

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-78684; File No. SR-CHX-2016-15)

August 25, 2016

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Modify the Handling of Intermarket Sweep Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup>, and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on August 17, 2016, the Chicago Stock Exchange, Inc. ("CHX" or the "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

CHX proposes to amend the Rules of the Exchange ("CHX Rules") to modify the handling of Intermarket Sweep Orders ("ISOs").

CHX has designated this proposed rule change as non-controversial pursuant to Section 19(b)(3)(A)<sup>3</sup> of the Act and Rule 19b-4(f)(6)<sup>4</sup> thereunder and has provided the Commission with the notice required by Rule 19b-4(f)(6)(iii).<sup>5</sup>

The text of this proposed rule change is available on the Exchange's Web site at ([www.chx.com](http://www.chx.com)) and in the Commission's Public Reference Room.

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> 17 CFR 240.19b-4(f)(6)(iii).

**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 CHX included statements concerning the purpose of and basis for the proposed rule changes and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The CHX 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 Changes**

**1. Purpose**

The Exchange proposes various amendments to the CHX Rules to amend the operation of the Exchange's ISO modifiers as follows:

- Amend the operation of the ISO modifier to be similar to the ISO modifiers offered by other national securities exchanges.<sup>6</sup> As amended, a limit order marked ISO ("ISO limit") would behave like a simple limit order<sup>7</sup> (*i.e.*, executable through multiple price points not beyond its limit price with the unexecuted balance to be immediately cancelled or ranked on the CHX book depending on the attached Time-In-Force<sup>8</sup> and display modifier<sup>9</sup>), but without regard to the Protected Quotations<sup>10</sup> of away markets when it is being processed as a new incoming order.

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<sup>6</sup> See e.g., NYSE ARCA Equities Rule 7.31(e)(2); see also e.g., Bats BYX Rule 11.9(d).

<sup>7</sup> See CHX Article 1, Rule 2(a)(1).

<sup>8</sup> See CHX Article 1, Rule 2(d).

<sup>9</sup> See CHX Article 1, Rule 2(e).

<sup>10</sup> See 17 CFR 242.600(b)(58).

- Require a limit order marked by any one of the Exchange's three ISO modifiers (i.e., BBO ISO,<sup>11</sup> Price-Penetrating ISO,<sup>12</sup> and ISO<sup>13</sup>) to be handled as if it were marked ISO, as amended.<sup>14</sup>

The Exchange also proposes to clarify the current handling of cross orders<sup>15</sup> marked ISO ("ISO cross") and Participants'<sup>16</sup> obligations with respect to ISOs.

The Exchange believes that the proposed rule change will harmonize the operation of the Exchange's ISO modifier with ISO modifiers offered by other national securities exchanges, as well as clarify and simplify the order types and modifiers offered by the Exchange, all of which further the objectives of the Act, as described below.

#### Current CHX ISOs

The Exchange currently offers three different ISO modifiers: BBO ISO, Price-Penetrating ISO, and ISO.<sup>17</sup> While all three modifiers can be used to mark an order as

<sup>11</sup> See CHX Article 1, Rule 2(b)(1)(A).

<sup>12</sup> See CHX Article 1, Rule 2(b)(1)(E).

<sup>13</sup> See CHX Article 1, Rule 2(b)(3)(B).

<sup>14</sup> In order to facilitate the transition to the amended ISO, the Exchange does not propose to eliminate the BBO ISO and Price-Penetrating ISO modifiers at this time.

<sup>15</sup> See CHX Article 1, Rule 2(a)(2).

<sup>16</sup> A "Participant" is a "member" of the Exchange for purposes of the Act. See CHX Article 1, Rule 1(s).

