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SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-87154; File No. SR-CboeBYX-2019-014]

Self-Regulatory Organizations; Cboe BYX Exchange, Inc.; Order Approving a Proposed Rule Change to Make Permanent the Exchange's Pilot Retail Price Improvement Program, Rule 11.24, Which is Set to Expire on September 30, 2019, and Order Granting Limited Exemption Pursuant to Rule 612(c) of Regulation NMS

September 30, 2019.

I. Introduction

On August 22, 2019, Cboe BYX Exchange, Inc. (the "Exchange" or "BYX") filed with the Securities and Exchange Commission (the "Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to make permanent Exchange Rule 11.24, which sets forth the Exchange's Pilot Retail Price Improvement ("RPI") Program ("Program").³ The proposed rule change was published for comment in the Federal Register on August 29, 2019.⁴ The Commission received no comment letters on the proposed rule change. In connection with the proposed rule change, the Exchange requests exemptive relief from Rule 612 of Regulation NMS,⁵ which, among other things, prohibits a national securities exchange from accepting or ranking orders priced greater than \$1.00 per share in an increment smaller than \$0.01 ("Sub-Penny Rule").⁶ The Commission is issuing this

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 68303 (November 27, 2012), 77 FR 71652 (December 3, 2012) ("RPI Approval Order") (SR-BYX-2012-019).

⁴ See Securities Exchange Act Release No. 86742 (August 23, 2019), 84 FR 45575 ("Notice").

⁵ 17 CFR 242.612(c).

⁶ See note 11 infra.

⁷ See Notice, supra note 4, at 45575.

order approving the proposed rule change and granting the Exchange limited exemptive relief pursuant to Rule 612(c) of Regulation NMS.

II. Description of the Proposed Rule Change

The Exchange proposes to make the Program permanent. In the Notice, the Exchange sets forth and discusses its analysis of the Program and basis for permanent approval.

Overview of the Program

The Program is designed to attract retail order flow to the Exchange, and allow such order flow to receive potential price improvement.⁷ All Regulation NMS securities traded on the Exchange are eligible for the RPI Program. The Program is limited to trades occurring at prices equal to or greater than \$1.00 per share.⁸

Exchange Rule 11.24 sets forth the rules governing the Program. Exchange Rule 11.24(a) contains the defined terms for the Program. It defines a “Retail Member Organization” (or “RMO”) as a Member (or a division thereof) that has been approved by the Exchange to submit Retail Orders. Under Exchange Rule 11.24(b)(1), to qualify as an RMO, a Member of the Exchange must conduct a retail business or route retail orders on behalf of another broker-dealer. Exchange Rule 11.24(b)(2) sets forth the process for a Member to apply to become an RMO, which includes an attestation from the Member that substantially all orders that it submits as Retail Orders will qualify as such. Exchange Rule 11.24(c) sets forth when and how the Exchange would remove a Member’s RMO Status (i.e., disqualification), and Exchange Rule 11.24(d) sets forth the process for a Member to appeal a disapproval of its RMO application or an RMO disqualification under Exchange Rule 11.24(c).

⁷ See Notice, supra note 4, at 45575.

⁸ Exchange Rule 11.24(h).

Exchange Rule 11.24(a) defines the terms “Retail Order”⁹ and “Retail Price Improvement Order” (“RPI Order” or collectively, “RPI Interest”).¹⁰ Both Retail Orders and RPI Orders are non-display orders. A Retail Order must be submitted by an RMO, and an RPI Order must provide price improvement of at least \$0.001 to Retail Orders. RPI Orders may only execute against Retail Orders, and an RPI Order may only execute against a Retail Order if it provides price improvement of at least \$0.001 better than the national best bid or offer (NBBO).¹¹

Under Exchange Rule 11.24(e), the Exchange disseminates an identifier when RPI interest priced at least \$0.001 better than the Exchange’s Protected Bid or Protected Offer for a particular security is available in the System (“Retail Liquidity Identifier”). The Retail Liquidity Identifier is disseminated through consolidated data streams (i.e., pursuant to the Consolidated

⁹ Under Exchange Rule 11.24(a)(2), a “Retail Order” is defined as 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. A Retail Order is an Immediate or Cancel (“IOC”) Order and shall operate in accordance with Rule 11.24(f). A Retail Order may be an odd lot, round lot, or mixed lot.

¹⁰ Under Exchange Rule 11.24(a)(3), an RPI Order is consists of non-displayed interest on the Exchange that is priced better than the Protected NBB or Protected NBO by at least \$0.001 and that is identified as such (“RPI interest”). The System will monitor whether RPI buy or sell interest, adjusted by any offset and subject to the ceiling or floor price, is eligible to interact with incoming Retail Orders. An RPI Order remains non-displayed in its entirety (the buy or sell interest, the offset, and the ceiling or floor). An RPI Order may also be entered in a sub-penny increment with an explicit limit price. Any User is permitted, but not required, to submit RPI Orders. An RPI Order may be an odd lot, round lot or mixed lot.

