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October 14, 2016

VIA E-MAIL

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C., 20549-1090

Re: Securities Exchange Act Release No. 78860 (Sept. 16, 2016), 81 FR 65442 (Sept. 22, 2016) (SR-CHX-2016-16) (the "CHX Proposal")

Dear Mr. Fields:

NYSE Group ("NYSE") appreciates the opportunity to submit a comment letter on the above-referenced rule proposal filed by the Chicago Stock Exchange, Inc. ("CHX"). CHX is proposing to adopt an intentional delay that would allow resting displayed orders to be re-priced or cancelled, while arriving, marketable orders are systemically delayed from being processed. CHX claims its proposed asymmetrical delay would be better suited for protecting resting displayed orders against latency arbitrage strategies than the intentional delay that the Commission recently approved for Investors Exchange LLC ("IEX").[1]

NYSE has previously cautioned that approval of the IEX application to be registered as an exchange would result in other exchanges making similar assessments to permit systemic, intentional delays.[2] More specifically, NYSE posed whether Commission approval of IEX would result in an exchange applying a delay to aggressive orders, thereby allowing participants posting displayed orders to re-price their orders.[3] At that time, NYSE noted that such asymmetrical delay would shift who could manage the risk of the intentional delay from dark, pegged orders (IEX) to displayed orders.

As NYSE predicted, approval of IEX and the Commission's related interpretation of Rule 611 under Regulation NMS ("Rule 611")[4] to allow for *de minimis* delay on exchange response times

[1] See Securities Exchange Act Release No. 78101 (June 17, 2016), 81 FR 41141 (June 23, 2016) ("IEX Approval Order").

[2] See Letter from Elizabeth K. King, General Counsel & Secretary, New York Stock Exchange, to Brent J. Fields, Secretary, Securities and Exchange Commission, dated November 12, 2015, available here: https://www.sec.gov/comments/10-222/10222-19.pdf.

[3] See Letter from Elizabeth K. King, General Counsel and Corporate Secretary, New York Stock Exchange, to Brent J. Fields, Secretary, Commission, dated April 18, 2016, available here: https://www.sec.gov/comments/10-222/10222-472.pdf.

[4] 17 CFR 242.611.

has opened the door to additional experimentation with intentional delays.[5] The NYSE believes that the CHX Proposal to adopt an asymmetrical, intentional delay that would facilitate displayed orders ability to be re-priced or cancelled before they can be accessed would violate both the Quote Rule as set forth in Rule 602 of Regulation NMS ("Rule 602")[6] and the Order Protection Rule as set forth in Rule 611. Therefore, the CHX Proposal is not consistent with the Securities Exchange Act of 1934 (the "Act"). The CHX Proposal also demonstrates that the Commission's recent approval of IEX and the Rule 611 Interpretation is encouraging more, rather than less, complexity for the U.S. equities markets.

I. Background

CHX has proposed a new "CHX Liquidity Taking Access Delay," or "LTAD" that CHX claims is designed to neutralize microsecond speed advantages exploited by low-latency market participants engaged in latency arbitrage.[7] As proposed, all new incoming orders, and certain related cancel messages, that could immediately execute against one or more resting orders on the CHX book would be intentionally delayed for 350 microseconds before such delayed messages would be executed against resting orders. However, the following would not be subject to the intentional delay: (i) non-marketable orders that would be posted to the CHX book; (ii) requests to cancel resting orders; (iii) orders that are treated as incoming orders, such as resting orders that are subject to price sliding processes, or any unexecuted remainder of orders that are routed; (iv) outbound messages (e.g., reports of executions); and (v) market data.

CHX claims that it has proposed LTAD to address recent declines in CHX trading volume in the SPDR S&P 500 trust exchange-traded fund ("SPY"), which CHX attributes to latency arbitrage activity in that symbol. CHX further claims that the best way to minimize the impact of latency arbitrage is to implement an asymmetric delay to provide liquidity providers an additional time to cancel or adjust resting orders based on the most recent market data so that market participants engaging in low-latency arbitrage could not take advantage of potentially "stale" prices.

II. LTAD Would Violate Regulation NMS

A. LTAD Would Violate the Quote Rule

The Quote Rule, first adopted in 1978 and amended in 1996, is a foundational element of the reliability and availability of quotation information in the U.S. securities markets. The Quote Rule requires a national securities exchange to establish procedures for collecting, processing, and making available to vendors the best bid, best offer, and aggregate quotation sizes for NMS securities that are communicated on that exchange by an exchange member to another

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5 See Securities Exchange Act Release No. 78102 (June 17, 2016), 81 FR 40785 (June 23, 2016) (File No. S7-03-16) ("Rule 611 Interpretation").

6 17 CFR 242.602.