<sup>17</sup> BBO ISO and Price-Penetrating ISOs are limit order modifiers, whereas ISO is a limit and cross order modifier. The Exchange last modified the operation of BBO ISO and Price-Penetrating ISO in 2014. See Securities Exchange Act Release No. 73572 (November 10, 2014), 79 FR 68736 (November 18, 2014) (SR-CHX-2014-18).

required by Rule 600(b)(30) of Regulation NMS,<sup>18</sup> each modifier is handled differently by the CHX Matching System ("Matching System").<sup>19</sup>

An incoming BBO ISO will execute against orders resting on the CHX book at prices not to exceed the more restrictive of its limit price or the contra-side displayed best bid or offer. Any unexecuted balance of the BBO ISO will be immediately cancelled if - 1- marked Immediate Or Cancel ("IOC")<sup>20</sup> or -2- the incoming BBO ISO sell (buy) order could execute against any resting order(s) priced below (above) the displayed best bid (offer), regardless of the Time-In-Force. If the unexecuted balance of the BBO ISO would not be cancelled as described above, it will be ranked on the CHX Book and will be displayable at its limit price. A limit order marked BBO ISO may not be marked Do Not Display.<sup>21</sup> The Matching System, in executing the ISO as soon as the order is received by the Matching System, will not take any of the actions described in Article 20, Rule 5 to prevent an improper trade-through or any of the actions described in Article 20, Rule 6 to prevent a locked or crossed market; provided, however, that in executing any initially unexecuted balance of the ISO that is placed in the Matching System, the requirements of Article 20, Rule 5 will be followed. These orders shall be executed on the assumption that the Participant routing the order to the Matching System has already satisfied the quotations of other markets as required by Rule 600(b)(30)<sup>22</sup> and shall be displayed because the Participant routing the order to the Matching System has already

<sup>18</sup> See 17 CFR 242.600(b)(30).

<sup>19</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>20</sup> See CHX Article 1, Rule 2(d)(4).

<sup>21</sup> See CHX Article 1, Rule 2(c)(2).

<sup>22</sup> 17 CFR 242.600(b)(30).

satisfied the quotations of other markets as required by Article 20, Rule 6(c)(3). A limit order marked BBO ISO shall be deemed to have been received Do Not Route,<sup>23</sup> which cannot be overridden by the order sender.

A Price-Penetrating ISO will execute at or better than its limit price as soon as the order is received by the Matching System, with any unexecuted balance of the order to be immediately cancelled, as it is always handled IOC. A Price-Penetrating ISO cannot be displayed or otherwise post to the CHX book. Price-Penetrating ISOs will execute against any eligible orders in the Matching System (including any Reserve Size or undisplayed orders) through multiple price points. The Matching System, in executing these orders, will not take any of the actions described in Article 20, Rule 5 to prevent an improper trade-through. A limit order marked Price-Penetrating ISO shall be deemed to have been received IOC, which cannot be overridden by the order sender.

ISO is a limit and cross order modifier. A limit order marked ISO that is not marked BBO ISO is deemed to have been received Price-Penetrating ISO, which cannot be overridden by the order sender. Thus, a limit order marked ISO will always be handled as a BBO ISO or Price-Penetrating ISO. A cross order marked ISO is handled like a simple cross order, except that the Exchange would not take any actions described in Article 20, Rule 5 to prevent an improper trade-through.<sup>24</sup>

<sup>23</sup> See CHX Article 1, Rule 2(b)(3)(A).

<sup>24</sup> In eliminating the definition of "ISO Cross" in 2013, the Exchange explained that "ISO Cross is simply a cross order marked ISO and not a distinct order modifier." See Exchange Act Release No. 69538 (May 8, 2013), 78 FR 28671 (May 15, 2013) (SR-CHX-2013-10).