¹¹ In the RPI Approval Order, the Commission also granted the Exchange’s request for exemptive relief from the Sub-Penny Rule. See RPI Approval Order, supra note 3, at 71658. In conjunction with this proposal to make the Program Permanent, the Exchange has submitted a separate written request for exemptive relief from the Sub-Penny Rule. See Letter from Adrian Griffith, Assistant General Counsel, Cboe, to Vanessa Countryman, Secretary, Securities and Exchange Commission dated September 23, 2019.

Tape Association Plan/Consolidated Quotation System, or CTA/CQS, for Tape A and Tape B securities, and The Nasdaq Stock Market, LLC (“Nasdaq”) UTP Plan for Tape C securities) as well as through proprietary Exchange data feeds. The Retail Liquidity Identifier reflects the symbol and the side (buy or sell) of the RPI interest, but does not include the price or size of the RPI interest.

Under Exchange Rule 11.24(f), an RMO can designate how a Retail Order interacts with available contra-side interest. Under Exchange Rule 11.24(f), Retail Orders can be designated as either Type-1 or Type-2. A Type 1-designated Retail Order interact with available contra-side RPI Orders and any other price improving contra-side interest but will not interact with other available contra-side interest in the System that is not offering price improvement or route to other markets. The portion of a Type-1 Retail Order that does not execute against contra-side RPI Orders or other price improving liquidity will be immediately and automatically cancelled. A Type 2-designated Retail Order will interact first with available contra-side RPI Orders and other price improving liquidity and then any remaining portion of the Retail Order will be executed as an Immediate-or-Cancel (“IOC”) Order pursuant to Rule 11.9(b)(1). A Type2-designated Order can either be submitted as a BYX Only Order or as an order eligible for routing pursuant to Rule 11.13(a)(2).

Exchange Rule 11.24(g) sets forth the priority and order allocation rules for how RPI Orders are ranked against both RPI and non-RPI orders when the Exchange receives a contra-side Retail Order. Competing RPI Orders in the same security are ranked and allocated according to price then time of entry into the Exchange’s System. Executions occur in price/time priority in accordance with Exchange Rule 11.12. When an RPI executes against a Retail Order, any remaining unexecuted RPI interest will be available to interact with other incoming Retail Orders if such interest is at an eligible price, but any remaining unexecuted portion of the Retail

Order will cancel or execute in accordance with its Retail Order designation under Exchange Rule 11.24(f).

Exchange Rule 11.24(h) currently provides that the program is a pilot set to expire the earlier of approval of this proposal or September 30, 2019. The Exchange proposes to eliminate this provision of the rule and make the Program permanent based on its analysis of the Program.

Analysis of the Program

As more fully set forth in the Notice, the Exchange submitted data and analysis to support its proposal for making the Program permanent.¹² The Exchange stated that the Program provided \$4.5 million in price improvement to retail investors during its review period, January 2016 and June 2018.¹³ The Exchange also asserted that it has achieved its goal of attracting retail order flow to the Exchange, noting there has been consistent retail investor interest in the Program, which has provided tangible price improvement to those retail investors through a competitive pricing process over the course of the pilot.¹⁴ The Exchange stated that it has not received any complaints or negative feedback concerning the Program.¹⁵

In addition, the Exchange undertook a difference-in-difference (“DID”) analysis to also analyze the Program’s impact on the broader market.¹⁶ The Exchange noted that the introduction

¹² See Notice, supra note 4, at 45579-45599.

¹³ See id. at 45575.

¹⁴ See id. at 45579.

¹⁵ See id.

¹⁶ A DID statistical technique allows studying the differential effect of a treatment on data measured between a treatment group and a control group. The two groups are measured during two or more different time periods, usually a period before “treatment” and at least one time period after “treatment,” that is, a time period after which the treatment group is impacted but the control group is not. For each group, the difference between a measure in the pre-treatment and the treatment period is computed. Those differences for a measure for the two groups are then compared to each other by taking the difference between them.

