

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-86280; File No. SR-CboeEDGX-2019-012)

July 2, 2019

Self-Regulatory Organizations; Cboe EDGX Exchange, Inc.; Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove of a Proposed Rule Change, as Modified by Amendment No. 1, to Introduce Order Book Priority for Equity Orders Submitted on Behalf of Retail Investors

On March 18, 2019, Cboe EDGX Exchange, Inc. (“Exchange” or “EDGX”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to introduce order book priority for equity orders submitted on behalf of retail investors. The proposed rule change was published for comment in the Federal Register on April 5, 2019.³ The Commission received four comment letters on the proposed rule change.⁴ On May 16, 2019, the Commission extended the time period within which to approve, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 85482 (April 2, 2019), 84 FR 13729 (“Notice”).

⁴ See letters to Vanessa Countryman, Acting Secretary, Commission, from Sean Paylor, Trader, AJO, L.P., dated April 25, 2019 (“AJO Letter”); Joseph Saluzzi and Sal Arnuik, Partners, Themis Trading LLC, dated May 8, 2019 (“Themis Letter”); T. Sean Bennett, Principal Associate General Counsel, Nasdaq, dated May 9, 2019 (“Nasdaq Letter”); letter to Eduardo A. Aleman, Deputy Secretary, Commission from Stephen John Berger, Global Head of Government & Regulatory Policy, Citadel Securities, dated April 26, 2019 (“Citadel Letter”). All comments received by the Commission on the proposed rule change are available at: <https://www.sec.gov/comments/sr-cboeedgx-2019-012/srcboeedgx2019012.htm>.

change to July 4, 2019.⁵ On June 18, 2019, the Exchange filed Amendment No. 1 to the proposed rule change.⁶

The Commission is publishing this notice and to solicit comments on the proposed rule change, as modified by Amendment No. 1, from interested persons and to institute proceedings pursuant to Section 19(b)(2)(B) of the Act⁷ to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 1.

I. Exchange's Description of the Proposal, as Modified by Amendment No. 1

The Exchange proposes to introduce order book priority for equity orders submitted on behalf of retail investors.

The text of the proposed rule change is also available on the Exchange's website (http://markets.cboe.com/us/options/regulation/rule_filings/edgx/), at the Exchange's Office of the Secretary, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

⁵ See Securities Exchange Act Release No. 85879, 84 FR 23591 (May 16, 2019).

⁶ Amendment No. 1 modifies the proposed rule change by: (1) adding a proposed definition of "Retail Priority Order"; (2) applying the proposed enhanced priority to "Retail Priority Orders" instead of "Retail Orders"; (3) imposing certain requirements on Retail Member Organizations that enter "Retail Priority Orders"; (4) removing the proposed requirement that "Retail Orders" must be identified as such on the EDGX Book Feed; and (5) requiring that all "Retail Priority Orders" be identified as such on the EDGX Book Feed. Amendment No. 1 is available at: <https://www.sec.gov/comments/sr-cboeedgx-2019-012/srcboeedgx2019012-5705327-185928.pdf>.

⁷ 15 U.S.C. 78s(b)(2)(B).

Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the proposed rule change is to introduce order book priority for equity orders submitted on behalf of retail investors. Forty three million U.S. households hold a retirement or brokerage account,⁸ and these investors are increasingly turning to the equities markets to fund important life goals. It is therefore critical that our markets are sensitive to the needs of the investing public. The Exchange continuously strives to innovate and improve market structure in ways that facilitate ordinary investors achieving their investment goals. The proposed introduction of retail priority is designed with this objective in mind. The Exchange believes that introducing retail priority may provide retail investors with better execution quality and better position the Exchange as the “home” for retail limit orders. This, in turn, will further allow retail liquidity to contribute to overall price formation and attract more market participants to the Exchange, creating a richer and more diverse ecosystem with deeper liquidity. Retail priority would therefore be consistent with the goals of the Commission to encourage markets that are structured to benefit ordinary investors,⁹ while facilitating order interaction and price discovery to the benefit of all market participants.

⁸ See The Evolving Market for Retail Investment Services and Forward-Looking Regulation — Adding Clarity and Investor Protection while Ensuring Access and Choice, Chairman Jay Clayton, Commission (May 2, 2018), available at <https://www.sec.gov/news/speech/speech-clayton-2018-05-02>.

⁹ See e.g., U.S. Securities and Exchange Commission, Strategic Plan, Fiscal Years 2018-2022, available at https://www.sec.gov/files/SEC_Strategic_Plan_FY18-FY22_FINAL_0.pdf (“Commission Strategic Plan”).

Background

As defined in EDGX Rule 11.21, a “Retail Order” is an agency or riskless principal order that meets the criteria of FINRA Rule 5320.03¹⁰ that originates from a natural person and is submitted to the Exchange by a Retail Member Organization, provided that no change is made to the terms of the order with respect to price or side of market and the order does not originate from a trading algorithm or any other computerized methodology.¹¹ A “Retail Member Organization” or “RMO” is a Member (or a division thereof) that has been approved by the Exchange under EDGX Rule 11.21 to submit Retail Orders. Pursuant to EDGX Rule 11.21(b), which describes the qualification and application process for becoming a Retail Member Organization, any member may qualify as a Retail Member Organization if it conducts a retail business or routes retail orders on behalf of another broker-dealer.