### Amended CHX ISOs

The Exchange now proposes to amend the definition of "ISO" under Article 1, Rule 2(b)(3)(B) so that the amended ISOs behave like ISOs offered by other national securities exchanges.<sup>25</sup> Specifically, the Exchange proposes to amend the definition of ISO to -1- require an ISO limit to behave like a simple limit order (*i.e.*, executable through multiple price points not beyond its limit price with the unexecuted balance to be immediately cancelled or posted to the CHX book depending on the attached Time-In-Force), but without regard to the Protected Quotations of away markets when it is being processed as a new incoming order;<sup>26</sup> -2- provide that the default Time-In-Force for an ISO limit is IOC, unless it is marked with another available Time-In-Force<sup>27</sup> (*i.e.*, Day<sup>28</sup> or GTD<sup>29</sup>); -3- clarify the current applicability of the ISO modifier to cross orders; -4- clarify that it is the Participant's responsibility in complying with the requirements of Regulation NMS when submitting an ISO to the Exchange; and -5- delete obviated language. The mechanical result of these proposed amendments is that an amended ISO

<sup>25</sup> See supra note 6.

<sup>26</sup> The Exchange notes that the current BBO ISO may be ranked on the CHX book if it is -1- not marked IOC and -2- does not execute against any contra-side orders within the Matching System at prices inferior to the then-current best displayed contra-side order on the CHX book. See current CHX Article 1, Rule 2(b)(1)(A). As proposed, an ISO will be permitted to be ranked on the CHX book even if a portion of the ISO executes against contra-side orders within the Matching System at prices inferior to the then-current best displayed contra-side order on the CHX book.

<sup>27</sup> The Exchange notes that the Fill Or Kill modifier, as defined under CHX Article 1, Rule 2(d)(2), has been unavailable since December 4, 2013. Any order marked FOK will be rejected upon receipt. See CHX Market Regulation Department Information Memorandum No. MR-13-12 (December 3, 2013).

<sup>28</sup> See CHX Article 1, Rule 2(d)(1).

<sup>29</sup> See CHX Article 1, Rule 2(d)(3).

limit will behave like the current Price-Penetrating ISO, except that the amended ISO limit may have a Time-In-Force other than IOC, which would permit the unexecuted balance of the amended ISO limit to be ranked on the CHX book and displayable at its limit price. To this end, amended Article 1, Rule 2(b)(3)(B) provides as follows:

"Intermarket Sweep" or "ISO": a limit or cross order modifier that marks an order as required by SEC Rule 600(b)(30).<sup>30</sup> The Exchange relies on the marking of an order as an ISO when handling such an order, and thus, it is the entering Participant's responsibility, not the Exchange's responsibility, to comply with the requirements of Regulation NMS and Article 20, Rule 6(c)(3)<sup>31</sup> relating to ISOs. Any new incoming order marked ISO will not be rejected or cancelled if it would lock, cross, or trade-through a Protected Quotation of an away market. ISOs shall be deemed to have been received "Do Not Route," as defined under paragraph (b)(3)(A), which cannot be overridden by the order sender.

(i) ISO limit. A new incoming limit order marked ISO ("ISO limit") may be executed at one or multiple price levels in the Matching System without regard to Protected Quotations at away markets consistent with Regulation NMS. All ISO limits shall be deemed to have been received IOC, unless an ISO limit is marked with another Time-In-Force.

(ii) ISO cross. A cross order marked ISO ("ISO cross") may execute at its crossing price as soon as it is received by the Matching System without regard to Protected Quotations at away markets consistent with Regulation NMS. An ISO cross that could not be immediately executed within the Matching System upon receipt shall be immediately cancelled.<sup>32</sup>

The Exchange also proposes to amend Article 1, Rule 2(b)(1)(A) and Article 1, Rule 2(b)(1)(E) to delete the current definition of BBO ISO and Price-Penetrating ISO, respectively, and replace each definition with language that provides that the modifier is a

<sup>30</sup> See 17 CFR 242.600(b)(30).

<sup>31</sup> CHX Article 20, Rule 6(c)(3) excepts a Participants [sic] from the locked and crossed markets prohibition described under CHX Article 20, Rule 6(b) if "The Exchange Participant displaying the locking or crossing quotation simultaneously routed an intermarket sweep order to execute against the full displayed size of any locked or crossed protected quotation."