of the Program applied to all stocks traded on the Exchange and, therefore, control stocks in the strict sense were not available. To account for this, the Exchange identified stocks with relatively high levels of participation in the Program for use as the “treatment” group, and used stocks with low participation in the Program as the “control” group.¹⁷ The Exchange sought to enhance the validity of the DID analysis by otherwise making the treatment group and the control group as similar as possible. The Exchange divided the analysis into two parts: active securities and less active securities. The active securities consist of stocks with consolidated average daily volume (“CADV”) of 500,000 shares or more. The less active securities consist of stocks with CADV of between 50,000 and 500,000 shares.¹⁸ Within each subgroup, the Exchange conducted what it describes as a “matched pair” process to identify a smaller set of treatment and control groups that are as similar as possible across three market quality statistics: (i) consolidated average daily share volume; (ii) average price; and (iii) average BBO spread across exchanges.¹⁹ To conduct the analysis of the Program’s effect on overall market quality, the Exchange compared those statistics during a pre-treatment period (October 2012 to December 2012) against those statistics from January 2013 to December 2013 and January 2017 to December 2018, obtaining a set of four DID regression analyses.²⁰

Based on results for each sample group in the Exchange’s regression analysis, the Exchange concluded that the overall results were not statistically significant to support a conclusion that the introduction of the Program caused spreads to widen.²¹ In fact, the Exchange’s regressions suggested some narrowing of spreads between the pretreatment period

¹⁷ See id. at 45585-86 for a full description of the Exchange’s methodology.

¹⁸ See id. at 45586.

¹⁹ See id.

²⁰ See id.

²¹ See id.

and the post treatment periods, however the Exchange stated that these observations could not necessarily be attributed to the Program, but did support a conclusion that the Program did not result in wider spreads.²²

The Exchange also analyzed available size and found a decrease in the average bid and ask size on BYX in treatment securities observed from 2017-2018 with less liquid securities relative to the control group –16.54 round lots on the bid side and 13.22 round lots on the ask side.²³ The Exchange stated that it believes these changes may have been caused by factors unrelated to the Program and noted that the average BYX bid and ask sizes materially increased during the course of the pilot for securities in both the treatment and control groups.²⁴ The Exchange concluded that the regression results are consistent with a finding that the Program did not materially harm depth on BYX.²⁵

Overall, the based on its analysis, including its DID analysis, as well as the small size of the Program, the Exchange concluded that the Program did not have a negative impact on market quality.

III. Discussion and Commission Findings

After careful review, the Commission finds that the Exchange’s proposal to make permanent the Program, Exchange Rule 11.24, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange.²⁶ In particular, the Commission finds that the proposed rule change is consistent with

²² See id. at 45588.

²³ See id.

²⁴ See id.

²⁵ See id.

²⁶ In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

Sections 6(b)(5)²⁷ and 6(b)(8)²⁸ of the Exchange Act. 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.

The Commission approved the Program on a pilot basis to allow the Exchange and market participants to gain valuable practical experience with the Program during the pilot period, and to allow the Commission to determine whether modifications to the Program were necessary or appropriate prior to any Commission decision to approve or disapprove the Program on a permanent basis. The Program's pilot period was originally scheduled to end on January 11, 2014, and the Exchange filed to extend the operation of the pilot on several occasions.²⁹ The pilot is now set to expire on September 30, 2019, and the Exchange proposes to make the Program permanent.

As set forth in the RPI Approval Order, the Exchange agreed to provide the Commission with a significant amount of data to assist the Commission's evaluation of the Program prior to

²⁷ 15 U.S.C. 78f(b)(5).

²⁸ 15 U.S.C. 78f(b)(8).

²⁹ See Securities Exchange Act Release Nos. 71249 (January 7, 2014), 79 FR 2229 (January 13, 2014) (SR-BYX-2014-001); 74111 (January 22, 2015), 80 FR 4598 (January 28, 2015) (SR-BYX-2015-05); 76965 (January 22, 2016), 81 FR 4682 (January 27, 2016) (SR-BYX-2016-01); 78180 (June 28, 2016), 81 FR 43306 (July 1, 2016) (SR-BatsBYX-2016-15); 81368 (August 10, 2017), 82 FR 38960 (August 16, 2017) (SR-BatsBYX-2017-18); 84830 (December 17, 2018), 83 FR 65769 (December 21, 2018) (SR-CboeBYX-2018-025); 86206 (June 26, 2019), 84 FR 31650 (July 2, 2019) (SR-CboeBYX-2019-010).

any permanent approval of the Program.³⁰ Specifically, the Exchange represented that it would “produce data throughout the pilot, which will include statistics about participation, the frequency and level of price improvement provided by the Program, and any effects on the broader market structure.”³¹ The Commission expected the Exchange to monitor the scope and operation of the Program and study the data produced during that time with respect to such issues.³²

After careful consideration, the Commission believes that the Exchange’s Program data and analysis about price improvement for retail investors and the DID analysis support the Exchange’s conclusion that the Program provides meaningful price improvement to retail investors on a regulated exchange venue and has not demonstrably caused harm to the broader market. As noted above, the Exchange demonstrated that during the operation of the Program, retail orders received price improvement on the Exchange. Furthermore, in undertaking the DID analysis, the Exchange examined whether spreads on the Exchange widened to the detriment of the broader market, and concluded that they did not.³³ Based on the foregoing, and after careful consideration of the Exchange’s analysis of the data generated by the Program, the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act.

