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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-80740; File No. SR-CHX-2017-04)

May 22, 2017

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt the CHX Liquidity Enhancing Access Delay

I. Introduction

On February 10, 2017, 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 CHX Liquidity Enhancing Access Delay ("LEAD"). The proposed rule change was published for comment in the Federal Register on February 21, 2017.[3] On April 3, 2017, 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 the proposed rule change should be disapproved.[4] The Commission received eleven comment letters on the proposed rule change, including a response from the Exchange.[5] This order institutes

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 80041 (February 14, 2017), 82 FR 11252 ("Notice").

4 See Securities Exchange Act Release No. 80364, 82 FR 11252 (April 7, 2017).

5 See letters from: (1) Ryan Hitch, Head of Equities Trading, XR Securities LLC, dated February 24, 2017 ("XR Securities Letter"); (2) Douglas A. Cifu, Chief Executive Officer, Virtu Financial LLC, dated February 27, 2017 ("Virtu Letter"); (3) Joanna Mallers, Secretary, FIA Principal Traders Group, dated March 13, 2017 ("FIA PTG Letter"); (4) Adam Nunes, Head of Business Development, Hudson River Trading LLC, dated March 13, 2017 ("Hudson River Trading Letter"); (5) R.T. Leuchtkafer, dated March 14, 2017 ("Leuchtkafter Letter"); (6) Stephen John Berger, Managing Director, Government & Regulatory Policy, Citadel Securities, dated March 14, 2017 ("Citadel

proceedings under Section 19(b)(2)(B) of the Exchange Act[6] to determine whether to approve or disapprove the proposed rule change.

II. Summary of the Proposal

The Exchange proposes to adopt the LEAD, which would subject all new incoming orders,[7] cancel and cancel/replace messages to a 350-microsecond intentional access delay, provided that certain types of messages would not be subject to the delay: (1) new incoming orders submitted by LEAD Market Makers ("LEAD MM"), a new class of CHX Market Maker[8] with heightened quoting and trading obligations (referred to collectively as the "minimum performance standards"), which would be immediately ranked on the CHX book without executing against any resting orders on the CHX book; (2) certain cancel messages related to resting orders that were submitted by LEAD MMs; (3) cancel/replace messages related to resting orders that were submitted by LEAD MMs (except that any part of the replace portion of the order that would immediately execute against a resting order would be intentionally delayed);

Letter"); (7) Tyler Gellasch, Executive Director, Healthy Markets Association, March 17, 2017 ("Healthy Markets Letter"); (8) Elizabeth K. King, General Counsel and Corporate Secretary, New York Stock Exchange, dated March 20, 2017 ("NYSE Letter"); (9) James G. Ongena, Executive Vice President and General Counsel, CHX, dated March 24, 2017 ("CHX Letter"); (10) Steve Crutchfield, Head of Market Structure, CTC Trading Group, LLC, dated April 4, 2017 ("CTC Trading Letter"); and (11) Theodore R. Lazo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated May 17, 2017 ("SIFMA Letter"). All comments on the proposed rule change are available at: https://www.sec.gov/comments/sr-chx-2017-04/chx201704.htm.

6 15 U.S.C. 78s(b)(2)(B).

7 New incoming orders are orders received by the Matching System for the first time. The LEAD would not apply to other situations where existing orders or portions thereof are treated as incoming orders, such as: (1) resting orders that are price slid into a new price point pursuant to the CHX only price sliding or limit up-limit down price sliding processes; and (2) unexecuted remainders of routed orders released into the matching system.

8 See CHX Article 1, Rule 1(tt) (defining "Market Maker"); see also generally CHX Article 16 (Market Makers).

and (4) the portion of a routable order that is to be routed away, regardless of who submitted the routable order. A message will be subject to a 350 microsecond delay after initial receipt by the Exchange ("Fixed LEAD Period"), but will only be processed after the Exchange's matching system[9] has evaluated and processed, if applicable, all messages in the security received by the Exchange during the Fixed LEAD Period. A delayed message will retain its original sequence number and may be delayed only once. The LEAD would be applied to all securities traded on the Exchange throughout the trading day.