<sup>32</sup> Cross orders are always handled IOC. See CHX Article 1, Rule 2(a)(2).

limit order modifier that shall be handled as an ISO, as defined under amended paragraph (b)(3)(B).<sup>33</sup> Moreover, so as to contemplate the proposed default IOC handling of ISO limits, the Exchange proposes to amend the definition of "Limit order" under Article 1, Rule 2(a)(1) to provide that all limit orders, except those marked Price-Penetrating ISO, BBO ISO, and ISO, shall be deemed to have been received Day, if an order duration modifier is not specified.

#### Interaction with Certain Order Modifiers

The Exchange notes that the amended ISO would be compatible with all display modifiers (*i.e.*, Always Quote,<sup>34</sup> Do Not Display,<sup>35</sup> and Reserve Size<sup>36</sup>). A new incoming ISO limit marked Day and Do Not Display would be permitted to trade-through and/or lock or cross Protected Quotations of away markets and the unexecuted balance would be ranked on the CHX book at its limit price. Similarly, a new incoming ISO limit marked Day and Reserve Size would be permitted to trade-through and/or lock or cross Protected Quotations of away markets and the unexecuted balance would be ranked on the CHX book at its limit price with the displayable portion displayed at its limit price. Also, an ISO limit marked Day and Always Quote would be permitted to trade-through and/or lock or cross Protected Quotations of away markets and the unexecuted balance would be ranked on the CHX book if it could be displayed at its limit price or cancelled if it could not be displayed at its limit price.

<sup>33</sup> See supra note 14.

<sup>34</sup> See CHX Article 1, Rule 2(c)(1).

<sup>35</sup> See CHX Article 1, Rule 2(c)(2).

<sup>36</sup> See CHX Article 1, Rule 2(c)(3).

Moreover, if the Exchange were to receive an ISO limit marked CHX Only,<sup>37</sup> the Exchange will ignore the CHX Only modifier and handle the ISO limit as if it were not marked CHX Only, which is consistent with current practice.<sup>38</sup> This is because the ISO and CHX Only modifiers are incompatible in that ISO instructs the Exchange to ignore the Protected Quotations of away markets when initially processing the order, whereas CHX Only requires the Exchange to price slide the order upon initial receipt to prevent locked and crossed markets.

### Examples

The following Examples are illustrative of the amended ISO modifier, but do not exhaustively depict every possible scenario regarding ISOs. Moreover, the Examples do not necessarily depict the actual technical processes of prioritizing messages and executing orders.

Example 1. Assume that proposed rule change is operative and the following:

- The NBBO for security XYZ is 10.00 x 10.01.
- The displayed CHX BBO for XYZ is 9.99 x 10.01.
- There is only one buy order for XYZ priced at 9.99 resting on the CHX book ("CHX Buy Order") and there are no undisplayed orders for XYZ resting on the CHX book.
- There is only one away market with a Protected Bid for XYZ at 10.00 ("Away Protected Bid").
- All Protected Quotations in XYZ are for 100 shares.

Assume then that the Exchange receives an ISO limit marked Day to sell 200 shares of XYZ at 9.99 ("Incoming Sell ISO Limit").

<sup>37</sup> See CHX Article 1, Rule 2(b)(1)(C).

<sup>38</sup> See Securities Exchange Act Release No. 69075 (March 8, 2013), 78 FR 16311 (March 14, 2013) (SR-CHX-2013-07).

Under this Example 1, the Exchange would execute 100 shares of Incoming Sell ISO Limit against the CHX Buy Order at 9.99, without taking any actions to prevent a trade-through of Away Protected Bid. The Exchange would then rank and display the unexecuted 100 shares of Incoming Sell ISO Limit at 9.99, without taking any actions to prevent a crossed market.

Example 2. Assume the same as Example 1, except that Incoming Sell ISO Limit is not marked with a Time-In-Force. Under Example 2, the unexecuted balance of Incoming Sell ISO Limit would be cancelled, as the default handling for ISO limits is IOC.

Example 3. Assume the same as Example 1, except that Incoming Sell ISO Limit is marked Price-Penetrating ISO or BBO ISO and is also marked Day. Under Example 3, Incoming Sell ISO Limit would be handled as if it were marked ISO and would behave identically as described under Example 1.

