

**October 3, 2016**

Mr. Robert W. Errett  
Deputy Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: Exemptive Application Pursuant to Rule 608 of Regulation NMS – NMS Plan to Implement a Tick Size Pilot Program

Dear Mr. Errett:

Pursuant to Rule 608(e) of Regulation NMS under the Securities Exchange Act of 1934 (“Exchange Act”), the Chicago Stock Exchange, Inc. (“CHX” or “Exchange”) requests that the Securities and Exchange Commission (“Commission” or “SEC”) grant an exemption from the quoting and trading requirements in the National Market System Plan to Implement a Tick Size Pilot Program (“Plan” or “Pilot”), as discussed below. Capitalized terms used herein, but not otherwise defined, shall have the meanings ascribed to them in the Plan.<sup>1</sup>

On September 30, 2016, the Exchange filed a proposed rule change to amend various CHX rules to describe changes to the CHX Matching System<sup>2</sup> functionality necessary to implement the quoting and trading provisions of the Plan.<sup>3</sup> To the extent that the proposed amendment alters the quoting and trading requirements of the Plan, as approved by the Commission, the Exchange respectfully requests that the Commission grant an exemption from those provisions of the Plan. Specifically, CHX requests exemptive relief from the requirement under Section VI of the Plan that the Exchange only accept orders for Pilot Securities in the Test Groups in \$0.05 minimum increments (“\$0.05 minimum order increment requirement”) so as to permit the Exchange to accept cross orders<sup>4</sup> for Test Group One securities in increments less than \$0.05 and to accept cross orders for Test Groups Two and Three securities in increments less than \$0.05 only if the cross orders would qualify as Negotiated Trades.<sup>5 6</sup>

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<sup>1</sup> Unless otherwise specified, capitalized terms used in this rule filing are defined as set forth in the Plan.

<sup>2</sup> The Matching System is an automated order execution system, which is a part of the Exchange’s “Trading Facilities,” as defined under CHX Article 1, Rule 1(z).

<sup>3</sup> See SR-CHX-2016-19.

<sup>4</sup> See CHX Article 1, Rule 2(a)(3) defining “cross order.”

<sup>5</sup> See Section I(P) of the Plan.

<sup>6</sup> Currently, the Exchange permits any type of cross order in any security, whether the order is priced less than or at or above \$1.00, to be submitted in an increment as small as \$0.000001. See CHX Article 20, Rule 4(a)(7)(B). This rule is based on exemptive

The Exchange believes that the proposed exemptive relief is consistent with the public interest, the protection of investors, and the maintenance of fair and orderly markets. Specifically, CHX believes that the proposed exemptive relief will more closely align the \$0.05 minimum order increment requirement under Section VI of the Plan with Rule 612 of Regulation NMS.<sup>7</sup>

### Background

On August 25, 2014, NYSE Group, Inc., on behalf of the Exchange, Bats BZX Exchange, Inc. f/k/a BATS Z-Exchange, Inc., Bats BYX Exchange, Inc. f/k/a BATS Y-Exchange, Inc., Bats EDGA Exchange, Inc. f/k/a EDGA Exchange, Inc., Bats EDGX Exchange, Inc. f/k/a EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc. (“FINRA”), NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, the Nasdaq Stock Market LLC, New York Stock Exchange LLC (“NYSE”), NYSE MKT LLC, and NYSE Arca, Inc. (collectively “Plan Participants”),<sup>8</sup> filed with the Commission, pursuant to Section 11A of the Act<sup>9</sup> and Rule 608 of Regulation NMS thereunder, the Plan.<sup>10</sup> The Plan Participants filed the Plan to comply with an order issued by the Commission on June 24, 2014.<sup>11</sup> The Plan was published for comment in the Federal Register on November 7, 2014, and approved by the Commission, as modified, on May 6, 2015.<sup>12</sup>

The Plan is designed to allow the Commission, market participants, and the public to study and assess the impact of increment conventions on the liquidity and trading of the common stocks of small-capitalization companies. Each Plan Participant is required to comply with, and to enforce compliance by its member organizations, as applicable, with the provisions of the Plan.

The Pilot will consist of a control group of approximately 1400 Pilot Securities and three test groups with 400 Pilot Securities in each selected by a stratified sampling.<sup>13</sup> During the Pilot, Pilot Securities in the control group will be quoted and traded at the currently permissible

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relief from Rule 612 granted by the Commission to the national securities exchanges in 2006. See Securities Exchange Act Release No. 54714 (November 6, 2006), 71 FR 66352 (November 14, 2006) (“Rule 612 Exemptive Relief Order”).

<sup>7</sup> See 17 CFR 242.612.

