

the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

Rule 17a-5 is the basic financial reporting rule for brokers and dealers.<sup>1</sup> The rule requires the filing of Form X-17A-5, the Financial and Operational Combined Uniform Single Report (“FOCUS Report”), which was the result of years of study and comments by representatives of the securities industry through advisory committees and through the normal rule proposal methods. The FOCUS Report was designed to eliminate the overlapping regulatory reports required by various self-regulatory organizations and the Commission and to reduce reporting burdens as much as possible. The rule also requires the filing of an annual audited report of financial statements.

The FOCUS Report consists of: (1) Part I, which is a monthly report that must be filed by brokers or dealers that clear transactions or carry customer securities; (2) one of three alternative quarterly reports: Part II, which must be filed by brokers or dealers that clear transactions or carry customer securities; Part IIA, which must be filed by brokers or dealers that do not clear transactions or carry customer securities; and Part IIB, which must be filed by specialized broker-dealers registered with the Commission as OTC derivatives dealers;<sup>2</sup> (3) supplemental schedules, which must be filed annually; and (4) a facing page, which must be filed with the annual audited report of financial statements. Under the rule, a broker or dealer that computes certain of its capital charges in accordance with Appendix E to Exchange Act Rule 15c3-1 must file additional monthly, quarterly, and annual reports with the Commission.

The Commission estimates that the total hours burden under Rule 17a-5 is approximately 353,510 hours per year when annualized, and the total cost burden under Rule 17a-5 is approximately \$45,131,475 per year.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information under the PRA unless it displays a currently valid OMB control number.

The public may view background documentation for this information collection at the following Web site: [www.reginfo.gov](http://www.reginfo.gov). Comments should be directed to: (i) Desk Officer for the

Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10102, New Executive Office Building, Washington, DC 20503, or by sending an email to: [Shagufta.Ahmed@omb.eop.gov](mailto:Shagufta.Ahmed@omb.eop.gov); and (ii) Pamela Dyson, Director/Chief Information Officer, Securities and Exchange Commission, c/o Remi Pavlik-Simon, 100 F Street NE., Washington, DC 20549, or by sending an email to: [PRA\\_Mailbox@sec.gov](mailto:PRA_Mailbox@sec.gov). Comments must be submitted to OMB within 30 days of this notice.

Dated: May 19, 2017.

**Eduardo A. Aleman,**  
Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-80740; File No. SR-CHX-2017-04]

### 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

May 22, 2017.

#### 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”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> 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.<sup>3</sup> 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.<sup>4</sup> The Commission received eleven comment letters on the proposed rule change, including a response from the Exchange.<sup>5</sup> This order institutes

proceedings under Section 19(b)(2)(B) of the Exchange Act<sup>6</sup> 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,<sup>7</sup> 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<sup>8</sup> 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); 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

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 (“Leuchtkafer Letter”); (6) Stephen John Berger, Managing Director, Government & Regulatory Policy, Citadel Securities, dated March 14, 2017 (“Citadel 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>.

<sup>6</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>7</sup> 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.

<sup>8</sup> See CHX Article 1, Rule 1(tt) (defining “Market Maker”); see also generally CHX Article 16 (Market Makers).

<sup>1</sup> Rule 17a-5(c) requires a broker or dealer to furnish certain of its financial information to customers and is subject to a separate PRA filing (OMB Control Number 3235-0199).

<sup>2</sup> Part IIB of Form X-17A-5 must be filed by OTC derivatives dealers under Exchange Act Rule 17a-12 and is subject to a separate PRA filing (OMB control number 3235-0498).

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

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

<sup>3</sup> See Securities Exchange Act Release No. 80041 (February 14, 2017), 82 FR 11252 (“Notice”).

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

<sup>5</sup> See letters from: (1) Ryan Hitch, Head of Equities Trading, XR Securities LLC, dated

microsecond delay after initial receipt by the Exchange (“Fixed LEAD Period”), but will only be processed after the Exchange’s matching system<sup>9</sup> 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,<sup>10</sup> 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 CHX.<sup>11</sup> 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.<sup>12</sup>

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),<sup>13</sup> except that the Designated Percentages described under current Article 16, Rule 4(d)(2)(B) shall be halved;<sup>14</sup>
- 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;<sup>15</sup>
- a LEAD MM’s Qualified Executions;<sup>16</sup> 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;<sup>17</sup> 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

<sup>13</sup> 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).

<sup>14</sup> 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.

<sup>15</sup> 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 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.

<sup>16</sup> “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).

<sup>17</sup> See proposed CHX Article 16, Rule 4(f)(2)(C).

account<sup>18</sup> over the course of a calendar month.<sup>19</sup>

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 securities,<sup>20</sup> 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.<sup>21</sup>

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.<sup>22</sup> 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,

<sup>18</sup> 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).