Today, the Exchange operates based on a price/display/time priority execution algorithm that is similar to those employed by most other U.S. equities exchanges.¹² As such, the first Displayed¹³ order resting on the EDGX Book¹⁴ at a particular price has priority over the next

¹⁰ FINRA Rule 5320.03 clarifies that an RMO may enter Retail Orders on a riskless principal basis, provided that (i) the entry of such riskless principal orders meet the requirements of FINRA Rule 5320.03, including that the RMO maintains supervisory systems to reconstruct, in a time-sequenced manner, all Retail Orders that are entered on a riskless principal basis; and (ii) the RMO submits a report, contemporaneously with the execution of the facilitated order, that identifies the trade as riskless principal.

¹¹ Retail Member Organizations are able to designate their orders as Retail Orders on either an order-by-order basis using FIX ports or by designating certain of their FIX ports at the Exchange as “Retail Order Ports.” Unless otherwise instructed by the Retail Member Organization, a Retail Order will be identified as Retail when routed to an away Trading Center. See EDGX Rule 11.21(d).

¹² See EDGX Rule 11.12.

¹³ “Displayed” is an instruction the User may attach to an order stating that the order is to be displayed by the System on the EDGX Book. See EDGX Rule 11.6(e)(1).

¹⁴ “EDGX Book” means the System’s electronic file of orders. See EDGX Rule 1.5(d)

order and so on based on the time of order entry. Non-Displayed¹⁵ orders at that price are further categorized into a number of priority bands, with orders within each priority band prioritized again based on the time of order entry, as provided in EDGX Rule 11.9. The generally applicable allocation bands for orders executed on the Exchange are described in EDGX Rule 11.9(a)(2)(A), and similar allocation bands applicable to orders executed at the midpoint of the NBBO are described in EDGX Rule 11.9(a)(2)(B).¹⁶ The price time allocation model has provided significant benefits to the equities markets as it encourages increased efficiency by rewarding market participants that are the first to provide liquidity at a particular price. At the same time, because this allocation methodology preferences speed, retail investors may have a more limited ability to secure an execution for their non-marketable orders under this model. The Exchange believes that retail priority would improve trading outcomes for retail investors and could perhaps encourage even more retail order flow to be entered into the displayed market.

Retail Priority Orders

The Exchange would offer priority benefits exclusively to Retail Orders that are entered on behalf of retail investors that enter a limited number of equity orders each trading day. As such, the Exchange would define a new term, “Retail Priority Order” to designate Retail Orders that are eligible for priority on the EDGX Book. Specifically, a “Retail Priority Order” would be defined as a Retail Order, as defined in Rule 11.21(a)(2), that is entered on behalf of a person that does not place more than 390 equity orders per day on average during a calendar month for its own beneficial account(s). The selected 390 orders per day threshold to qualify as a Retail

¹⁵ “Non-Displayed” is an instruction the User may attach to an order stating that the order is not to be displayed by the System on the EDGX Book. See EDGX Rule 11.6(e)(2).

¹⁶ In addition, EDGX Rule 11.9(a)(2)(C) describes the sequence in which orders are timestamped when re-ranked by the System upon clearance of a locking quotation.

Priority Order is similarly used for the options industry Priority Customer definition,¹⁷ and represents one order entered each minute during regular trading hours – i.e., from 9:30 a.m. ET to 4:00 p.m. ET. All orders entered on behalf of the retail customer would be counted to determine whether a customer’s Retail Orders could be identified as Retail Priority Orders. This would therefore include both orders routed to other exchanges and orders that are not entered as Retail Orders (e.g., because the price of such orders is modified by a broker-dealer algorithm). The Exchange believes that limiting the Retail Orders that would be priority eligible, as described, would assist in ensuring that these benefits flow only to retail investors that are not engaged in trading activity akin to that of a professional.

Similar to the rules of the Exchange’s options trading platform (“EDGX Options”),¹⁸ the EDGX Equities rules would describe how to count parent/child orders and cancel/replace orders when determining whether the 390 order per day threshold has been exceeded. As proposed, parent/child orders would be counted as a single order – i.e., a “parent” order that is broken into multiple “child” orders by a broker or dealer, or by an algorithm housed at a broker or dealer or by an algorithm licensed from a broker or dealer, but which is housed with the customer, would count as one order even if the “child” orders are routed across multiple exchanges. Similarly, with one exception for parent/child orders, any order that cancels and replaces an existing order would count as a separate order. An order that cancels and replaces any “child” order resulting from a “parent” order that is broken into multiple “child” orders, would not count as a new order.

¹⁷ See e.g., EDGX Rule 16.1(a)(46),(47).

¹⁸ See Interpretations and Policies .01 to EDGX Rule 16.1. Due to differences between equities and options trading there are some differences between the proposed methodology and the methodology used by options exchanges. For example, EDGX Options rules contain provisions related to complex orders and pegged orders, and differentiate between parent orders that are broken up into multiple child orders on the same side and series or both sides and/or multiple series.

The Exchange believes that this guidance would assist RMOs in determining whether Retail Orders entered on behalf of a particular retail customer would qualify to be entered as Retail Priority Orders. Similar to the implementation of the Priority Customer designation in the options industry,¹⁹ RMOs that enter Retail Priority Orders would also be required to have reasonable policies and procedures in place to ensure that such orders are appropriately represented on the Exchange. Such policies and procedures should provide for a review of retail customers' activity on at least a quarterly basis. Retail Orders for any retail customer that had an average of more than 390 orders per day during any month of a calendar quarter would not be eligible to be entered as Retail Priority Orders for the next calendar quarter. RMOs would be required to conduct a quarterly review and make any appropriate changes to the way in which they are representing orders within five business days after the end of each calendar quarter. While RMOs would only be required to review their accounts on a quarterly basis, if during a quarter the Exchange identifies a retail customer for which orders are being represented as Retail Priority Orders but that has averaged more than 390 orders per day during a month, the Exchange would notify the RMO, and the RMO would be required to change the manner in which it is representing the retail customer's orders within five business days.