The Exchange states that the LEAD is designed to enhance displayed liquidity and price discovery by minimizing the effectiveness of "latency arbitrage" strategies,[10] which the Exchange says diminish displayed liquidity and impair price discovery. According to the Exchange, latency arbitrage is and has been effected at CHX by low-latency market participants that leverage microsecond speed advantages to take resting liquidity at stale prices from the CHX limit order book. Specifically, in 2016, the Exchange experienced a decline in volume in the SPDR S&P 500 trust exchange-traded fund ("SPY"), which the Exchange attributes to latency arbitrage activity in SPY first observed at CHX in January 2016. Between January and July 2016, the Exchange found that SPY latency arbitrage activity caused CHX liquidity providers to dramatically reduce displayed trading interest in SPY (and at times withdraw from the market altogether).

The Exchange believes that the LEAD would not materially impact the ability of liquidity takers not engaged in latency arbitrage, such as retail investors, to access displayed liquidity at

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9 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).

10 The Exchange defines "latency arbitrage" as the practice of exploiting disparities in the price of a security or related securities that are being traded in different markets by taking advantage of the time it takes to access and respond to symmetric public information.

CHX.[11] The Exchange also contends that, to the extent a sophisticated market participant seeks to take displayed liquidity pursuant to better or different information (as opposed to the same information exploited by latency arbitrageurs), the LEAD would be too short to have an incrementally negative impact on such non-latency arbitrage strategies.[12]

A LEAD MM would be required to meet the proposed minimum performance standards in return for undelayed access to submit liquidity providing orders and to cancel its resting orders. The proposed minimum performance standards require:

- a LEAD MM to satisfy the Quotation Requirements and Obligations prescribed under current CHX Article 16, Rule 4(d),[13] except that the Designated Percentages described under current Article 16, Rule 4(d)(2)(B) shall be halved;[14]
- a LEAD MM to maintain a "Monthly Average NBBO Quoting Percentage," as defined in proposed CHX Article 16, Rule 4(f)(2)(B)(iv), in each of the securities assigned to the LEAD MM ("LEAD MM Securities"), of at least 10% over the course of a calendar month;[15]

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11 See Notice, supra note 3, 82 FR at 11268.

12 See id. at 11253.

13 Currently, CHX Market Makers must disseminate throughout the "Open Trading State" a continuous two-sided quote with bids and offers being no further away from the National Best Bid ("NBB") and National Best Offer ("NBO"), respectively, than the Designated Percentage or Defined Limit, as applicable. See CHX Article 16, Rule 4(d).

14 See proposed CHX Article 16, Rule 4(f)(2)(A). For example, the 8% Designated Percentage for securities subject to the Article 20, Rule 2A(c)(1)(A) pursuant to current CHX Article 16, Rule 4(d)(2)(A) and (B) would be 4% for LEAD MMs.

15 See proposed CHX Rule Article 16, Rule 4(f)(2)(B). For each such security, the Exchange will determine: (1) the "Daily NBB Quoting Percentage" by determining the percentage of time the LEAD MM has at least one Round Lot (as defined in CHX Article 1, Rule 2(f)(3)) of displayed interest in an Exchange bid at the NBB during the Open Trading State (as defined in CHX Article 1, Rule 1(qq)) of each trading day for a

- a LEAD MM's Qualified Executions[16] in each of its LEAD MM Securities must comprise on an equally-weighted daily average at least 2% of all Qualified Executions in the same security over the course of a calendar month;[17] and
- that at least 80% of the LEAD MM's Qualified Executions in each of its LEAD MM Securities must result from its resting orders that originated from the corresponding LEAD MM trading account[18] over the course of a calendar month.[19]

The proposed rule change also establishes the procedure for CHX to designate LEAD MMs in a security. Only a Market Maker could apply to be a LEAD MM in one or more

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calendar month; (2) the "Daily NBO Quoting Percentage" by determining the percentage of time the LEAD MM has at least one Round Lot of displayed interest in an Exchange offer at the NBO during the Open Trading State of each trading day for a calendar month; (3) the "Average Daily NBBO Quoting Percentage" for each trading day by summing the "Daily NBB Quoting Percentage" and the "Daily NBO Quoting Percentage" then dividing such sum by two; and (4) the "Monthly Average NBBO Quoting Percentage" for each security by summing the security's "Average Daily NBBO Quoting Percentages" for each trading day in a calendar month then dividing the resulting sum by the total number of trading days in such calendar month.

