposal as a pilot does not reduce its significance or potential impact on overall equity market structure.

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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