Retail Priority Proposal

The Exchange proposes to introduce retail priority in order to ensure that non-marketable orders submitted on behalf of retail investors can more readily compete for execution with orders entered by sophisticated market participants that may be better equipped to optimize their place in the intermarket queue. Retail priority would be in place during all trading sessions, and would

¹⁹ See Securities Exchange Act Release No. 78221 (July 1, 2016), 81 FR 44353 (July 7, 2016) (SR-BatsEDGX-2016-28).

also be available to orders entered for participation in the Exchange’s opening process and the re-opening process following a halt.

As proposed, the portion of a Retail Priority Order with a Displayed instruction would be given allocation priority ahead of all other available interest on the EDGX Book. This would be true of both orders executed pursuant to the regular priority bands described in EDGX Rule 11.9(a)(2)(A), and orders priced at the midpoint of the NBBO pursuant to EDGX Rule 11.9(a)(2)(B) where Retail Priority Orders subject to Display-Price Sliding²⁰ would have priority ahead of limit orders entered with such an instruction as well as any other orders resting at the midpoint of the NBBO.²¹ In addition, since Reserve Orders contain a Displayed instruction but include both Displayed and Non-Displayed shares, the Reserve Quantity²² of Retail Priority Orders would be given priority ahead of the Reserve Quantity of other limit orders on the EDGX Book.

Retail Priority Orders that are not willing to be displayed, or are only willing to be displayed at a less aggressive price than the execution price, would not receive any special priority. For example, a Retail Priority Order that is entered as a MidPoint Peg Order,²³ which by

²⁰ Display-Price Sliding is an order instruction provided for compliance with Rule 610(d) of Regulation NMS. See EDGX Rule 11.6(l)(B). While a significant majority of Retail Orders are entered into the EDGX Book with a routing instruction, an RMO may choose to perform its own routing, in which case those orders may be handled pursuant to the Display-Price Sliding process, which is the default handling unless Price Adjust or Cancel Back is elected. See EDGX Rule 11.8(b)(10).

²¹ Orders entered with Display-Price Sliding are ranked at the locking price and are therefore given priority when executed at the midpoint of the NBBO pursuant to current EDGX Rule 11.9(a)(2)(B).

²² “Reserve Quantity” is the portion of an order that includes a Non-Displayed instruction in which a portion of that order is also displayed on the EDGX Book. See EDGX Rule 11.6(m).

²³ A “MidPoint Peg Order” is a non-displayed Market Order or Limit Order with an instruction to execute at the midpoint of the NBBO, or, alternatively, pegged to the less

definition is Non-Displayed, would be prioritized along with all other MidPoint Peg Orders notwithstanding the fact that it is a Retail Priority Order. Similarly, a MidPoint Discretionary Order (“MDO”)²⁴ executed within its Discretionary Range would receive the same priority as other orders entered with a Discretionary Range instruction, regardless of whether the MDO is displayed at its pegged price.

The following examples illustrate the proposed implementation of retail priority.²⁵

Example 1: Displayed Retail Priority Order has Priority at a Given Price

NBBO: \$10.00 x \$10.10

Order 1: Buy 100 shares @ \$10.00 – Displayed, Non-Retail Priority Order

Order 2: Buy 100 shares @ \$10.00 – Displayed, Retail Priority Order

Order 3: Sell 100 shares @ \$10.00

A Retail Priority Order entered with a Displayed instruction would have priority over Non-Retail Priority Orders at the same price. As a result, Order 3 would trade with Order 2 for 100 shares @ \$10.00, securing a timely execution for the retail investor.

Example 2: Better Priced Non-Retail Priority Order has Priority

NBBO: \$10.00 x \$10.10

Order 1: Buy 100 shares @ \$10.00 – Retail Priority Order

aggressive of the midpoint of the NBBO or one minimum price variation inside the same side of the NBBO as the order. See EDGX Rule 11.8(d).

²⁴ A “MidPoint Discretionary Order” is a Limit Order that is executable at the NBB for an order to buy or the NBO for an order to sell while resting on the EDGX Book, with discretion to execute at prices to and including the midpoint of the NBBO. See EDGX Rule 11.8(g).

²⁵ In each example, orders are shown in the order in which they are entered.

Order 2: Buy 100 shares @ \$10.01 – Non-Retail Priority Order

Order 3: Sell 100 shares @ \$10.00

Allocations would continue to be prioritized based on price. Although Retail Priority Orders entered with a Displayed instruction would have priority over Non-Retail Priority Orders at the same price, they would not have priority over Non-Retail Priority Orders at a better price. As a result, Order 3 would trade with the better priced Order 2 for 100 shares @ \$10.01.

Example 3: No Retail Priority for Non-Displayed Orders

NBBO: \$10.00 x \$10.10

Order 1: Buy 100 shares @ \$10.01 – Non-Displayed, Non-Retail Priority
Order

Order 2: Buy 100 shares @ \$10.01 – Non-Displayed, Retail Priority Order

Order 3: Sell 100 shares @ \$10.00

A Retail Priority Order entered with a Non-Displayed instruction is not eligible for retail priority. As a result, Order 3 trades with Order 1 for 100 shares @ \$10.01 based on time priority. Retail Priority Orders would need to be submitted with a Displayed or Reserve instruction to qualify for the benefits of retail priority, which should encourage displayed retail liquidity.