[16] "Qualified Executions" are all executed shares at CHX, during all trading sessions resulting from single-sided orders, excluding any executed shares resulting from auctions. See proposed CHX Article 16, Rule 4(f)(1)(D).

[17] See proposed CHX Article 16, Rule 4(f)(2)(C).

[18] Prior to commencing LEAD market making activities in a security, a LEAD MM must, among other things, establish at least one separately designated LEAD MM trading account through which all and only LEAD market making activities in LEAD MM Securities must originate. See proposed CHX Article 16, Rule 4(f)(3)(B)(i).

[19] See proposed CHX Article 16, Rule 4(f)(2)(D). Unlike the standards provided under proposed paragraphs (f)(2)(A)-(C), this standard would be measured based on aggregate activity over the course of a calendar month. Trading days on which the Exchange does not open for trading would be excluded from the Exchange's calculations regarding compliance with the proposed minimum performance standards.

securities,[20] and Market Makers must receive written approval from the Exchange to be assigned securities as a LEAD MM. LEAD MMs would be selected by the Exchange based on factors including, but not limited to, experience with making markets in securities, adequacy of capital, willingness to promote the Exchange as a marketplace, issuer preference, operational capacity, support personnel and history of adherence to Exchange rules and securities laws. Current Article 16, Rules 2(c)-(e) govern Market Maker withdrawal from assigned securities, and would apply to LEAD MMs and LEAD MM Securities. The Exchange could approve at its discretion more than one LEAD MM to be assigned to any LEAD MM Security and limit the number of LEAD MMs assigned to any security.[21]

Proposed CHX Article 16, Rule 4(f)(3)(D) outlines requirements regarding LEAD MM trading accounts and, according to the Exchange, facilitates the ability of the Exchange to monitor compliance with the proposed minimum performance standards. The Exchange would review each LEAD MM's quoting and trading activity on a monthly basis to determine whether the LEAD MM has met the minimum performance standards.[22] A LEAD MM's failure to meet the minimum performance standards on any given month would result in the Exchange: (1) suspending or terminating a LEAD MM's registration as a Market Maker pursuant to current Article 16, Rule 1(d); or (2) suspending or terminating assignment to a LEAD MM Security pursuant to proposed CHX Article 16, Rule 4(f)(3)(A).[23] These proposed provisions would not limit any other power of the Exchange to discipline a LEAD MM pursuant to other CHX rules.[24]

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20 See proposed CHX Article 16, Rule 4(f)(3)(A).

21 See proposed CHX Article 16, Rule 4(f)(3)(C).

22 See proposed CHX Article 16, Rule 4(f)(3)(D).

23 See id.

24 See id.

III. Summary of the Comments

The Commission has received eleven comments on the proposed rule change, including a response letter from the Exchange.[25] Two commenters expressed support for the proposal,[26] and eight commenters expressed opposition to the proposal.[27]

Some commenters questioned whether, as asserted by CHX, latency arbitrage is to blame for the decline in CHX's market share, and whether the LEAD would solve the purported problem.[28] One commenter questioned CHX's assertion that there is structural bias against displayed liquidity, and the need for an asymmetrical remedy.[29] Another commenter opined that the proposed rule change is overbroad because the proposed LEAD is a systemic solution to a problem – namely a decline in CHX's market share in one security – that CHX has not demonstrated to be market-wide.[30] In addition, a commenter questioned whether CHX could address what it perceives as latency arbitrage by improving its technology to reduce the time to cancel for liquidity providers.[31] Another commenter suggested other ways to confront latency arbitrage, including that the Exchange could move its servers closer to the Chicago Mercantile

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25 See supra note 5.

26 See Virtu Letter, supra note 5; and CTC Trading Group Letter, supra note 5.

27 See XR Securities Letter, supra note 5; FIA PTG Letter, supra note 5; Hudson River Trading Letter, supra note 5; Leuchtkafer Letter, supra note 5; Citadel Letter, supra note 5; Healthy Markets Letter, supra note 5; NYSE Letter, supra note 5; and SIFMA Letter, supra note 5.