<sup>19</sup> 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.

<sup>20</sup> See proposed CHX Article 16, Rule 4(f)(3)(A).

<sup>21</sup> See proposed CHX Article 16, Rule 4(f)(3)(C).

<sup>22</sup> See proposed CHX Article 16, Rule 4(f)(3)(D).

<sup>9</sup> The matching system is an automated order execution system, which is a part of the Exchange’s “Trading Facilities,” as defined under CHX Article 1, Rule 1(z).

<sup>10</sup> 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.

<sup>11</sup> See Notice, *supra* note 3, 82 FR at 11268.

<sup>12</sup> See *id.* at 11253.

Rule 4(f)(3)(A).<sup>23</sup> These proposed provisions would not limit any other power of the Exchange to discipline a LEAD MM pursuant to other CHX rules.<sup>24</sup>

### III. Summary of the Comments

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

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.<sup>28</sup> One commenter questioned CHX's assertion that there is structural bias against displayed liquidity, and the need for an asymmetrical remedy.<sup>29</sup> 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.<sup>30</sup> 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.<sup>31</sup> Another commenter suggested other ways to confront latency arbitrage, including that the Exchange could move its servers closer to the Chicago Mercantile 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.<sup>32</sup>

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.<sup>33</sup> Six

commenters, however, expressed concern that the LEAD could deteriorate the accessibility of quotes and overall market quality.<sup>34</sup> For example, one commenter predicted that, while overall spreads and liquidity may improve, the increased liquidity would be more conditional and less accessible.<sup>35</sup> In addition, a commenter predicted that spreads made by "real" liquidity providers—as distinguished from "fleeting" quotes submitted by LEAD MMs—would widen.<sup>36</sup> 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.<sup>37</sup>

In addition, some commenters stated that the LEAD would impinge upon price discovery across the national market system.<sup>38</sup> 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.<sup>39</sup> 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.<sup>40</sup> 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

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).

<sup>34</sup> 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.

<sup>35</sup> 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.

<sup>36</sup> 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).

<sup>37</sup> See CHX Letter, *supra* note 5, at 4–5.

<sup>38</sup> 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.

<sup>39</sup> 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](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2860359).

<sup>40</sup> See Hudson River Trading Letter, *supra* note 5, at 2.

coupling it with "robust and rigorous" affirmative obligations for those benefitting from the delay.<sup>41</sup> 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.<sup>42</sup> The Exchange also observed that TSX Alpha does not require its liquidity providers to meet heightened requirements designed to enhance market quality.<sup>43</sup>

One commenter asserted that the indeterminacy of the proposed delay may result in the LEAD producing delays that are not *de minimis*.<sup>44</sup> In response, the Exchange stated that processing delays and message queuing currently exists in every market.<sup>45</sup> 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.<sup>46</sup>

Several commenters stated that the LEAD would unfairly discriminate in favor of the LEAD MMs.<sup>47</sup> 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.<sup>48</sup> In addition, a commenter stated that the LEAD would give LEAD MMs an unfair advantage.<sup>49</sup> One commenter asserted that the LEAD could make it more difficult for non-LEAD MMs to quote better prices at larger size.<sup>50</sup> Two commenters stated that the LEAD would unfairly discriminate against market participants that are primarily liquidity takers, such

<sup>41</sup> See Healthy Markets Letter, *supra* note 5, at 5.

<sup>42</sup> See CHX Letter, *supra* note 5, at 8.

<sup>43</sup> See *id.* at 8–9.

<sup>44</sup> 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 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).

<sup>45</sup> See CHX Letter, *supra* note 5, at 9. See also CTC Letter, *supra* note 5, at 5.

<sup>46</sup> See CHX Letter, *supra* note 5, at 9.

<sup>47</sup> 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).

<sup>48</sup> See Hudson River Trading Letter, *supra* note 5, at 2.

<sup>49</sup> See XR Securities Letter, *supra* note 5, at 2.

<sup>50</sup> See Hudson River Trading Letter, *supra* note 5, at 1–2.

<sup>23</sup> See *id.*

<sup>24</sup> See *id.*

<sup>25</sup> See *supra* note 5.

<sup>26</sup> See Virtu Letter, *supra* note 5; and CTC Trading Group Letter, *supra* note 5.

<sup>27</sup> 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.

<sup>28</sup> See FIA PTG Letter, *supra* note 5, at 2; and Hudson River Trading Letter, *supra* note 5, at 2, 5.

<sup>29</sup> See FIA PTG Letter, *supra* note 5, at 2.

<sup>30</sup> See Citadel Letter, *supra* note 5, at 7.

<sup>31</sup> See SIFMA Letter, *supra* note 5, at 7–8.

<sup>32</sup> See Leuchtkafer Letter, *supra* note 5, at 6–7.