Example 4: No Retail Priority in Discretionary Range

NBBO: \$10.00 x \$10.10

Order 1: Buy 100 shares @ \$10.00 + \$0.03 Discretion – Non-Retail Priority
Order

Order 2: Buy 100 shares @ \$10.00 + \$0.03 Discretion – Retail Priority Order

Order 3: Sell 100 shares @ \$10.02

Retail Priority Orders would only have priority if willing to be displayed at the execution price. Although orders entered with a Discretionary Range instruction may be displayed at their ranked price, the execution would occur at a non-displayed price within the Discretionary Range. As a result, Order 3 trades with Order 1 for 100 shares @ \$10.02 based on time priority.²⁶

Example 5: Retail Priority Reserve Order has Displayed and Non-Displayed Priority

NBBO: \$10.00 x \$10.10

Order 1: Buy 500 @ \$10.00 – Non-Retail Priority Reserve Order, 100 shares displayed

Order 2: Buy 500 @ \$10.00 – Retail Priority Reserve Order, 100 shares displayed

Order 3: Sell 300 @ \$10.00

A Retail Priority Order entered as a Reserve Order would have retail priority for both displayed and non-displayed size. However, any Reserve Quantity would be executed after other orders with a higher priority, including the displayed size available from Non-Retail Priority Orders. As a result, Order 3 would trade 100 shares @ \$10.00 with Order 2 based on retail priority, then would trade 100 shares @ \$10.00 with Order 1. After exhausting the available displayed size, Order 3 would trade the remaining 100 shares @ \$10.00 with Order 2 based on retail priority.

Example 6: Display-Price Sliding Retail Priority Orders are Eligible for Priority at

Midpoint

NBBO: \$10.00 x \$10.01

EDGX BBO: \$10.00 x \$10.02

²⁶ If Order 3 was to sell 100 shares @ \$10.00 then retail priority would be observed at the displayed price and Order 3 would trade with Order 2 for 100 shares @ \$10.00.

Order 1: Buy 100 shares @ \$10.01 – Book Only, Display-Price Sliding, Non-Retail
Priority Order

Order 2: Buy 100 shares @ \$10.01 – Book Only, Display-Price Sliding, Retail Priority
Order

Order 3: Sell 100 shares @ \$10.01 – Post Only

Order 4: Sell 100 shares @ \$10.00

Due to the Display-Price Sliding instruction, both Order 1 and Order 2 are ranked at \$10.01 and displayed at \$10.00 to avoid locking the National Best Offer at \$10.01.²⁷ Then, because of the Post Only instruction, Order 3 posts and displays on the EDGX Book at \$10.01. Since there is displayed interest now resting on the same side of the order book, Order 4 is eligible for execution on entry at the midpoint price of \$10.005 – i.e., one-half minimum price variation better than Order 3.²⁸ At the midpoint of the NBBO, a Retail Priority Order subject to Display-Price Sliding that is willing but unable to display at or better than the execution price would have priority over other orders. As a result, Order 4 would trade with Order 2 for 100 shares @ \$10.005, securing a timely execution for the retail investor.

Example 7: Reserve and Other Orders on EDGX Book

NBBO: \$10.00 x \$10.01

EDGX BBO: \$10.00 x \$10.02

Order 1: Buy 100 shares @ \$10.00 – Non-Retail Priority Order

Order 2: Buy 500 @ \$10.00 – Non-Retail Priority Reserve Order, 100 shares
displayed

²⁷ An order with a Display-Price Sliding instruction that would be a locking quotation on entry is instead ranked at the locking price and displayed at a price that is one minimum price variation less aggressive than the locking price. See EDGX Rule 11.6(l)(B).

²⁸ See EDGX Rule 11.6(l)(1)(B)(v); EDGX Rule 11.10(a)(4)(D).

- Order 3: Buy 500 @ \$10.00 – Retail Priority Reserve Order, 100 shares displayed
- Order 4: Buy 100 shares @ \$10.01 – Book Only, Display-Price Sliding, Non-Retail Priority Order
- Order 5: Sell 500 shares @ \$10.00

Due to the Display-Price Sliding instruction, Order 4 is displayed at \$10.00 to avoid locking the National Best Offer at \$10.01, but ranked and executable at its \$10.01 limit price. Since allocations would continue to be prioritized based on price, Order 5 would first trade 100 shares @ \$10.01 with Order 4. At any given price, the displayed size of a Retail Priority Order would have priority over Non-Retail Priority Orders at the same price. As such, Order 5 would next trade 100 shares @ \$10.00 with Order 3. Next, the displayed size of Non-Retail Priority Orders would trade in time priority. Order 5 would therefore trade 100 shares @ \$10.00 with Order 1, followed by 100 shares @ \$10.00 with Order 2. Finally, after exhausting the available displayed size, the Reserve Quantity of the remaining Reserve Orders would trade, with Retail Priority Orders being eligible for retail priority. As a result, Order 5 would trade the remaining 100 shares @ \$10.00 with Order 3.