<sup>8</sup> A “Participant” is a “member” of the Exchange for purposes of the Act. See CHX Article 1, Rule 1(s). For clarity, the Exchange proposes to utilize the term “CHX Participant” when referring to members of the Exchange and the term “Plan Participant” when referring to Participants of the Plan.

<sup>9</sup> 15 U.S.C. 78k-1.

<sup>10</sup> See Letter from Brendon J. Weiss, Vice President, Intercontinental Exchange, Inc., to Secretary, Commission, dated August 25, 2014.

<sup>11</sup> See Securities Exchange Act Release No. 72460 (June 24, 2014), 79 FR 36840 (June 30, 2014).

<sup>12</sup> See Securities Exchange Act Release No. 74892 (May 6, 2015), 80 FR 27514 (May 13, 2015) (“Approval Order”).

<sup>13</sup> See Section V of the Plan for identification of Pilot Securities, including criteria for selection and grouping.

increments. Pilot Securities in Test Group One will be quoted in \$0.05 minimum increments but will continue to trade at any price increment that is currently permitted.<sup>14</sup> Pilot Securities in Test Group Two will be quoted in \$0.05 minimum increments and will trade at \$0.05 minimum increments subject to a midpoint exception, a retail investor order exception, and a negotiated trade exception.<sup>15</sup> Pilot Securities in Test Group Three will be subject to the same restrictions as Test Group Two and also will be subject to the “Trade-at” requirement to prevent price matching by a market participant that is not displaying at a price of a Trading Center’s<sup>16</sup> “Best Protected Bid” or “Best Protected Offer” (“Trade-at Prohibition”), unless an enumerated exception applies.<sup>17</sup> In addition to the exceptions provided under Test Group Two, an exception for Block Size orders and exceptions that mirror those under Rule 611 of Regulation NMS<sup>18</sup> will apply to the Trade-at Prohibition.

The Commission approved the Pilot on a two-year basis, with implementation to begin no later than May 6, 2016. On November 6, 2015, the SEC provided an exemption to the Plan Participants from implementing the pilot until October 3, 2016. The Plan requires the Exchange to establish, maintain, and enforce written policies and procedures that are reasonably designed to comply with applicable quoting and trading requirements specified in the Plan. Accordingly, the Exchange adopted Article 20, Rule 13(a) to require CHX Participants to comply with the quoting and trading provisions of the Plan.<sup>19</sup> The Exchange also adopted Article 20, Rule 13(b) to require CHX Participants to comply with the data collection provisions under Appendix B and C of the Plan.<sup>20</sup>

#### Rule 608 and the Proposed Exemption

Rule 608(c) of Regulation NMS provides that “[e]ach self-regulatory organization shall comply with the terms of any effective national market system plan of which it is a sponsor or a participant. Each self-regulatory organization also shall, absent reasonable justification or excuse, enforce compliance with any such plan by its members and persons associated with its members.”<sup>21</sup> Rule 608(e) allows the Commission to “exempt from the provisions of this section, either unconditionally or on specified terms and conditions, any self-regulatory organization,

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<sup>14</sup> See Section VI(B) of the Plan.

<sup>15</sup> See Section VI(C) of the Plan.

<sup>16</sup> The Plan incorporates the definition of “Trading Center” from Rule 600(b)(78) of Regulation NMS. Regulation NMS defines a Trading Center as “a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent.”

<sup>17</sup> See Section VI(D) of the Plan.

<sup>18</sup> 17 CFR 242.611.

<sup>19</sup> See Securities Exchange Act Release No. 78146 (June 23, 2016), 81 FR 42380 (June 29, 2016) (SR-CHX-2016-09).

<sup>20</sup> See Exchange Act Release No. 77469 (March 29, 2016), 81 FR 19275 (April 4, 2016) (SR-CHX-2016-03); see also SR-CHX-2016-17.

<sup>21</sup> 17 CFR 242.608(c).

member thereof, or specified security, if the Commission determines that such exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanisms of, a national market system.”<sup>22</sup> The Exchange is now seeking exemptive relief as set forth below.