28 See FIA PTG Letter, supra note 5, at 2; and Hudson River Trading Letter, supra note 5, at 2, 5.

29 See FIA PTG Letter, supra note 5, at 2.

30 See Citadel Letter, supra note 5, at 7.

31 See SIFMA Letter, supra note 5, at 7-8.

Exchange's ("CME") servers or to New Jersey, apply a delay to messages coming from CME's data centers, implement a random delay for everyone, or prohibit latency arbitrage by rule.[32]

Several commenters discussed the potential impact of the proposal on displayed liquidity and price discovery. Two commenters asserted that the LEAD would enable liquidity providers to improve displayed liquidity.[33] Six commenters, however, expressed concern that the LEAD could deteriorate the accessibility of quotes and overall market quality.[34] For example, one commenter predicted that, while overall spreads and liquidity may improve, the increased liquidity would be more conditional and less accessible.[35] In addition, a commenter predicted that spreads made by "real" liquidity providers – as distinguished from "fleeting" quotes submitted by LEAD MMs – would widen.[36] In response, the Exchange asserted that the proposal would promote tighter spreads and larger size, and that there is no evidence that it would result in CHX quotes being less accessible to "natural" buyers and sellers.[37]

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32 See Leuchtkafer Letter, supra note 5, at 6-7.

33 See Virtu Letter, supra note 5, at 2 (stating that the proposal would improve displayed liquidity available to institutional investors without limiting the ability of "natural" buyers and sellers to access liquidity); and CTC Trading Letter, supra note 5, at 3 (asserting that the LEAD would result in tighter bid-ask spreads).

34 See Healthy Markets Letter, supra note 5, at 4-5; XR Securities Letter, supra note 5, at 2; FIA PTG Letter, supra note 5, at 4; SIFMA Letter, supra note 5, at 6; Citadel Letter, supra note 5, at 3; and Hudson River Trading Letter supra note 5, at 6.

35 See Hudson River Trading Letter, supra note 5, at 6. Another commenter similarly predicted that the LEAD would result in complex trickle-down impacts on the NBBO including CHX quotes that would not be accessible. See FIA PTG Letter, supra note 5, at 3.

36 See XR Securities Letter, supra note 5, at 2. See also FIA PTG Letter, supra note 5, at 4 (expressing concern that non-LEAD MMS would be forced to widen their bid/ask spreads across the marketplace).

37 See CHX Letter, supra note 5, at 4-5.

In addition, some commenters stated that the LEAD would impinge upon price discovery across the national market system.[38] Some commenters noted that an asymmetric delay on TSX Alpha, a Canadian exchange, degraded overall market quality, harmed institutional order routers, and increased effective spreads.[39] One commenter noted that while quoted depth increased on TSX Alpha, the exchange did not demonstrate tighter spreads, and the accessibility of quotes significantly degraded.[40] In addition, a commenter asserted that the only counterbalance to the negative impact on market quality caused by an asymmetric delay (such as that exhibited due to TSX Alpha) would be coupling it with "robust and rigorous" affirmative obligations for those benefitting from the delay.[41] In response, the Exchange asserted that the TSX Alpha delay is materially different from LEAD because it is randomized and, unlike CHX, TSX Alpha utilizes an inverted maker-taker model.[42] The Exchange also observed that TSX Alpha does not require its liquidity providers to meet heightened requirements designed to enhance market quality.[43]

One commenter asserted that the indeterminacy of the proposed delay may result in the LEAD producing delays that are not de minimis.[44] In response, the Exchange stated that

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38 See XR Securities Letter, supra note 5, at 3; FIA PTG Letter, supra note 5, at 3-4, and Hudson River Trading Letter supra note 5, at 5.

39 See Hudson River Trading Letter, supra note 5, at 2. See also Healthy Markets Letter, supra note 5, at 5; and SIFMA Letter, supra note 5, at 6. These commenters cite a recent study regarding TSX Alpha: See Chen, Haoming, Foley, Sean, Goldstein, Michael, and Ruf, Thomas, "The Value of a Millisecond: Harnessing Information in Fast, Fragmented Markets" https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2860359.