³⁰ See RPI Approval Order, supra note 3, at 71657.

³¹ See id.

³² See id.

³³ See supra notes 21 and 22 and accompanying text. The Commission also notes that it recently approved on a permanent basis two other exchange’s substantially similar retail price improvement program based on a similar type of DID analysis. See Securities Exchange Act Release Nos. 85160 (February 15, 2019), 84 FR 5754 (February 22, 2019) (SR-NYSE-2018-28) (approving the New York Stock Exchange’s Retail Liquidity Program on a permanent basis and granting a limited exemption to the Sub-Penny Rule); and 86194 (June 25, 2019), 84 FR 31373 (July 1, 2019) (approving the Nasdaq BX’s Retail Liquidity Program on a permanent basis and granting a limited exemption to the Sub-Penny Rule).

IV. Limited Exemption from the Sub-Penny Rule

Pursuant to its authority under Rule 612(c) of Regulation NMS,³⁴ the Commission hereby grants the Exchange a limited exemption from the Sub-Penny Rule to operate the Program. For the reasons discussed below, the Commission determines that such action is necessary or appropriate in the public interest, and is consistent with the protection of investors.

When the Commission adopted the Sub-Penny Rule in 2005, the Commission identified a variety of problems caused by sub-pennies that the Sub-Penny Rule was designed to address:

- If investors' limit orders lose execution priority for a nominal amount, investors may over time decline to use them, thus depriving the markets of liquidity.
- When market participants can gain execution priority for a nominal amount, important customer protection rules such as exchange priority rules and the Manning Rule³⁵ could be undermined.
- Flickering quotations that can result from widespread sub-penny pricing could make it more difficult for broker-dealers to satisfy their best execution obligations and other regulatory responsibilities.
- Widespread sub-penny quoting could decrease market depth and lead to higher transaction costs.
- Decreasing depth at the inside could cause institutions to rely more on execution alternatives away from the exchanges, potentially increasing fragmentation in the securities markets.³⁶

³⁴ 17 CFR 242.612(c).

³⁵ See Financial Industry Regulatory Authority Rule 5320 (Prohibition Against Trading Ahead of Customer Orders).

³⁶ See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (Adopting Order for Regulation NMS).

The Commission believes that the limited exemption granted today should continue to promote competition between exchanges and OTC market makers in a manner that is reasonably designed to minimize the problems that the Commission identified when adopting the Sub-Penny Rule. Under the Program, sub-penny prices will not be disseminated through the consolidated quotation data stream, which should avoid quote flickering and its reduced depth at the inside quotation.

Furthermore, the Commission does not believe that granting this limited exemption and approving the proposal would reduce incentives for market participants to display limit orders. As noted in the RPI Approval Order, market participants that displayed limit orders at the time were not able to interact with marketable retail order flow because that order flow was almost entirely routed to internalizing OTC market makers that offered sub-penny executions.³⁷ The Program has attracted a small volume from the OTC market makers. As a result, enabling the Exchange to continue to compete for retail order flow through the Program should not materially detract from the current incentives to display limit orders, while potentially resulting in greater order interaction and price improvement for marketable retail orders on a public national securities exchange. To the extent that the Program may raise Manning and best execution issues for broker-dealers, these issues are already presented by the existing practices of OTC market makers.

This permanent and limited exemption from the Sub-Penny Rule is limited solely to the operation of the Program by the Exchange. This exemption does not extend beyond the scope of Exchange Rule 11.24. In addition, this exemption is conditioned on the Exchange continuing to conduct the Program, in accordance with Exchange Rule 11.24 and substantially as described in

³⁷ See RPI Approval Order, supra note 3, at 71658.

the Exchange's request for exemptive relief and the proposed rule change.³⁸ Any changes in Exchange Rule 11.24 may cause the Commission to reconsider this exemption.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,³⁹ that the proposed rule change (SR-CboeBYX-2019-014) be, and it hereby is, approved.

IT IS FURTHER ORDERED that, pursuant to Rule 612(c) under Regulation NMS, that the Exchange shall be exempt from Rule 612(a) of Regulation NMS with respect to the operation of the Program as set forth in Exchange Rule 11.24 as described herein.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁰

Jill M. Peterson,
Assistant Secretary.

³⁸ See supra note 11.

³⁹ 15 U.S.C. 78s(b)(2).

⁴⁰ 17 CFR 200.30-3(a)(12) and 17 CFR 200.30-3(a)(83).