#### Proposed Exemption for Cross Orders

CHX seeks exemptive relief from the \$0.05 minimum order increment requirement under Section VI of the Plan to permit the Exchange to accept cross orders for Test Group One securities in increments less than \$0.05 and to accept cross orders for Test Groups Two and Three securities in increments less than \$0.05 only if the cross orders would qualify as Negotiated Trades.<sup>23</sup> The \$0.05 minimum order increment requirement set forth under Section VI of the Plan and in CHX Article 20, Rule 13(a)(4) are, in part, based on Rule 612. Following the adoption of Rule 612, the Commission granted the national securities exchanges a limited exemption from Rule 612 to permit the exchanges to accept cross orders priced in sub-penny increments if (1) the orders are immediately executed against each other and (2) the cross transaction is effected in accordance with exchange rules approved or established pursuant to Section 19(b) of the Exchange Act<sup>24</sup> (“cross order exemption”).<sup>25</sup> This exception is not set forth in the Plan, and thus does not currently apply to cross orders for Test Groups securities. The Exchange has determined that it is appropriate to incorporate the cross order exemption to the \$0.05 minimum order increment requirement, as this exemption is equally applicable to cross orders for Test Groups securities. Accordingly, the Exchange is proposing to adopt CHX Article 20, Rule 13(c)(4), which provides as follows:

In Test Group One, the Exchange shall accept cross orders in increments less than \$0.05, subject to Article 20, Rule 4(a)(7)(B).<sup>26</sup> In Test Groups Two and Three, the Exchange shall accept cross orders in increments less than \$0.05 only if the cross orders would qualify as Negotiated Trades, subject to Article 20, Rule 4(a)(7)(B).

In connection with this proposed amendment, the Exchange seeks exemptive relief from complying with the \$0.05 minimum order increment requirement as currently set forth in the Plan, which does not contain this exception.

The Exchange further notes that the Plan Participants previously requested exemptive relief from the Trade-at Prohibition for Error Correction Transactions<sup>27</sup> stating that Error Correction

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<sup>22</sup> 17 CFR 242.608(e).

<sup>23</sup> See supra note 6.

<sup>24</sup> 15 U.S.C. 78s(b)(1).

<sup>25</sup> See Rule 612 Exemptive Relief Order, supra note 6, at 66354.

<sup>26</sup> See supra note 6.

<sup>27</sup> See CHX Article 20, Rule 9A.

Transactions are exempt from the trade-through provisions of Rule 611<sup>28</sup> and that the exemption is equally applicable to the Trade-at context.<sup>29</sup> In granting the exemptive relief request for Error Correction Transactions, the Commission stated the following:

The Commission has determined that this exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and the perfection of a national market system because it would provide consistency in how error correction transactions are treated.”<sup>30</sup>

Given that cross orders are exempt from Rule 612 and that the cross order exemption is equally applicable to the \$0.05 minimum order increment context, the Exchange believes that granting the proposed exemptive relief would provide consistency as to how cross orders are treated and is appropriate.

Thus, if the proposed exemptive relief were granted, cross orders for Test Groups securities would be handled as follows:

- In Test Group One, cross orders would be accepted and executed in any currently permissible increment smaller than \$0.05. For example, the Exchange would be permitted to accept and execute a simple cross order for a Test Group One security priced at \$10.01.
- In Test Groups Two and Three, cross orders would be accepted in any currently permissible increment smaller than \$0.05 only if the cross orders qualified as Negotiated Trades. For example, the Exchange would be permitted to accept and execute a cross order marked Qualified Contingent Trade<sup>31</sup> for a Test Group Two security priced at \$10.01 because a Pilot Qualified Contingent Trade is a Negotiated Trade that may execute in an increment less than \$0.05 pursuant to Section VI(C)(3) of the Plan.<sup>32</sup>

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<sup>28</sup> See Securities Exchange Act Release No. 55884 (June 8, 2007), 72 FR 32926 (June 14, 2007); Securities Exchange Act Release No. 55883 (June 8, 2007), 72 FR 32927 (June 14, 2007).

<sup>29</sup> See Letter from Marcia E. Asquith, Senior Vice President and Corporate Secretary, FINRA, to Robert W. Errett, Deputy Secretary, Commission, dated February 23, 2016.

<sup>30</sup> See Letter from David S. Shillman, Associate Director, Division of Trading and Markets, Commission, to Albert Kim, Vice President and Associate General Counsel, CHX, dated June 23, 2016.

<sup>31</sup> See CHX Article 1, Rule 2(b)(2)(E) defining “Qualified Contingent Trade.”

<sup>32</sup> All Negotiated Trades executed on the Exchange result from cross orders submitted with a specified crossing price. While the Plan permits the Exchange to execute such Negotiated Trades in an increment smaller than \$0.05, without exemptive relief, the Exchange would not be permitted to accept cross orders that would effect Negotiated

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For the reasons set forth above, the Exchange respectfully requests that, pursuant to Rule 608(c), the Commission grant exemptive relief to the provisions in the Plan as set forth above. The Exchange therefore believes that this exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanisms of, a national market system.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Albert J. Kim', with a long horizontal stroke extending to the right.

Albert J. Kim  
Vice President and Associate General Counsel

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Trades (e.g., Qualified Contingent Trades) in an increment smaller than \$0.05. The proposed exemptive relief would address this logical inconsistency.