40 See Hudson River Trading Letter, supra note 5, at 2.

41 See Healthy Markets Letter, supra note 5, at 5.

42 See CHX Letter, supra note 5, at 8.

43 See id. at 8-9.

44 See Leuchtkafer Letter, supra note 5, at 2. See also Healthy Markets Letter, supra note 5, at 5 (urging the Commission to consider concerns about the delay being implemented by

processing delays and message queuing currently exists in every market.[45] The Exchange also asserted that these delays would not provide LEAD MMs with more than a 350 microsecond window to adjust or cancel their resting orders at CHX.[46]

Several commenters stated that the LEAD would unfairly discriminate in favor of the LEAD MMs.[47] Specifically, commenters asserted that the LEAD would harm market participants seeking to access liquidity provided by LEAD MMs as the LEAD MMs may alter their prices while incoming orders are being delayed.[48] In addition, a commenter stated that the LEAD would give LEAD MMs an unfair advantage.[49] One commenter asserted that the LEAD could make it more difficult for non-LEAD MMs to quote better prices at larger size.[50] Two commenters stated that the LEAD would unfairly discriminate against market participants that are primarily liquidity takers, such as retail investors or institutions.[51] Another commenter expressed concern that, unlike other examples of "permissible" discrimination, the LEAD would affect the regulatory mechanics of trading because, in some cases, traders would be required to

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software as opposed to hardware, what happens in periods of high volume, and how CHX would ensure that the delay does not vary under different circumstances).

45 See CHX Letter, supra note 5, at 9. See also CTC Letter, supra note 5, at 5.

46 See CHX Letter, supra note 5, at 9.

47 See FIA PTG Letter, supra note 5, at 2-3; Leuchtkafer Letter, supra note 5, at 4; Citadel Letter, supra note 5, at 4; Hudson River Trading Letter, supra note 5, at 5-6. See also XR Securities Letter, supra note 5, at 2 (stating that the LEAD would give LEAD MMs an "unfair advantage"); and Healthy Markets Letter, supra note 5, at 4 (stating that the proposal would "venture into unchartered discriminatory waters, and offers little explanation or justification"). See also SIFMA Letter, supra note 5, at 5 (asserting that any intentional delay should be universally applied to all market participants in a non-discriminatory manner).

48 See Hudson River Trading Letter, supra note 5, at 2.

49 See XR Securities Letter, supra note 5, at 2.

50 See Hudson River Trading Letter, supra note 5, at 1-2.

51 See Citadel Letter, supra note 5, at 5-6; Leuchtkafer Letter, supra note 5, at 4.

route orders to the Exchange pursuant to Rule 611 of Regulation NMS.[52] In addition, one commenter asserted that the delay would only benefit market participants who become LEAD MMs and subscribe to the CME's data feeds.[53] In response, CHX stated that the LEAD would discriminate on fair terms because it is designed to correct the current asymmetry that CHX says currently exists in the market.[54] In addition, CHX asserted that the LEAD would reduce the cost of providing liquidity to the LEAD MMs, which CHX asserted would result in efficient price discovery for retail and institutional investors.[55]

Other commenters expressed concern that the proposal would be unfairly discriminatory because only firms selected by CHX as LEAD MMs would be given the speed advantage,[56] and LEAD MMs would be named based on subjective criteria.[57] CHX responded that the LEAD MM factors are designed to forecast how well that applicant would perform as a LEAD MM if approved.[58] CHX further noted that the criteria are "virtually identical" to the criteria under Bats BZX's rules for its lead market maker program.[59]

Several commenters commented on the proposed minimum performance standards. Two commenters expressed support for the proposed minimum performance standards.[60] One of these commenters asserted that the proposal would effectively couple heightened quoting and

52 See FIA PTG Letter, supra note 5, at 4.

53 See Leuchtkafer Letter, supra note 5, at 4.

54 See CHX Letter, supra note 5, at 10-11.

55 See id. at 4.

56 See XR Securities Letter, supra note 5, at 1; and FIA PTG Letter, supra note 5, at 2.

57 See Citadel Letter, supra note 5, at 4.

58 See CHX Letter, supra note 5, at 11-12.

59 See id.

60 See Virtu Letter, supra note 5, at 2; and CTC Trading Letter, supra note 5, at 4.

trading requirements with the ability to adequately manage the heightened risks of such requirements.[61] Other commenters expressed concern that the minimum performance standards may not be adequate to justify the benefits that LEAD MMs would receive under the proposal.[62] Two commenters suggested that CHX should provide data regarding the materiality of the minimum performance standards, how they will improve market quality, and whether CHX market makers already satisfy these criteria.[63] In response, the Exchange asserted that the proposed minimum performance standards are "substantial and proportionate to the benefits conferred upon LEAD MMs," and that they would minimize the risk of incremental quote fading and other non-bona fide liquidity provision strategies.[64] Further, the Exchange stated that the minimum performance standards are appropriate in light of the requirements imposed upon and benefits incurred by market makers on other exchanges.[65]