<sup>33</sup> See Virtu Letter, *supra* note 5, at 2 (stating that the proposal would improve displayed liquidity

as retail investors or institutions.<sup>51</sup> 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 route orders to the Exchange pursuant to Rule 611 of Regulation NMS.<sup>52</sup> 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.<sup>53</sup> 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.<sup>54</sup> 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.<sup>55</sup>

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,<sup>56</sup> and LEAD MMs would be named based on subjective criteria.<sup>57</sup> CHX responded that the LEAD MM factors are designed to forecast how well that applicant would perform as a LEAD MM if approved.<sup>58</sup> CHX further noted that the criteria are “virtually identical” to the criteria under Bats BZX’s rules for its lead market maker program.<sup>59</sup>

Several commenters commented on the proposed minimum performance standards. Two commenters expressed support for the proposed minimum performance standards.<sup>60</sup> One of these commenters asserted that the proposal would effectively couple heightened quoting and trading requirements with the ability to adequately manage the heightened risks of such requirements.<sup>61</sup> 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.<sup>62</sup> 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.<sup>63</sup> 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.<sup>64</sup> 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.<sup>65</sup>

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.<sup>66</sup> Another 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.<sup>67</sup> 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.<sup>68</sup>

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

In addition, some commenters asserted that the LEAD may be

(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).

<sup>63</sup> See Citadel Letter, *supra* note 5, at 3; and Healthy Markets Letter, *supra* note 5, at 4.

<sup>64</sup> 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.

<sup>65</sup> See CHX Letter, *supra* note 5, at 6.

<sup>66</sup> See Leuchtkafer Letter, *supra* note 5, at 6.

<sup>67</sup> See FIA PTG Letter, *supra* note 5, at 3.

<sup>68</sup> See CHX Letter, *supra* note 5, at 8.

<sup>69</sup> See Hudson River Trading Letter, *supra* note 5, at 8.

<sup>70</sup> See Citadel Letter, *supra* note 5, at 8.

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.<sup>71</sup> 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.<sup>72</sup>

Several commenters asserted that the adoption of the LEAD could be inconsistent with CHX’s protected quotation status under Regulation NMS.<sup>73</sup> 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.<sup>74</sup> 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 quote-by-quote basis.<sup>75</sup>

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.<sup>76</sup> 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 350-microsecond LEAD would not be eligible for market data revenue rebates,

<sup>71</sup> 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.

<sup>72</sup> See CHX Letter, *supra* note 5, at 12.

<sup>73</sup> 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”).

<sup>74</sup> 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).

<sup>75</sup> See CHX Letter, *supra* note 5, at 14.

<sup>76</sup> 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.

<sup>51</sup> See Citadel Letter, *supra* note 5, at 5–6; Leuchtkafer Letter, *supra* note 5, at 4.

<sup>52</sup> See FIA PTG Letter, *supra* note 5, at 4.

<sup>53</sup> See Leuchtkafer Letter, *supra* note 5, at 4.

<sup>54</sup> See CHX Letter, *supra* note 5, at 10–11.

<sup>55</sup> See *id.* at 4.

<sup>56</sup> See XR Securities Letter, *supra* note 5, at 1; and FIA PTG Letter, *supra* note 5, at 2.

<sup>57</sup> See Citadel Letter, *supra* note 5, at 4.

<sup>58</sup> See CHX Letter, *supra* note 5, at 11–12.

<sup>59</sup> See *id.*

<sup>60</sup> See Virtu Letter, *supra* note 5, at 2; and CTC Trading Letter, *supra* note 5, at 4.

<sup>61</sup> See Virtu Letter, *supra* note 5, at 2.

<sup>62</sup> See Leuchtkafer 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

and cancellation of such quotes could result in the CHX participant being assessed an order cancellation fee.<sup>77</sup>

#### 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<sup>78</sup> 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,<sup>79</sup> 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;<sup>80</sup> (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 appropriate in furtherance of the purposes of the Exchange Act;<sup>81</sup> and (3) Section 11A of the Exchange Act.<sup>82</sup>

#### 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.<sup>83</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by June 16, 2017. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by June 30, 2017. 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. 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:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto: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 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 Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the

<sup>77</sup> See CHX Letter, *supra* note 5, at 10.

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

<sup>79</sup> *Id.*

<sup>80</sup> 15 U.S.C. 78f(b)(5).

<sup>81</sup> 15 U.S.C. 78f(b)(8).

<sup>82</sup> 15 U.S.C. 78k-1.

<sup>83</sup> Section 19(b)(2) of the Exchange Act, as amended by the Securities Act Amendments of 1975, Public Law 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).

