December 16, 2016

Via Electronic Mail (rule-comments@sec.gov)

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

Re: File No. SR-CHX-2016-16: Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change to Adopt the CHX Liquidity Taking Access Delay

Dear Mr. Fields:

The Securities Industry and Financial Markets Association ("SIFMA")[1] submits this letter to the Securities and Exchange Commission ("Commission") to comment on the above-referenced proposed rule change filed by the Chicago Stock Exchange ("CHX") to implement a Liquidity Taking Access Delay ("LTAD"). CHX's proposal raises issues that we addressed in our May 2, 2016, comment letter on the Commission's proposed interpretation of Regulation NMS.[2] In particular, the LTAD proposal highlights that structural changes at individual exchanges can raise significant market structure questions and result in increased market complexity. SIFMA believes that after considering all the factors and potential implications associated with CHX's particular proposed delay – including existing geographic latency, underlying intent of the exchange, and selective application of the delay to certain order types – the Commission should not approve the proposal.

Overview

CHX has proposed to adopt an access delay, which would impose a 350 microsecond delay on all incoming orders that could immediately execute against one or more resting orders on the CHX book, as well as certain related cancel messages.[3] In contrast, CHX would impose

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[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] Securities Exchange Act Release No. 78102 (June 17, 2016), 81 FR 40785 (June 23, 2016) ("**Automated Quotation Interpretation**").

[3] *See* Securities Exchange Act Release No. 78860 (September 16, 2016), 81 FR 65442, 65443 (September 22, 2016).

no delay on liquidity providing orders (*i.e.*, orders that would not immediately execute against one or more resting orders) and related cancel messages for resting orders.[4] Further, CHX would be able to activate or deactivate the LTAD on a per security basis with notice to participants.[5]

CHX states that the implementation of the LTAD is in direct response to recent declines in CHX volume and liquidity in certain securities. CHX attributes these declines to "latency arbitrage strategies,"[6] which, according to CHX, is a *market-wide* problem that is the result of a structural bias inherent in the national market system.[7] CHX insists that the LTAD is intended to address this structural issue by giving liquidity providers additional time to cancel or adjust resting orders because, absent an asymmetric delay, resting orders would likely immediately execute against an incoming contra-side order. CHX argues that implementation of a symmetric delay is not practical to address latency arbitrage, because CHX liquidity providers employ proprietary algorithms to cancel or adjust resting limits orders that cannot be adequately replicated by CHX.[8]

<u>Analysis</u>

As we noted previously in the Automated Quotation Interpretation, SIFMA believes that the implementation of intentional access delays, either symmetric or asymmetric, have the potential to create unnecessary complexity in the market. But to the extent that automated quotations can include an intentional delay, any such delay should be predictable and universally applied to all market participants in a non-discriminatory manner.[9] In this regard, we have previously provided the Commission with an illustrative and non-exhaustive list of activity and access that should not be permitted in connection with intentional access delays, such as:

- A trading center allowing particular types of market participants (*e.g.*, market makers) or customers (*e.g.*, institutional) to avoid the delay.

- A trading center subjecting principal orders to the delay but allowing agency orders to avoid it.

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[4] *Id.*

[5] *Id.* at 65545.

[6] *Id.* at 65543.

[7] *See* Letter from James Ongena, Executive Vice President and General Counsel, CHX to Brent J. Fields, Secretary, Securities and Exchange Commission dated October 28, 2016.

[8] 81 FR at 65544.

[9] *See* Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA to Brent J. Fields, Secretary, Securities and Exchange Commission dated May 2, 2016.

- A trading center establishing a delay and then offering specific order types that avoid the delay.

- A trading center establishing fee schedules that permit firms to pay an extra fee to avoid the delay.[10]

CHX's proposal raises significant questions that we believe warrants disapproval by the Commission. In the Automated Quotation Interpretation, the Commission stated that any intentional access delay will only be approved after a finding that it is consistent with the applicable standards set forth in the Securities and Exchange Act of 1934.[11] In this regard, the Commission stated that a proposed access delay that is only imposed on certain market participants or certain types of orders would be scrutinized to determine whether or not the discriminatory application of that delay is unfair.[12] Further, the Commission expressed its general concern about access delays that would be imposed only on certain market participants or intentional access delays that were relieved based upon payment of certain fees.[13]

SIFMA is concerned with the potential market-wide implications of an access delay that discriminates based on type of order submitted (liquidity taking vs. liquidity providing) and can be applied on a security-by-security basis. For instance, a recent academic study evaluated the impact of a Canadian speed bump offered by an exchange that similarly delayed liquidity taking orders and found that, in aggregate, liquidity was negatively impacted, with increased market-wide costs for liquidity takers.[14] It is also important to note that this Canadian exchange has been operating its asymmetric speedbump for well over a year and that, consistent with Canadian regulations, the exchange is operating as a "unprotected" venue that no market participant is required to access.[15] Given a different approach in the U.S. with respect to speedbump venues and protected status, the Commission should carefully consider the implications of market participants having to send liquidity taking orders pursuant to their Order Protection Rule ("OPR") obligations to access a protected CHX quote when the accessibility of such quote is questionable based on the fact that liquidity providers can cancel their quotes without having to go through the speedbump. In addition, we request that the Commission give close scrutiny to CHX's proposal that it would be allowed to apply the LTAD on a security-by-security basis,

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[10] *Id.*

[11] *See* **SEC Automated Quotation Interpretation** at 40792 n.75.

