

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-83425; File No. SR-CHX-2018-001)

June 13, 2018

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt the Route QCT Cross Routing Option

I. Introduction

On March 6, 2018, the Chicago Stock Exchange, Inc. (“CHX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt the Route QCT Cross routing option. The proposed rule change was published for comment in the Federal Register on March 20, 2018.³ On May 1, 2018, pursuant to Section 19(b)(2) of the Exchange Act,⁴ the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.⁵ The Commission received no comment letters on the proposed rule change. This order institutes proceedings under Section

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 82870 (March 14, 2018), 83 FR 12214 (“Notice”).

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 83143, 83 FR 20123 (May 7, 2018). The Commission designated June 18, 2018, as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change.

19(b)(2)(B) of the Exchange Act⁶ to determine whether to approve or disapprove the proposed rule change.

II. Description of the Proposed Rule Change

Currently, under the Exchange's rules, Routable Orders⁷ submitted to the CHX matching system ("Matching System")⁸ for execution are routed away from the Matching System automatically if a Routing Event⁹ is triggered. The Exchange's current rules provide that all Routable Orders¹⁰ are limit orders. Market¹¹ and cross orders¹² are never routable. The Exchange does not currently permit orders to be directly routed to an away Trading Center¹³ without first being submitted to the Matching System.

Because Qualified Contingent Trade ("QCT") Crosses¹⁴ are exempt from the trade-through prohibition of Rule 611 of Regulation NMS,¹⁵ the Matching System permits QCT Crosses to trade-through protected quotes of away markets. Under the Exchange's current rules,

⁶ 15 U.S.C. 78s(b)(2)(B).

⁷ See CHX Article 1, Rule 1(oo).

⁸ The Matching System is part of the Exchange's "Trading Facilities," as defined under CHX Article 1, Rule 1(z).

⁹ See CHX Article 19, Rule 3(a)(1)-(5).

¹⁰ See CHX Article 1, Rule 1(oo) defining "Routable Order."

¹¹ See CHX Article 1, Rule 2(a)(3) defining "market order."

¹² See CHX Article 1, Rule 2(a)(2) defining "cross order."

¹³ See CHX Article 1, Rule 1(nn) defining "Trading Center."

¹⁴ QCT Crosses are cross orders that are component orders to Qualified Contingent Trades that are submitted by an Institutional Broker. See CHX Article 1, Rule 2(b)(2)(E) defining "Qualified Contingent Trade." See also CHX Article 1, Rule 2(a)(2) defining "cross order."

¹⁵ See Securities Exchange Act Release No. 57620 (April 4, 2008), 73 FR 19271 (April 4, 2008).

QCT Crosses are handled IOC¹⁶ and can never rest on the CHX book. Moreover, a QCT Cross submitted to the Matching System will be cancelled back to the order sender as “blocked” if a precedent limit order priced at or better than the QCT Cross is resting on the CHX book,¹⁷ except that a QCT Cross priced at the top of the CHX book (i.e., the best-ranked order on the CHX book pursuant to Article 20, Rule 8(b)) that qualifies for Cross With Size¹⁸ handling will be permitted to execute.

The Exchange has proposed to adopt the Route QCT Cross routing option, which will permit only Institutional Brokers (“IBs”)¹⁹ to directly route a QCT Cross to a non-affiliated third-party broker-dealer designated by the IB (“designated executing broker”) for execution. Route QCT Cross orders will be handled like current Routable Orders,²⁰ except that the Route QCT Cross order will never be submitted to the Matching System for execution. Specifically, upon receipt of a Route QCT Cross order, the Exchange will cause the order to be routed IOC²¹ from the Exchange, through CHXBD, LLC (“CHXBD”), the Exchange’s affiliated routing broker, to the designated executing broker identified by the IB.²² The Exchange states that the relationship between a designated executing broker and CHXBD will be governed by applicable CHX

¹⁶ See CHX Article 1, Rule 2(a)(2)

¹⁷ See CHX Article 1, Rule 2(a)(2). See also CHX Article 20, Rule 8(e)(1).

¹⁸ See CHX Article 1, Rule 2(g)(1).

¹⁹ The Exchange states that it has proposed to limit use of Route QCT Cross to IBs to be consistent with the fact that only IBs are currently permitted to submit QCT Crosses to the Matching System. See CHX Article 1, Rule 2(b)(2)(E).

²⁰ See CHX Article 1, Rule 1(oo).

²¹ See CHX Article 1, Rule 2(a)(2).

²² The Exchange states that IBs will be permitted to identify only one designated executing broker to which all Route QCT Cross orders submitted by the IB will be routed, subject to additional requirements, as described below.