Example 8: Display-Price Sliding and Midpoint Peg Orders on EDGX Book

NBBO: \$10.00 x \$10.01

EDGX BBO: \$10.00 x \$10.02

- Order 1: Buy 100 shares @ \$10.01 – Book Only, Display-Price Sliding, Non-Retail Priority Order
- Order 2: Buy 500 shares @ \$10.01 – Book Only, Display-Price Sliding, Retail Priority Reserve Order, 100 shares displayed
- Order 3: Buy 100 shares @ \$10.01 – MidPoint Peg, Non-Retail Priority Order

Order 4: Sell 100 shares @ \$10.01 – Post Only

Order 5: Sell 500 shares @ \$10.00

Due to the Display-Price Sliding instruction, both Order 1 and Order 2 are ranked at \$10.01 and displayed at \$10.00 to avoid locking the National Best Offer at \$10.01. Order 3, meanwhile is ranked at the midpoint price of \$10.005. Then, because of the Post Only instruction, Order 4 posts and displays on the EDGX Book at \$10.01. Since there is displayed interest now resting on the same side of the order book, Order 5 is eligible for execution on entry at the midpoint price of \$10.005 – i.e., one-half minimum price variation better than Order 4. At the midpoint of the NBBO, a Retail Priority Order subject to Display-Price Sliding that is willing but unable to display at or better than the execution price would have priority over other orders. As a result, Order 5 would first trade with Order 2 for 100 shares @ \$10.005. Non-Retail Priority Orders with Display-Price Sliding would be next in priority, and Order 5 would therefore next trade 100 shares @ \$10.005 with Order 1. Finally, Order 5 would trade the remaining 300 shares @ 10.005 with Order 2. Order 3 would not receive an execution since its ranked price of \$10.005 is worse than the ranked price of Orders 1 and 2, which are both ranked at the locking price of \$10.01.²⁹

Retail Attribution

A Retail Member Organization on EDGX has the option of designating Retail Orders to be identified as such on the EDGX Book Feed,³⁰ which may increase potential execution opportunities for that order. Today, pursuant to EDGX Rule 11.21(f), this designation may be

²⁹ Pursuant to EDGA Rule 11.9(a)(1), the best-priced orders to buy or sell have priority on the EDGA Book in all cases. Although executable at the midpoint, Orders 1 and 2 are the highest-priced buy orders based on the \$10.01 ranked price. As such, the full size of those orders would trade before orders that are both ranked and executable at the midpoint.

³⁰ See EDGX Rule 13.8.

made on either an order-by-order or port-by-port basis,³¹ thereby giving members flexibility in how they would like their Retail Orders attributed on the Exchange. To support the introduction of retail priority, the Exchange proposes to provide that Retail Priority Orders will always be designated as such on the EDGX Book Feed – i.e., Retail Priority Orders would be identified as having been entered with a priority designation.³² Retail Orders that are not designated as Retail Priority Orders could continue to be attributed, or not, at the discretion of the RMO entering the order. Although RMOs have the choice to determine which Retail Orders would be marked as retail on market data, the Exchange believes that it is important to ensure that Retail Priority Orders would be attributable as priority eligible. Designating Retail Priority Orders on the EDGX Book Feed will increase transparency by informing market participants when there is priority eligible retail investor interest available to trade on the Exchange, thereby allowing market participants to make informed routing decisions, including the decision to route contra-side interest to trade with such orders. Based on the Exchange’s experience with Retail Order attribution, this approach has the potential to increase execution opportunities for Retail Priority Orders (and other non-marketable orders) by encouraging additional order flow to be routed to the Exchange to trade with resting Retail Priority Orders.³³

³¹ A Retail Member Organization that instructs the Exchange to identify all its Retail Orders as Retail on a Retail Order Port is able to override such setting and designate any individual Retail Order from that port as Attributable or as Non-Attributable, as set forth in Rule 11.6(a). See EDGX Rule 11.21(f).

³² The retail indicator on the EDGX Book Feed would indicate that the order is a Retail Priority Order and would not provide the market participant identifier (“MPID”) of the entering firm. Members may separately include an Attributable instruction on their orders pursuant to Rule 11.6(a) if they would also like MPID attribution.

³³ Prior to the original introduction of retail attribution, the Exchange conducted a study that found that Retail Orders received an 18% higher execution rate when members used Attributable Orders to include their MPID in the published quote on the EDGX Book Feed. See Securities Exchange Act Release No. 72016 (April 24, 2014), 79 FR 24463

In addition, since only Retail Priority Orders would be required to be attributed, RMOs would retain the option of not attributing Retail Orders entered into the EDGX Book. While Retail Orders not entered with the Retail Priority Order designation would not be eligible for priority, they would retain all other benefits associated with Retail Orders today, including the materially enhanced rebates that are made available to such orders.³⁴ The purpose of requiring attribution of Retail Priority Orders is, first and foremost, to ensure that market participants can ascertain their priority on the order book. Although the Exchange believes that RMOs are comfortable attributing their orders, if a specific RMO would prefer not to have one or more of their orders attributed, the member would be able to choose not to enter such orders as Retail Priority Orders without losing any of the benefits that they are provided today. Customer indicators are widely-used in the options industry, and the Exchange believes that they would be equally appropriate on EDGX with the introduction of retail priority.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the requirements of Section 6(b) of the Act,³⁵ in general, and Section 6(b)(5) of the Act,³⁶ in particular, in that it is designed to remove impediments to and perfect the mechanism of a free and open market and a national market system, to promote just and equitable principles of trade, and, in general, to

(April 30, 2014) (SR-EDGX-2014-13).

³⁴ The equities industry is highly competitive, and competition for retail order flow is particularly fierce as the equities exchanges compete vigorously with each other, and with wholesale market makers that execute this order flow off-exchange. As a result, the Exchange provides a rebate of \$0.0032 per share to all Retail Orders. This rebate applies irrespective of whether the RMO attributes Retail Orders on the EDGX Book Feed.

³⁵ 15 U.S.C. § 78f(b).