Some commenters suggested that the LEAD could increase the risk of manipulative activity. One commenter argued that the LEAD would enable intra-exchange latency arbitrage because CHX would impose neither negative obligations on its LEAD MMs nor information barriers to segregate LEAD market making from other proprietary trading.[66] Another

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61 See Virtu Letter, supra note 5, at 2.

62 See Leuchtkafter Letter, supra note 5, at 5; NYSE Letter, supra note 5, at 4-5 (stating that the benefit is "disproportionate" to the proposed standards); Citadel Letter, supra note 5, at 7 (asserting that the minimum performance standards appear to be "largely immaterial in substance" and the benefits of the LEAD would be "entirely disproportionate" to these obligations).

63 See Citadel Letter, supra note 5, at 3; and Healthy Markets Letter, supra note 5, at 4.

64 See CHX Letter, supra note 5, at 6. Another commenter agreed with CHX that the proposed quoting requirements are "substantial and proportionate." See CTC Trading Letter, supra note 5, at 4.

65 See CHX Letter, supra note 5, at 6.

66 See Leuchtkafer Letter, supra note 5, at 6.

commenter expressed concern that the LEAD would frustrate strategies that involve taking prices across multiple venues by giving extra time to LEAD MMs to pull their quotes in the middle of a multi-venue order.[67] The Exchange responded that sophisticated order routing strategies would minimize incremental leakage, and that the LEAD is much shorter than the time that it would take for information regarding a CHX routed order that is executed away to be consumed and processed by the LEAD MM.[68]

One commenter asserted that the LEAD would unduly burden competition among CHX members and among national securities exchanges.[69] Another commenter stated that the LEAD would alter the competitive balance in the market by benefitting only LEAD MMs.[70]

In addition, some commenters asserted that the LEAD may be inconsistent with the "firm quote" provisions of Rule 602 of Regulation NMS ("Quote Rule") because commenters asserted that it would allow liquidity providers to back away from their quotes.[71] The Exchange responded that the LEAD would not violate the Quote Rule because the duty of a broker or dealer to stand behind its quote would not vest because the LEAD would prevent the liquidity provider from receiving (i.e., being presented with) a marketable contra-side order.[72]

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67 See FIA PTG Letter, supra note 5, at 3.

68 See CHX Letter, supra note 5, at 8.

69 See Hudson River Trading Letter, supra note 5, at 8.

70 See Citadel Letter, supra note 5, at 8.

71 See FIA PTG Letter, supra note 5, at 5; Hudson River Trading Letter, supra note 5, at 6; Citadel Letter, supra note 5, at 5; NYSE Letter, supra note 5, at 2.

72 See CHX Letter, supra note 5, at 12.

Several commenters asserted that the adoption of the LEAD could be inconsistent with CHX's protected quotation status under Regulation NMS.[73] In particular, some commenters asserted that by providing LEAD MMs with a structural advantage, the LEAD would frustrate the purposes of Rule 611 by impairing fair and efficient access to an exchange's quotations.[74] In response, the Exchange stated that it believes that LEAD would be a de minimis delay so short as not to: (1) frustrate the purposes of the Rule 611 by impairing fair and efficient access to the Exchange's quotations; and (2) neither provide an incremental advantage other than neutralizing structural bias nor permit a LEAD MM to back away from a quote on a quotation-by-quotation basis.[75]

Certain commenters also asserted that the LEAD would result in unfair allocation of consolidated market data revenue by generating an increase in quoting, but not necessarily trading, on the Exchange.[76] The Exchange responded that the LEAD would not encourage non-bona fide quote activity for the purpose of earning rebates because quotes cancelled within the

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73 See Hudson River Trading Letter, supra note 5, at 7; Citadel Letter, supra note 5, at 6; NYSE Letter, supra note 5, at 4; XR Securities Letter, supra note 5, at 1. See also SIFMA Letter, supra note 5, at 7 (suggesting that the Commission should "carefully consider the implications" of market participants routing orders to CHX to access a protected quote when the accessibility of such quote is "questionable").

