

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-100115; File No. SR-CboeBZX-2024-007)

May 13, 2024

Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Change to Amend the Definition of Retail Order, and Codify Interpretations and Policies Regarding Permissible Uses of Algorithms by RMOs

I. Introduction

On January 25, 2024, Cboe BZX Exchange, Inc (“Exchange”) 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 amend the definition of Retail Order,³ and codify interpretations and policies regarding permissible uses of algorithms by Retail Member Organizations.⁴ The proposed rule change was published for comment in the Federal Register on February 13, 2024.⁵ On March 21, 2024, pursuant to Section 19(b)(2) of the Act,⁶ 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.⁷ The Commission did not receive any

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The term “Retail Order” is defined in Exchange Rule 11.25(a)(2). See infra section II.

⁴ The term “Retail Member Organization” (or “RMO”) is defined in Exchange Rule 11.25(a)(1) to mean a member of the Exchange (or a division thereof) that has been approved by the Exchange under Exchange Rule 11.25 to submit Retail Orders.

⁵ See Securities Exchange Act Release No. 99488 (February 7, 2024), 89 FR 10121 (“Notice”).

⁶ 15 U.S.C. 78s(b)(2).

⁷ See Securities Exchange Act Release No. 99815, 89 FR 21290 (March 27, 2024) (designating May 13, 2024, as the date by which the Commission shall either approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change).

comments. The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act⁸ to determine whether to approve or disapprove the proposed rule change.

II. Description of the Proposed Rule Change⁹

Currently, the Exchange operates a retail attribution program (“Retail Attribution Program” or “Program”) pursuant to Exchange Rule 11.25. Under the Program, RMOs may designate a Retail Order to be identified as such on the Exchange’s proprietary feeds, either on an order-by-order or port-by-port basis. Pursuant to Exchange Rule 11.25(a)(2), a Retail Order is an agency order or riskless principal that meets the criteria of FINRA Rule 5320.03 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.

The Exchange states it has received member feedback that its rule is unclear as to whether the use of algorithms or other computerized methodologies is permitted when submitting individual investors’ orders to the Exchange,¹⁰ and proposes to amend its definition of Retail Order to provide that the use of an algorithm to submit orders to the Exchange on behalf of a retail investor does not automatically preclude an RMO from designating such orders as “Retail Orders.”¹¹ The Exchange proposes that use of an algorithm to submit a Retail Order would be permissible provided that the order, or investment criteria for the order, originates from

⁸ 15 U.S.C. 78s(b)(2)(B).

⁹ For a full description of the proposed rule change, refer to the Notice, supra note 5. The text of the Exchange’s proposed Rule 11.25(a)(2) and Interpretations and Policies .01-.04 is available on the Commission’s website at <https://www.sec.gov/files/rules/sro/cboebzx/2024/34-99488-ex5.pdf>.

¹⁰ See Notice, supra note at 10122.

¹¹ Id.

a natural person, such as the investor themselves, or a natural person on behalf of a retail investor (such as a financial advisor or trader).¹² The Exchange states that by amending the Retail Order definition, more RMOs may choose to avail themselves of the benefits offered by the Exchange's Retail Attribution Program, and that the enhanced opportunity to interact with retail order flow is likely to incentivize more retail liquidity provision, as it is generally considered preferable to trade with retail orders than with orders of professional investors that are typically more informed regarding short-term price movements.¹³

In connection with the proposed amendments to its definition of Retail Order, the Exchange is proposing to adopt several Interpretations and Policies to describe: (1) the meaning of the term "retail investor" as used in the definition, (2) the meaning of the term "natural person" as used in the definition, (3) permissible uses of algorithms when entering Retail Orders onto the Exchange, and (4) when an RMO may amend a Retail Order's price or side. First, the Exchange is proposing Interpretation and Policy .01 to describe that the term "retail investor" is intended to refer to a non-professional, individual investor that invests money in their own account held at a brokerage firm or online brokerage firm, or an account held in corporate form for the benefit of an individual or group of related family members, and whose investment goals

¹² Id. Pursuant to proposed Exchange Rule 11.25(a)(2), a Retail Order would be defined as an agency or riskless principal order that meets the criteria of FINRA Rule 5320.03, and would require a Retail Order to originate from a natural person, such as the retail investors themselves, or by a natural person on behalf of a retail investor, and be submitted to the Exchange by a Retail Member Organization. In submitting a Retail Order to the Exchange, a Retail Member Organization may utilize an algorithm or other computerized methodology, provided the terms or investment criteria of the order originate from a retail investor her/himself, or a natural person on behalf of a retail investor, and the algorithm or other computerized methodology does not change the terms or investment criteria of the Retail Order with respect to price or side.