³⁶ 15 U.S.C. § 78f(b)(5).

protect investors and the public interest and not to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Commission has consistently emphasized the need to ensure that the U.S. capital markets are structured with the interests of retail investors in mind, and recently highlighted its focus on the “long-term interest of Main Street Investors” as the agency’s number one strategic goal for fiscal years 2018 to 2022.³⁷ The Exchange believes that retail priority is consistent with the goals of the Commission to ensure that the equities markets continue to serve the needs of the investing public. Specifically, introducing retail priority would protect investors and the public interest by giving retail investors the tools needed to compete for executions on non-marketable order flow submitted to a national securities exchange. The Exchange is committed to innovation that improves the quality of the equities markets, and believes that retail priority may increase the attractiveness of the Exchange for the execution of orders submitted on behalf of the millions of ordinary investors that rely on these markets for their investment needs.

Although the Commission has approved other allocation methodologies for equities trading,³⁸ most equities exchanges, including EDGX, continue to determine priority based on a price/display/time allocation model today. This has contributed to deep and liquid markets for equity securities as liquidity providers compete to be the first to establish a particular price. At the same time, ordinary investors may not be able to compete with market makers and other automated liquidity providers to be the first to set a new price. Importantly, retail investors, in contrast to their professional counterparts, tend to have longer investment time horizons and are

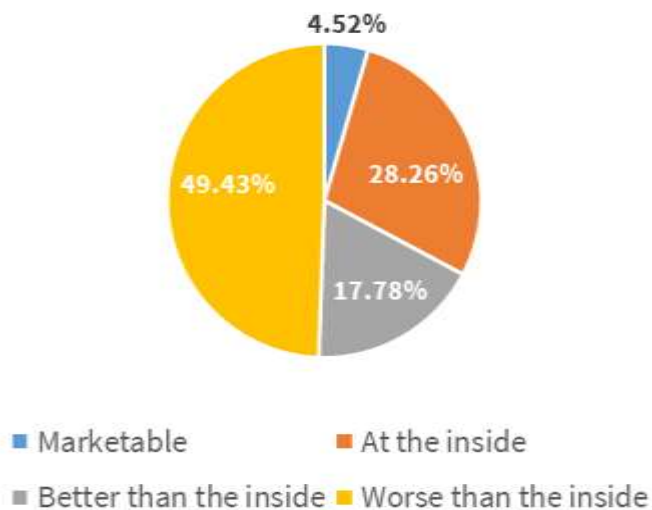
³⁷ See Commission Strategic Plan, *supra* note 4.

³⁸ Nasdaq PSX, for example, operates with a price setter pro rata model that rewards liquidity providers that set the best price and then rewards other market participants that enter larger sized orders. See Securities Exchange Act Release No. 72250 (May 23, 2014), 79 FR 31147 (May 30, 2014) (SR-Phlx-2014-24).

not in the business of optimizing queue placement under a time based allocation model. Thus, in order to facilitate the needs of these ordinary investors, the Exchange believes that an alternative approach is needed.

The proposed introduction of retail priority is designed, first and foremost, to benefit retail investors by increasing both the likelihood and speed with which their non-marketable orders are executed. Unlike marketable retail order flow that is routinely executed in full on entry at the national best bid or offer or better, non-marketable retail order flow has to compete for execution with orders entered by sophisticated market participants that may be quicker to establish a new price. As shown in the chart below,³⁹ the Exchange has found that in 2018, of volume executed from retail limit orders, 28.3% joined the national best bid or offer (“NBBO”) on entry, 17.8% were priced better than the inside, and 49.4% were priced worse than the inside.

EDGX Retail Limit Order Volume by Marketability



³⁹ Based on Retail Orders entered by members that have completed a retail attestation.

Although potentially beneficial for all Retail Priority Orders that do not trade immediately on entry, the Exchange believes that retail priority would be particularly beneficial to Retail Priority Orders that join the NBBO, as there would often already be a queue at this price. Introducing retail priority would thus give retail investors the ability to compete for an execution for these orders, and may therefore improve trading outcomes. As such, the Exchange believes that the proposed rule change is consistent with the goals of the Exchange, and of the Commission, to ensure that market structure evolves in ways that protect ordinary investors that participate in the capital markets. Furthermore, since retail priority is designed to improve trading outcomes for ordinary investors, the Exchange also believes that it may encourage retail brokers to route additional non-marketable retail order flow to the EDGX Book, which may broaden execution opportunities for other market participants. If successful in attracting retail order flow to the Exchange, the proposed rule change would benefit market participants by increasing the diversity of order flow with which they can interact on a national securities exchange, thereby increasing order interaction and contributing to price formation.

Giving queue priority to ordinary investors is not a novel concept in the securities markets. In fact, customer priority has a long tradition in the options market where orders entered on behalf of non-broker dealer public customers have historically been afforded priority over orders submitted by registered broker dealers. Today, most options exchanges, including the Exchange's equity options platform ("EDGX Options"),⁴⁰ employ a customer priority execution algorithm where orders submitted by a subset of public customers with more limited trading activity (i.e., "Priority Customers")⁴¹ are provided order book priority ahead of orders submitted

⁴⁰ See EDGX Rule 21.8(d)(1).

⁴¹ The term "Priority Customer" refers to any person or entity that is not a broker or dealer in securities and does not otherwise qualify as a "Professional" by virtue of placing more

by broker-dealers or other market professionals at the same price. This allocation model, which was first introduced by the International Securities Exchange LLC (“ISE”) in its current retail focused form a decade ago,⁴² ensures that orders from Priority Customers are executed ahead of similarly priced interest from sophisticated market participants. The Exchange believes that the time has come to introduce a similar concept for the equities market in order to facilitate the needs of retail investors that increasingly rely on these markets.