7 A recent study analyzed timestamp data from the Securities Information Processors ("SIPs") and found little evidence that fast traders initiate liquidity-taking orders to pick-off stale quotes, contradicting claims that fast traders systematically exploit traders who transact at the SIP national best bid or offer. Bartlett, R. and McCrary, J. (2016) "How Rigged Are Stock Markets? Evidence from Microsecond Timestamps," *Available at SSRN 2812123*.

member.[8] In addition, the Quote Rule establishes requirements for broker-dealers. Specifically, when a broker-dealer is a member of an exchange and communicates bids or offers in NMS securities to other members of that exchange, that broker-dealer is obligated under the Quote Rule to communicate its best bids, best offers, and quotation sizes to the exchange and to be "firm" for those published quotes. To be "firm" for its published quotations under the Quote Rule means a broker-dealer has an obligation "to execute any order . . . at a price at least as favorable . . . as [its] published bid or published offer . . . in an amount up its published quotation size.[9] The Quote Rule provides specific exceptions to a broker-dealer's obligation to be firm for its published quotes, including that "before the order sought to be executed is presented, . . . [the] broker or dealer has communicated to its exchange . . . a revised bid or offer."[10]

CHX's proposed LTAD would enable its members to violate those members' obligations under the Quote Rule. Specifically, CHX is proposing that, after a broker-dealer's quote has been published, orders seeking to trade with that quote will not be processed for 350 microseconds. Unless the exchange similarly delays a broker-dealer that is publishing a quotation from changing that quotation, the exchange would not be enforcing its members' obligation under the Quote Rule to trade with an order "at a price at least as favorable" as its published quote. In other words, the proposal would provide for a mechanized system that would allow for members to cancel or re-price quotes ***after*** an order sought to be executed is presented, which is inconsistent with the Quote Rule.

Accordingly, the NYSE believes the Commission must disapprove CHX's proposal as inconsistent with the purposes of the Quote Rule and Section 6(b)(1) of the Exchange Act, which requires exchanges to enforce compliance by its members with the securities laws.

B. LTAD Would Violate the Order Protection Rule

Regulation NMS requires that a trading center displaying an automated quotation provide "immediate-or-cancel" ("IOC") functionality for an incoming order to execute immediately and automatically against the displayed quotation up to its full size, and for any unexecuted portion of such incoming order to be cancelled immediately and automatically without being routed elsewhere.[11] Accordingly, to qualify as an automated trading center, "the trading center must have implemented such systems, procedures, and rules as are necessary to render it capable

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8 17 CFR 242.602. The Quote Rule was previously codified in Rule 11Ac1-1 under the Act. See Securities Exchange Act Release Nos. 14415 (January 26, 1978), 43 FR 4332 (February 1, 1978) and 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996). The Quote Rule similarly requires a national securities association (i.e., FINRA) to establish procedures for collecting bids, offers and quotation sizes with respect to NMS securities from its members when those members communicate bids and offers to a broker-dealer or customer.

9 17 CFR 242.602(b)(2).

10 17 CFR 242.602(b)(3)(ii). In addition, the Quote Rule does not require a broker-dealer to be "firm" for its published quotation if, "[a]t the time the order sought to be executed is presented, such . . . broker or dealer is in the process of effecting a transaction. . . ." Id.

11 See 17 CFR 242.600(b)(3) (defining the term "automated quotation") and 17 CFR 242.600(b)(57) (defining the terms "protected bid or protected offer," together, a "protected quotation," to mean an automated quotation that is the best bid or best offer of a national securities exchange).

of displaying quotations that meet the action, response, and updating requirements set forth in the definition of an automated quotation."[12]

The Commission determined that in the context of the Order Protection Rule, the term "immediate" does not preclude a programmed delay that is *de minimis*, provided that such delay "does not impair fair and efficient access to an exchange's protected quotation."[13] With IEX, the intentional delay approved by the Commission is applicable to both the entry of new orders and requests to cancel or modify resting displayed orders; the only orders that can update without delay are resting non-displayed orders. As the Commission noted in the IEX Approval Order, "[n]on-displayed orders are not reflected in an exchange's quotations, and Rule 611 applies order protection to publicly displayed quotes only. Accordingly, an access delay that does not allow the repricing of displayed orders does not impact an exchange's displayed quotation, and cannot be said to lead to 'maybe' quotations."[14]

In contrast to IEX, CHX is proposing an intentional delay that would allow for "maybe" quotations. The operation of the proposed LTAD delay would impair the fair and efficient access to CHX's protected quotations by allowing members to adjust protected quotations after CHX has received an order to trade with such displayed orders. In this scenario, even a delay that could be considered *de minimis* in other contexts should not be permitted under the Order Protection Rule.

Accordingly, the NYSE believes the Commission must disapprove CHX's proposal as inconsistent with the Order Protection Rule. The NYSE respectfully urges the Commission to further clarify its Rule 611 Interpretation to explicitly preclude exchanges from applying any form of programmed delay, *de minimis* or otherwise, that would provide an opportunity for displayed orders to be re-priced or cancelled after an exchange has received orders seeking to trade with that displayed liquidity.[15]

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12 See Securities Exchange Act Release No. 51808, 70 FR 37496, 37520 (June 29, 2005).

13 See Rule 611 Intepretation, supra note 5 at 40789.

14 See IEX Approval Order, supra note 1 at 41156, n. 216.

15 In the Rule 611 Interpretation, the Commission noted that the *de minimis* interpretation does not obviate the requirement that proposed access delays be reviewed for consistency with the Act and Regulation NMS. See supra note 5 at 40790.

The NYSE objected to the IEX application in part due to the complexity that would result if one market is approved to add an intentional delay. However, by approving IEX and issuing the Rule 611 Interpretation, the Commission has signaled that other exchanges should similarly be permitted to add an intentional delay consistent with Regulation NMS and the Act. Because CHX's proposed LTAD would result in CHX members' non-compliance with the Quote Rule and CHX's non-compliance with the Order Protection Rule, the CHX Proposal should be disapproved.

Sincerely,

Elizabeth K. King

cc: Hon. Mary Jo White, Chair
Hon. Michael Piwowar, Commissioner
Hon. Kara Stein, Commissioner
Stephen Luparello, Director of Trading and Markets
David Shillman, Associate Director of Trading and Markets