Rules²³ and customary interbroker agreements, such as fully-disclosed clearing and customer agreements. The Exchange represents that at all times, the use of Route QCT Cross will be optional.²⁴ The Exchange also states that Route QCT Cross is similar to the routing options available on the Nasdaq Stock Market²⁵ and Cboe BYX and Cboe BZX exchanges.²⁶

Specifically, the Exchange has proposed to adopt proposed Article 19, Rule 4 (Routing Options) to provide that routing options may be combined with all available order types, modifiers and related terms, except for order types, modifiers, and related terms that are inconsistent with the terms of a routing option, and that the Exchange may activate or deactivate any routing option at its discretion and, if practicable, after notice to Participants.²⁷ Article 19, Rule 4(a)(1) provides that Route QCT Cross is a routing option,²⁸ which may only be utilized by IBs, that instructs the Exchange to route a cross order marked QCT directly to a non-affiliated third-party broker-dealer designated by the IB without submitting the order into the Matching System for execution. In addition, each IB is permitted to identify only one designated executing broker to which all Route QCT Cross orders submitted by the IB would be routed. Furthermore,

²³ See e.g., CHX Article 19, Rule 2(a).

²⁴ See Notice, supra note 3 at 12215.

²⁵ See id. The Exchange states that like Route QCT Cross, the “Directed Order” routing option offered by the Nasdaq Stock Market (“Nasdaq”) permits an order sender to route an order to another market center while bypassing the Nasdaq’s order book, which may result in the routed order executing at a price through Nasdaq’s top of book. See id.

²⁶ The Exchange states that like Route QCT Cross, the “DRT” routing option offered by the Cboe BYX and Cboe BZX exchanges permits an order to be routed to one or more away alternative trading systems. See id.

²⁷ See CHX Article 1, Rule 1(s).

²⁸ In addition, since the cross orders are not currently Routable Orders, the Exchange has proposed to amend Article 1, Rule 1(oo) by adopting paragraph (oo)(2), which would expand the definition of Routable Orders to include any order marked by a routing option listed under proposed Article 19, Rule 4 (i.e., Route QCT Cross).

the Exchange represents that prior to the Exchange accepting any Route QCT Cross orders directed to a specific designated executing broker, the Exchange would confirm that the designated executing broker has established connectivity to the Exchange's routing systems.²⁹ In addition, the IB would be responsible for all away execution fees resulting from the execution of Route QCT Cross orders, including any guaranteed payments to its designated executing broker.³⁰ Moreover, Route QCT Cross orders would be routed IOC and a Route QCT Cross order that could not be executed by a designated executing broker, for any reason, would be cancelled back to the original order sender.³¹

As Route QCT Cross orders would be routed away from the Exchange without being submitted to the Matching System for execution, the Exchange proposes to amend Article 19, Rules 1(a) and (c), and Rule 2(a) to replace the term "Matching System" with "Exchange." Moreover, since Route QCT Cross orders are a subset of cross orders that will not be handled IOC upon receipt by the Exchange, and all cross orders currently received by the Exchange are deemed to have been received IOC, the Exchange proposes to amend the definition of "cross orders" under Article 1, Rule 2(a)(2) to provide that all cross orders submitted to the Matching System for execution shall be deemed to have been received IOC.

The Exchange has also proposed to amend Article 19, Rule 3(a) to provide that a Routable Order that is submitted to the Matching System would be routed away from the Matching System pursuant to the CHX Routing Services if a Routing Event is triggered.³²

²⁹ See Notice, supra note 3 at 12215.

³⁰ See id.

³¹ See id. at 12215-16.

³² To clarify this distinction, the Exchange has proposed to amend the title to Article 19, Rule 3 from "Routing Events" to "Mandatory Routing Events." Also, the Exchange has

In addition, the Exchange proposes non-substantive amendments to Article 19, Rules 3(a)(1)-(5) to clarify the current operation of the Routing Events.³³

II. Proceedings to Determine Whether to Approve or Disapprove SR-CHX-2018-001 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act³⁴ 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 Exchange Act,³⁵ the Commission is providing notice of the grounds for disapproval under consideration. As discussed above, the Exchange has proposed to offer a new Route QCT Cross routing option, which would be available only to IBs. Route QCT Crosses would not check the CHX order book. In addition, Route QCT Crosses would only route to a single designated broker, as designated by each IB, for execution.

The Commission is instituting proceedings to allow for additional analysis of the proposed rule change's consistency with Sections 6(b)(5)³⁶ and 6(b)(8)³⁷ of the Exchange Act.

proposed to eliminate the word "incoming" from proposed Rule 1(o)(1), which it states is redundant in light of the proposed clarifying amendments to Article 19, Rule 3.

³³ See Notice, *supra* note 3.

³⁴ 15 U.S.C. 78s(b)(2)(B).

³⁵ Id.

³⁶ 15 U.S.C. 78f(b)(5).

³⁷ 15 U.S.C. 78f(b)(8).

Section 6(b)(5) of the Exchange Act requires that the rules of a national securities exchange be designed, among other things, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest, and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. Section 6(b)(8) of the Exchange Act requires that the rules of a national securities exchange not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

III. 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 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 Sections 6(b)(5) and 6(b)(8), or any other provision of the Exchange 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.³⁸

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

³⁸ Section 19(b)(2) of the Exchange 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).

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].

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-CHX-2018-001 on the subject line.

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 Numbers SR-CHX-2018-001. 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, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of these filings 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-CHX-2018-001 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.³⁹

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Assistant Secretary

³⁹ 17 CFR 200.30-3(a)(57).