Similar to the options market Priority Customer definition, the Exchange proposes to introduce a new definition of “Retail Priority Orders” that would allow the Exchange to differentiate between more and less active retail investors. Although the Exchange currently has a robust regulatory program for Retail Orders that includes a number of safeguards to prevent misuse,⁴³ some equities market participants have expressed concerns that the current definition of Retail Order could provide market structure advantages to a subset of investors that are more akin to market professionals. The Exchange believes that limiting retail priority to Retail Orders that are entered on behalf of less active investors would alleviate any potential concerns while ensuring that retail investors would be able to reap the proposed priority benefits. As such, Retail Orders entered on the EDGX Book would be priority eligible only if the end investor submits fewer than 390 orders per day on average, or the equivalent of one order per minute during regular trading hours. The Exchange believes that this approach is consistent with the public

than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). See e.g., EDGX Rules 16.1(a)(46),(47).

⁴² See Securities Exchange Act Release No. 59287 (January 23, 2009), 74 FR 5694 (January 30, 2009) (SR-ISE-2006-26).

⁴³ The current Retail Order definition is enforced through an established process for approving the RMOs that are permitted to enter Retail Orders; an attestation that such RMOs must provide about the retail quality of their order flow; policies and procedures to ensure the effectiveness of that attestation; surveillance conducted by Exchange staff; and an exam process implemented by the Financial Industry Regulatory Authority.

interest and the protection of investors as an investor that enters more than one order per minute is effectively engaged in active trading activity that is more akin to a professional trader. A similar approach is used to differentiate between Priority and Professional Customers in the options industry today. Thus, identifying Retail Priority Orders based on the average number of orders entered for a beneficial account is both a familiar and appropriately objective approach that would reasonably distinguish between ordinary retail investors from more active traders that may compete with market professionals.

The Commission has approved other equities proposals to introduce meaningful market structure benefits for retail investors in recent years. For example, in 2012, the Commission approved proposals filed by the New York Stock Exchange LLC (“NYSE”) and its affiliate NYSE Amex LLC (“Amex”) to introduce retail price improvement programs.⁴⁴ Those programs were designed to provide price improvement opportunities for retail investors on a national securities exchange by allowing liquidity providers to give sub-penny price improvement to their orders pursuant to an exemption granted from Rule 612 of Regulation NMS. Similar programs now exist on a number of exchanges, including the Exchange’s affiliate, Cboe BYX Exchange, Inc. (“BYX”),⁴⁵ and have provided millions of dollars of price improvement to ordinary investors.⁴⁶ When approving such retail price improvement programs on a pilot basis, the Commission consistently found that the pilots were consistent with the Act because they were

⁴⁴ See Securities Exchange Act Release No. 67347 (July 3, 2012), 77 FR 40673 (July 10, 2012) (SR-NYSE-2011-55; SR-NYSEAmex-2011-84).

⁴⁵ See Securities Exchange Act Release No. 68303 (November 27, 2012), 77 FR 71652 (December 3, 2012) (SR-BYX-2012-019). Nasdaq BX Inc. (“BX”) similarly operates its own retail price improvement program. See Securities Exchange Act Release No. 73702 (November 28, 2014), 79 FR 72049 (December 4, 2014) (SR-BX-2014-048).

⁴⁶ See e.g. Securities Exchange Act Release No. 83831 (August 13, 2018), 83 FR 41128 (August 17, 2018) (SR-CboeBYX-2018-014).

“reasonably designed to benefit retail investors” and could “promote competition for retail order flow among execution venues.” The benefits to retail investors in the form of meaningful price improvement opportunities similarly animated the Commission’s recent approval of the NYSE retail liquidity program on a permanent basis.⁴⁷ Although retail priority is designed to increase fill rates and speed of execution rather than price improvement, the Exchange believes that it could have a similarly meaningful impact on execution quality for ordinary investors that trade in the public market. Furthermore, retail priority would complement existing retail price improvement programs by offering market structure benefits to non-marketable retail order flow that cannot participate in those programs.

Similarly, in 2017, the Commission approved a proposed rule change by The Nasdaq Stock Market LLC (“Nasdaq”) to introduce the “Extended Life Priority Order Attribute” for Retail Orders that were willing to remain on the book unaltered for a period of one second (“Retail Extended Life Order” or “Retail ELO”).⁴⁸ As proposed, displayed orders entered on Nasdaq with the Retail ELO attribute were to be provided a higher priority than other orders resting on the Nasdaq order book. When the Commission approved this proposed rule change, it opined that the proposal “should benefit retail investors by providing enhanced order book priority to retail order flow that is not marketable upon entry,” and that “[s]uch enhanced order book priority could result in additional or more immediate execution opportunities on the [e]xchange for resting retail orders that otherwise would be farther down in the order book

⁴⁷ See Securities Exchange Act Release No. 85160 (February 15, 2019), 84 FR 5754 (February 22, 2019) (SR-NYSE-2018-28).

⁴⁸ See Securities Exchange Act Release No. 81097 (July 7, 2017), 82 FR 32386 (July 13, 2017) (SR-NASDAQ-2016-161) (“Retail ELO Approval”). Nasdaq ultimately decided not to implement Retail ELO following Commission approval, and has since introduced a “Midpoint Extended Life Order” that is not limited to retail participation.

queue, and thereby enhance execution opportunities for retail investors.”⁴⁹ The same is true of the Exchange’s retail priority proposal, which would provide similar benefits to retail investors without the additional complexity of requiring that the order be willing to exist unaltered on the order book for a specified period of time. While the Exchange believes that the majority of retail investors have a longer investment time horizon and therefore do not actively manage their trading interest at sub-second time intervals, the Exchange believes that giving retail priority broadly to orders entered on behalf of less active retail investors may be more effective in encouraging retail brokers to route order flow to the Exchange.