Example 4. Assume the same as Example 1, except that Incoming Sell ISO Limit is marked Price-Penetrating ISO or BBO ISO and is not marked by a Time-In-Force. Under this Example 4, the Exchange would cancel the unexecuted balance of Incoming Sell ISO Limit, as an ISO that does not have a Time-In-Force identified would be handled IOC.

#### Operative Date

The proposed rule change shall be operative pursuant to notice to Participants on a date after the expiration of the 30-day preoperative waiting period.

#### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act in general,<sup>39</sup> and furthers the objectives of Section 6(b)(5) in particular,<sup>40</sup> in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments and perfect the mechanisms of a free and open market, and, in general, to protect investors and the public interest; and is not designed to permit

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<sup>39</sup> 15 U.S.C. 78f(b).

<sup>40</sup> 15 U.S.C. 78f(b)(5).

unfair discrimination between customers, issuers, brokers, or dealers. Specifically, the Exchange submits that harmonizing the operation of the ISO modifier with the ISO modifiers offered by other national securities exchanges, such as NYSE Arca and Bats BYX, would provide market participants with consistent and predictable handling of ISOS, which would facilitate their compliance with Regulation NMS regarding the use of ISOS, thereby removing impediments and perfecting the mechanisms of a free and open market.

Moreover, the Exchange believes that requiring the Exchange's various ISO modifiers to operate in the same manner and clarifying the handling of ISO crosses simplifies the CHX Rules, which furthers the objectives of Section 6(b)(1)<sup>41</sup> in that it further enables the Exchange to be so organized as to have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its Participants and persons associated with its Participants, with the provisions of the Act, the rules and regulations thereunder, and the rules of the Exchange.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. To the contrary, the Exchange believes that the proposed rule change will reduce the regulatory burden placed on market participants engaged in trading activities across different markets by harmonizing the operation of the Exchange's ISO modifier with those of other national securities exchanges. The Exchange believes that such

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<sup>41</sup> 15 U.S.C. 78f(b)(1).

harmonization across the various markets will reduce burdens on competition by removing impediments to participation in the national market system.

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

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Changes and Timing for Commission Action

The Exchange believes that the proposal qualifies for immediate effectiveness upon filing as non-controversial under Section 19(b)(3)(A) of the Act<sup>42</sup> and paragraph (f)(6) of Rule 19b-4 thereunder.<sup>43</sup>

The Exchange asserts that the proposed rule change: (1) will not significantly affect the protection of investors or the public interest, (2) will not impose any significant burden on competition, and (3) will not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate. In addition, the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing, or such shorter time as designated by the Commission.<sup>44</sup> The Exchange believes that the proposed rule change raises no novel issues, as the amended ISO modifier will operate similarly to the ISO modifiers of other national securities exchanges, such as NYSE Arca and Bats BYX.<sup>45</sup> As such, the Exchange has designated this rule filing as non-controversial under Section 19(b)(3)(A)

<sup>42</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>43</sup> 17 CFR 240.19b-4.

<sup>44</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>45</sup> See supra note 6.

of the Act<sup>46</sup> and paragraph (f)(6) of Rule 19b-4 thereunder.<sup>47</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings under Section 19(b)(2)(B) of the Act<sup>48</sup> to determine whether the proposed rule should be approved or disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposal is consistent with the Act. 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](mailto:rule-comments@sec.gov). Please include File No. SR-CHX-2016-15 on the subject line.

##### Paper Comments:

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

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<sup>46</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>47</sup> 17 CFR 240.19b-4.

<sup>48</sup> 15 U.S.C. 78s(b)(2)(B).

All submissions should refer to File No. SR-CHX-2016-15. 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 Web site (<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 changes 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, DC 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 CHX. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File No. SR-CHX-2016-15 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>49</sup>

Deputy Secretary  
Robert W. Errett

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<sup>49</sup> 17 CFR 200.30-3(a)(12).