74 See FIA PTG Letter, supra note 5, at 2; Hudson River Trading Letter, supra note 5, at 7; Citadel Letter, supra note 5, at 6; NYSE Letter, supra note 5, at 4; XR Securities, supra note 5, at 1; and SIFMA Letter, supra note 5, at 6 (questioning the effect of an access delay coupled with existing geographic or technological latencies on the fair and efficient access to an exchange's protected quotations).

75 See CHX Letter, supra note 5, at 14.

76 See Hudson River Trading Letter, supra note 5, at 7; Citadel Letter, supra note 5, at 6; and SIFMA Letter, supra note 5, at 7.

350-microsecond LEAD would not be eligible for market data revenue rebates, and cancellation of such quotes could result in the CHX participant being assessed an order cancellation fee.[77]

IV. Proceedings to Determine Whether to Approve or Disapprove SR-CHX-2017-04 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act[78] 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 stated 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,[79] 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: (1) Section 6(b)(5) of the Exchange Act, which requires, among other things, that the rules of a national securities exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers;[80] (2) Section 6(b)(8) of the Exchange Act, which requires that the rules of a national securities exchange not impose any burden on competition not necessary or

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77 See CHX Letter, supra note 5, at 10.

78 15 U.S.C. 78s(b)(2)(B).

79 Id.

80 15 U.S.C. 78f(b)(5).

appropriate in furtherance of the purposes of the Exchange Act;[81] and (3) Section 11A of the Exchange Act.[82]

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 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), 6(b)(8), and 11A of the Exchange Act, any other provision of the Exchange Act, or any other rule or regulation under the Exchange Act. 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.[83]

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, in addition to any other comments they may wish to

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81 15 U.S.C. 78f(b)(8).

82 15 U.S.C. 78k-1.

83 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).

submit about the proposed rule change. In particular, the Commission seeks comment on the following:

1. Would the proposed minimum performance standards for LEAD MMs enhance market quality? Why or why not? What metrics would help determine any enhancement to market quality? How should enhancements to market quality be measured with the delay in effect?

2. How would the proposal affect price volatility during stressed trading conditions?

3. How would the proposal affect transaction costs for retail and institutional investors?

4. How would the proposal affect an institutional investor's experience providing liquidity and removing liquidity on CHX?

5. Would the proposal provide an unfair advantage to LEAD MMs providing liquidity vis-à-vis other liquidity providers and in particular when the price of a security moves?

6. Do commenters agree with the Exchange's assertion that the proposed rule change would increase displayed liquidity on the Exchange?

7. Do the obligations for LEAD MMs to comply with the proposed minimum performance standards justify the LEAD MMs' speed advantage?

8. According to several commenters, liquidity provided by LEAD MMs would be "fleeting" because they could update their quotations while incoming orders are delayed. Do commenters agree? If so, what are commenters' views on how significant "fleeting" liquidity would be in comparison to the overall liquidity provided on the Exchange?

9. How would the proposal affect the national market system if exchanges with a larger percentage of overall trading volume were to adopt a similar proposal? In particular, how would the proposal affect market quality?

10. One of the stated goals of the proposal is to minimize the effectiveness of latency arbitrage strategies. What metrics would help determine if latency arbitrage is currently a problem on CHX? Is 350 microsecond necessary to minimize the effectiveness of latency arbitrage strategies? Should the delay be shorter or longer to accomplish this goal? Is the 350 microsecond delay appropriate for trading at both CHX's Chicago data center and its East Coast data center? Why or why not?

11. Does the proposal's protection against latency arbitrage strategies for LEAD MMs warrant the benefits of the delay?

12. Is the delay short enough that it would not harm liquidity takers or providers other than those engaging in latency arbitrage?

13. What are commenters' views on how the proposal would affect liquidity providers on CHX other than LEAD Market Makers as well as liquidity providers on other markets?

Comments may be submitted by any of the following methods:

<u>Electronic comments</u>:

- 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-2017-04 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-2017-04. 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; 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 Number SR-CHX-2017-04 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 the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[84]

Eduardo A. Aleman
Assistant Secretary

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[84] 17 CFR 200.30-3(a)(57).

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