The Exchange also believes that it is appropriate and not unfairly discriminatory to provide enhanced priority benefits solely to retail investor orders as the proposal is designed specifically to ensure that retail investors can compete for executions with sophisticated market participants. In today’s highly automated and efficient market, retail investors have a more limited opportunity to compete for an execution based purely on the time an order is placed. While sophisticated, latency sensitive market participants can compete to be the first at any particular price, retail investors with longer investment horizons cannot compete in the same fashion. The proposed introduction of retail priority would ensure that non-marketable Retail Priority Orders get filled first when there is available contra-side interest, and thereby improve investment outcomes for ordinary investors. The Commission has consistently held that it is consistent with the Act to offer certain advantages to retail customers,⁵⁰ and the proposal follows

⁴⁹ Id.

⁵⁰ Where the interest of long-term investors, such as the retail investors whose experience this filing is attempting to improve, diverges from that of short-term professional traders, the Commission “repeatedly has emphasized that its duty is to uphold the interests of long-term investors.” See Securities Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3593 (January 21, 2010) (File No. S7-02-10) (“Concept Release on Equity Market Structure”).

a line of other initiatives to improve the retail investor experience in the public markets. The Exchange believes that it is an important goal of both the Exchange and the Commission to ensure that our market structure continues to benefit retail investors by providing the tools that they need to invest in the capital markets. Although there are many ways to achieve that goal, the Exchange believes that doing so requires innovation in how retail investor orders are handled on the national securities exchanges in order to attract that order flow back to the displayed market.

The Exchange also believes that it is consistent with the public interest and the protection of investors to provide retail priority exclusively to those orders that contain a Displayed or Reserve instruction. The goals of the proposed rule change are twofold. First, the proposed change is designed to facilitate better trading outcomes for retail investors, which may encourage retail brokers to send additional retail order flow to the Exchange. Second, the proposed change is designed to encourage additional displayed retail liquidity, which could contribute to price discovery and encourage additional order flow and liquidity from other market participants. Although the first purpose could be achieved without limiting retail priority to orders that contain a Displayed component at a particular price, the second is only achieved when such orders are displayed to the broader market. For that reason, recent priority enhancements for retail investors, such as Nasdaq's Retail ELO, have also focused on displayed interest that could improve quote quality and contribute to a vibrant market.

Finally, the Exchange believes that it is consistent with just and equitable principles of trade to require that Retail Priority Orders be attributable as this would allow other market participants to gauge the available size in orders that would be eligible for retail priority. Although RMOs would not have the option to submit eligible Retail Priority Orders as non-attributable, the transparency achieved by so designating these orders is important to the proper

functioning of a market where such orders would be eligible for priority. As explained in the purpose section of this proposed rule change, RMOs would retain the ability to enter an order without a priority designation, and in doing so would ultimately retain the ability to control which orders are publicly attributed to retail investors. Priority Customer orders entered on the EDGX Options platform are similarly designated as such on the Exchange's market data feeds today, and the Exchange believes that this has contributed positively to the overall market environment.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change would impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. Rather, the proposed rule change is designed to increase inter-market competition for retail order flow, and intra-market competition for orders as market participants compete to transact with retail investor orders entered on the EDGX Book. The proposed rule change represents an effort by the Exchange to enhance the ability for retail investors to participate effectively on a national securities exchange without unnecessarily burdening competition. Although retail priority would be limited to retail investors, the Exchange does not believe that this produces an unnecessary burden on competition as these changes are necessary to attract retail order flow to a national securities exchange where they may interact with a wide range of market participants. If successful, the Exchange believes that retail priority would enhance competition by encouraging retail brokers to route increased order flow to the public markets, creating a more vibrant and competitive trading environment that benefits all market participants.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No comments were solicited or received on the proposed rule change.

III. Proceedings to Determine Whether to Approve or Disapprove SR-CboeEDGX-2019-012 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act⁵¹ to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described below, the Commission seeks and encourages interested persons to provide comments on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,⁵² the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposed rule change's consistency with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be "designed to perfect the operation of a free and open market and a national market system" and "protect investors and the public interest," and not be "designed to permit unfair discrimination between customers, issuers, brokers, or dealers,"⁵³ and Section 6(b)(8) of the Act, which requires that the rules of a national securities exchange "not impose any burden on competition not necessary or appropriate in furtherance of the purposes of [the Act]."⁵⁴

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other

⁵¹ 15 U.S.C. 78s(b)(2)(B).

⁵² Id.

⁵³ 15 U.S.C. 78f(b)(5).

⁵⁴ 15 U.S.C. 78f(b)(8).

concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposal is consistent with Section 6(b)(5), 6(b)(8) or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.⁵⁵

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register]. The Commission asks that commenters address the sufficiency of the Exchange's statements in support of the proposal, which are set forth in Amendment No. 1,⁵⁶ in addition to any other comments they may wish to submit about the proposed rule change.

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CboeEDGX-2019-012 on the subject line.

⁵⁵ Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

⁵⁶ See supra note 6.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CboeEDGX-2019-012. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change.

Persons submitting comments are cautioned that we do not redact or edit personal identifying

information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CboeEDGX-2019-012 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵⁷

Eduardo A. Aleman
Deputy Secretary

⁵⁷ 17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(57).