[12] *Id.*

[13] *Id.*

[14] *See* The Value of a Millisecond: Harnessing Information in Fast, Fragmented Markets (Chen, Foley, Goldstein, Ruf, 2016*).*

[15] *See e.g.* Ontario Securities Commission Staff Notice – Notice of Commission Approval of Proposed Changes to Alpha Exchange Inc. ("Alpha") *available at* https://www.osc.gov.on.ca/documents/en/Marketplaces/alpha-exchange_20150421_noa-proposed-changes.pdf

rather than applying it to all securities traded at the exchange. In its current form, the proposal would give CHX unreasonable flexibility at the added expense of market participants having to develop symbol specific routing strategies to meet their OPR obligations for solely the CHX's unique speedbump exchange model, and adds unnecessary market complexity.

Additionally, we are concerned with the underlying intent of the access delay, which in this case is explicitly intended and designed to benefit liquidity providers by providing them an advance opportunity to modify their orders in response to market data changes that would otherwise result in such orders executing against an incoming contra-side order, including those incoming orders attempting to access a liquidity provider's quote on the CHX that is protected under Regulation NMS and meant to be firm under the Commission's Quote Rule. This factor is critical in light of CHX's Market Data Rebate program, under which CHX members share in the quotation revenue that CHX receives under the terms of the NMS Plans governing the public market data feeds. As such, it is not clear whether the LTAD is intended to facilitate its members' ability to collect market data rebates with little to no risk that their quotes will get hit given that liquidity providers can cancel their quotes outside of the speedbump rather than address latency arbitrage issues.[16]

SIFMA also believes that the Commission should take into consideration implications of access delays that are coupled with other geographic and systems based latencies. The Commission noted in the Automated Quotation Interpretation that its evaluation of access delays focused on whether they impair the fair and efficient access to an exchange's quotations when a market participant routes an order to comply with Rule 611.[17] The Commission stated that system processing and transit times introduce latencies and that market participants today encounter delays in accessing protected quotations at other "away" automated trading centers. In particular, the Commission noted that a market participant co-located with the major exchanges' data centers in northern New Jersey may experience delays of between three and four milliseconds due to geography alone when accessing the protected quotations at CHX's matching engine in Chicago.[18] SIFMA believes that important questions are raised as to what are the implications when an access delay is coupled with existing geographic or technological latencies. For instance, do these delays and latencies in aggregate impede the fair and efficient access to an exchange's protected quotations? In addition, CHX's argument that CHX liquidity providers employ proprietary algorithms that cannot be adequately replicated by CHX raises the question of whether CHX could solve this perceived latency issue by improving its own technology, and thereby reducing the time to cancel for liquidity providers. In other words,

[16] For example, a firm might quote much larger size to earn a rebate if it could cancel its quote in the event of market data changes, even if the firm never had the intent for its quote to execute. Also, although the CHX states that its cancellation fee would inhibit such behavior, there are volume thresholds which exempt firms from cancellation fees. *See* Chicago Fee Schedule at 11 ("Order Cancellation Fee Exemption").

[17] *See* SEC Automated Quotation Interpretation at 40789.

[18] *Id.*

should liquidity taking orders be slowed down, or should the CHX systems be improved to allow for more efficient order handling?

CHX provides that latency arbitrage is a market-wide issue that is due to a structural bias. Based on these assertions, the Commission should not approve a solution that attempts to address such an issue on an isolated basis. Further, if such a structural issue exists in the market, the SEC should prepare a concept release designed to solicit market-wide input in order to thoroughly address the matter. The CHX proposal highlights that there are numerous implications associated with intentional access delays and that they may result in increased market complexity and costs, without providing overall benefits to the market. Accordingly, we believe the Commission after weighing these issues carefully should disapprove the CHX proposal.

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SIFMA greatly appreciates the Commission's consideration of the issues raised above and would be pleased to discuss these comments in greater detail with the Commission and the Staff. If you have any questions, please contact either me (at 202-962-7383 or tlazo@sifma.org) or Timothy Cummings (at 212-313-1239 or tcummings@sifma.org).

Sincerely,

Theodore R. Lazo
Managing Director and
Associate General Counsel

cc: The Honorable Mary Jo White, Chair
The Honorable Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner

Stephen Luparello, Director, Division of Trading and Markets
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