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 Web site 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 June 16, 2017. Rebuttal comments should be submitted by June 30, 2017.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>84</sup>

**Eduardo A. Aleman,**  
Assistant Secretary.

[FR Doc. 2017-10807 Filed 5-25-17; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-80738; File No. SR-CBOE-2017-029]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change Relating to the Exposure Periods of the Automated Improvement Mechanism and the Solicitation Auction Mechanism

May 22, 2017.

#### I. Introduction

On March 31, 2017, Chicago Board Options Exchange, Incorporated (the "Exchange" or "CBOE") filed with the Securities and Exchange Commission ("Commission") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend CBOE Rules 6.74A and 6.74B to reduce the exposure periods of the Exchange's Automated Improvement Mechanism ("AIM") and Solicitation Auction Mechanism ("SAM") from 1

second to a time period designated by the Exchange of no less than 100 milliseconds and no more than 1 second. The proposed rule change was published for comment in the **Federal Register** on April 14, 2017.<sup>3</sup> The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change.

#### II. Description of the Proposed Rule Change

CBOE's AIM auction allows a Trading Permit Holder ("TPH") to execute electronically an order it represents as agent against principal interest or against a solicited order.<sup>4</sup> CBOE's SAM auction allows a TPH to execute electronically an agency order of 500 contracts or more against solicited orders.<sup>5</sup> After an agency order is properly designated for AIM or SAM processing, the Exchange will send a Request for Responses ("RFR") to all TPHs who have elected to receive RFRs.<sup>6</sup> Orders entered in the AIM or SAM are currently exposed for a period of 1 second, during which time competitive responses to the auction may be submitted. The Exchange proposes to revise the RFR response periods for AIM and SAM to permit the Exchange to designate a specific time within a range of no less than 100 milliseconds and no more than 1 second.<sup>7</sup>

<sup>3</sup> See Securities Exchange Act Release No. 80421 (April 10, 2017), 82 FR 18048 ("Notice").

<sup>4</sup> See CBOE Rule 6.74A.

<sup>5</sup> See CBOE Rule 6.74B.

<sup>6</sup> The AIM RFR specifies the side and size of the order, while the SAM RFR specifies the price, side, and size of the order. See CBOE Rule 6.74A(b)(1)(B) and 6.74B(b)(1)(B).

<sup>7</sup> Although the proposed rule change would allow the Exchange to select an exposure period from a range of 1 second to 100 milliseconds, the Exchange stated that it currently plans to decrease the time period allowed for responses to 100 milliseconds. See Notice, *supra* note 3, at 18050. The Exchange noted that its proposal is consistent with exposure periods permitted in similar mechanisms on other options exchanges. See *id.* at 18049; see also Securities Exchange Act Release Nos. 76301 (October 29, 2015), 80 FR 68347 (November 4, 2015) (SR-BX-2015-032) (establishing an exposure period for the Nasdaq BX's options price improvement mechanism ("PRISM") of no less than 100 milliseconds and no more than 1 second); 77557 (April 7, 2016), 81 FR 21935 (April 13, 2016) (SR-Phlx-2016-40) (amending the exposure period for the Nasdaq Phlx's Price Improvement XL ("PIXL") to be no less than 100 milliseconds and no more than 1 second); and 79733 (January 4, 2017), 82 FR 3055 (January 10, 2017) (SR-ISE-2016-26) (amending the exposure period for the Nasdaq ISE's Price Improvement Mechanism ("PIM") to be no less than 100 milliseconds and no more than 1 second).

#### III. Discussion and Commission's Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>8</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>9</sup> which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating transactions in securities, 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. The Commission also finds that the proposed rule change is consistent with Section 6(b)(8) of the Act,<sup>10</sup> which requires that the rules of an exchange not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

The Commission believes that, given the electronic nature of the AIM and SAM mechanisms and the ability of TPHs to respond within the proposed exposure periods, reducing each of the exposure periods from 1 second to no less than 100 milliseconds could facilitate the prompt execution of orders, while continuing to provide market participants with an opportunity to compete to trade with the exposed order by submitting responses to the auctions. According to the Exchange, numerous TPHs have the capability to and do respond within a 100 millisecond exposure period or less on the Hybrid Trading System.<sup>11</sup> The Exchange notes that the response timers for its Exchange's Hybrid Agency Liaison ("HAL"), Complex Order Auction ("COA"), and Simple Auction Liaison ("SAL") mechanisms are set at 100 milliseconds or less and numerous TPHs can and do respond to HAL, SAL, and COA messages within these time frames.<sup>12</sup> The Exchange also notes that the AIM and SAM mechanisms operate on the Hybrid Trading System and employ the same type of mechanical

<sup>8</sup> 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).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> 15 U.S.C. 78f(b)(8).

<sup>11</sup> See Notice, *supra* note 3, at 18049 n.4.

<sup>12</sup> See *id.*

<sup>84</sup> 17 CFR 200.30-3(a)(57).

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

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