¹³ Id. at 10122-23.

are mainly saving for retirement or education, generating income, or growing wealth over the long term.¹⁴

Second, the Exchange is proposing to adopt Interpretation and Policy .02 to describe the meaning of the term “natural person” as referenced in the Exchange’s proposed definition of Retail Order. The Exchange states that it intends for the term “natural person” to refer to a human who enters an order or investment criteria for an order, and that this individual may be the retail investor him/herself, or a natural person entering the order on behalf of a retail investor, such as a financial advisor or trader.¹⁵ According to the Exchange, this will help to ensure that only bona fide retail orders are submitted to the Exchange as Retail Orders by making clear that orders generated automatically by an algorithm, without human intervention, shall not be considered Retail Orders.¹⁶

Third, the Exchange states that it seeks to ensure that only bona fide retail flow is designated as a Retail Order and does not intend for professional investors and professional trading firms to avail themselves of the benefits provided to RMOs by the Exchange, and is therefore proposing to adopt Interpretation and Policy .03 to describe how an RMO can permissibly utilize an algorithm when entering Retail Orders onto the Exchange. The Exchange states that an RMO could utilize an algorithm to enter individual investors’ orders onto the Exchange, and permissibly designate such orders as Retail Orders, provided the order or investment criteria used to generate an order originates from a natural person, such as the retail

¹⁴ Id. at 10123. According to the Exchange, the term “retail investor” would not be intended to include individual investors that engage in more professional trading strategies designed to profit from bid-ask spreads, short-term price movements, and arbitrage, or in trading behavior where multiple buy and sell orders are entered over a short period of time based on market conditions. Id.

¹⁵ Id.

¹⁶ Id.

investor him/herself, or a natural person on behalf of a retail investor, and is submitted to the Exchange for execution by an RMO.¹⁷ The Exchange states that, conversely, orders automatically generated and submitted to the Exchange by an algorithm based on factors such as market conditions and price movements, which do not originate from a manual entry of order terms or investment criteria by a natural person, shall not be considered Retail Orders.¹⁸

Fourth, the Exchange is proposing to adopt Interpretation and Policy .04 to provide that post-order entry an RMO may algorithmically amend the Retail Order's price or size provided such amendments are made for the purposes of seeking better execution, enhancing execution quality, or minimizing market impact, despite the provision in the Exchange's proposed definition of Retail Order that would otherwise prohibit the changing of the price or side of a Retail Order.¹⁹ The Exchange proposes that such order amendments may also be made manually by a natural person who entered the order on behalf of the retail investor. Pursuant to proposed Interpretation and Policy .04, the purpose of the prohibition on changing the terms of an order in

¹⁷ Id. at 10124. The Exchange states that acceptable uses of algorithms by an RMO would include, but not be limited to: a smart order router to route the Retail Order to the Exchange for execution; a smart order router to assess trading venues for the best priced quotation and liquidity prior to routing the Retail Order to the Exchange; an order management system, smart order router, or other functionality to change the terms an order to seek a better execution price; use of an order management system to assist with portfolio rebalancing and asset reallocation for the accounts of retail investors; and a retail investor's use of automated investment management tools offered by RMOs to manage their assets based on their goals and risk tolerance (i.e. robo-advisory solutions). Id.

¹⁸ Id. at 10125. The Exchange states that examples of such algorithms would include, but not be limited to, algorithms developed for market-making, high-frequency trading, liquidity provision, arbitrage, hedging, or proprietary trading. In addition to the fact that such orders do not typically originate from a natural person, entities engaging in such trading strategies are not typically doing so for the account of a retail investor. Id.

¹⁹ Id. See also supra note 12 describing the Exchange's proposed definition of Retail Order. The Exchange states that accordingly, an RMO may utilize an algorithm to add a limit price to an unpriced order, amend an order's price or size to manage an order's marketability or mitigate the risk of receiving executions at aberrant prices, or adjust the price or size of an order as market conditions or trading objectives may dictate. See Notice, supra note 5, at 10125.

Exchange Rule 11.25(a)(2) is to prevent RMOs from utilizing algorithms that trade in a manner more appropriate for professional trading.²⁰

The Exchange states that by routing Retail Orders to the Exchange, RMOs and their retail investors will benefit from the Exchange's retail-only pricing incentives.²¹ In support of its proposal, the Exchange also states that it has in place robust protections to ensure only bona fide retail orders are designated as "Retail Orders," and that the proposed amendments will augment the Exchange's existing RMO framework.²²

III. Proceedings to Determine Whether to Approve or Disapprove SR-CboeBZX-2024-007, and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act²³ 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 additional comment on the proposed rule change to inform the Commission's analysis of whether to approve or disapprove the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,²⁴ the Commission is providing notice of the grounds for disapproval under consideration. As described above, the Exchange has proposed to amend its definition of Retail Order and adopt related Interpretations and Policies describing: (1)

²⁰ Proposed Interpretation and Policy .04 to Exchange Rule 11.25.

²¹ See Notice, supra note 5, at 10127.

²² See id. at 10126.

²³ 15 U.S.C. 78s(b)(2)(B).

²⁴ Id.

the term “retail investor” as used therein, (2) the term “natural person” as used therein, (3) permissible uses of algorithms when entering Retail Orders onto the Exchange, and (4) when an RMO may amend a Retail Order’s price or side. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the proposed rule change’s consistency with the Act, and in particular, Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, 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.²⁵

The Commission asks that commenters address the sufficiency of the Exchange’s statements in support of the proposal, which are set forth in the Notice, in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on the following questions and asks commenters to submit data where appropriate to support their views:

1. The Exchange states that it “seeks to clarify precisely how Retail Orders may be entered onto the Exchange by RMOs through the use of algorithms.”²⁶ What are commenters’ views on whether the Exchange has described with sufficient clarity its proposed new definition of Retail Order and related Interpretations and Policies, including with respect to the circumstances under which (i) algorithms and computerized methodologies would be permitted for the submission of Retail Orders, and (ii) a Retail

²⁵ 15 U.S.C. 78f(b)(5).

²⁶ See Notice, supra note 5, at 10127.

Member Organization would be permitted to change the terms of a Retail Order with respect to price and side, either manually or algorithmically? Why or why not?

2. The Exchange states that the proposed rule change will “ensure that only bona fide retail orders are able to take advantage of the benefits provided to Retail Orders by the Exchange.”²⁷ What are commenters’ views on whether the proposed rule change would ensure that only bona fide retail orders benefit from retail-only pricing incentives²⁸ provided by the Exchange? Why or why not?

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their data, views, 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 proposed rule change, is consistent with Sections 6(b)(5) 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 data, views, and arguments, the Commission will consider, pursuant to Rule 19b-4 under the Act,²⁹ any request for an opportunity to make an oral presentation.³⁰

²⁷ Id.

²⁸ See Cboe U.S. Equities Fee Schedule for BZX available at https://www.cboe.com/us/equities/membership/fee_schedule/bzx/.

²⁹ 17 CFR 240.19b-4.

³⁰ Section 19(b)(2) of the Act, as amended by the Securities Acts Amendments of 1975, Public Law 94-29 (Jun. 4, 1975), grants to 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 Acts Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be approved or disapproved by [INSERT DATE 21 DAYS AFTER DATE OF 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 AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]. The Commission asks that commenters address the sufficiency of the Exchange's statements in support of the proposal, 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 (<https://www.sec.gov/rules/sro.shtml>); or
- Send an email to rule-comments@sec.gov. Please include file number SR-CboeBZX-2024-007 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 number SR-CboeBZX-2024-007. This file number should be included on the subject line if email 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 (<https://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 a.m. and 3 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to file number SR-CboeBZX-2024-007 and should be submitted by [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]. Rebuttal comments should be submitted by [INSERT DATE 35 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³¹

Sherry R. Haywood,
Assistant Secretary.

³¹ 17 CFR 200.30-3(a)(57).