



SNAP will be deactivated effective for trading on August 16, 2018. For more information, please see CHX Information Memorandum MR-18-05

December 2, 2016
MR-16-04A¹

***Chicago Stock Exchange, Inc.
Market Regulation Department
Information Memorandum***

RE: CHX Introduces SNAP – Regulatory Compliance Considerations

On October 16, 2015, the Securities and Exchange Commission (“SEC”) approved Chicago Stock Exchange, Inc., (“CHX” or “the Exchange”) Rule Filing SR-CHX-2015-03 to adopt and amend CHX Rules to implement CHX SNAP (Sub-second Non-displayed Auction Process), an intra-day and on-demand auction service, initiated upon the receipt of a valid limit order marked “Start SNAP,” submitted by an order sender (“Participant-initiated SNAP”). On April 26, 2016, the SEC approved Rule Filing SR-CHX-2016-01 to permit the Exchange to initiate a SNAP, without first receiving a valid Start SNAP order if, for a given SNAP-eligible security, a periodic review of: the CHX book of that security; the queue for SNAP Auction Only orders for that security; and the protected quotations of external markets for that security, show that the projected execution size that would result from a SNAP Cycle would meet certain minimum size and notional value requirements (“Exchange-initiated SNAP”). CHX launched both SNAP functionalities on May 13, 2016.²

The purpose of this Information Memorandum is to highlight the regulatory and compliance considerations that Participants should take into account when initiating or participating in a Participant-initiated SNAP functionality and, in the event Rule Filing SR-CHX-2016-01 is approved by the SEC, when participating in an Exchange-initiated SNAP functionality.³

I. SEC Regulation SHO Compliance Considerations

In connection with the implementation of the Participant-initiated SNAP and Exchange-initiated SNAP functionalities, Participants are reminded to be cognizant of their general order marking obligations under Rule 200 of Regulation SHO and, in particular, their marking obligations under Rule 200(g)(2), relating to broker-dealer marking of certain qualifying sell orders as “short exempt.” Rule 200(g) provides that a broker or dealer must mark all sell orders of any equity security as “long,” “short,” or “short exempt.” The

¹ This Information Memorandum supersedes and replaces MR-16-04, “CHX Introduces SNAP – Regulatory Compliance Considerations,” (April 18, 2016).

² See <http://www.chx.com/snap/>.

³ See <http://www.chx.com/regulatory-operations/rule-filings/>.

SEC recently clarified that the sell orders must be accurately marked “based on the seller’s net position in the security at the time of order entry.”⁴ Moreover, Rule 200(g)(2) provides that a sale order shall be marked “short exempt” only if the provisions of Rule 201(c) (Broker Dealer Provision) or 201(d) (Exceptions) of Regulation SHO are met. CHX also reminds Participants that regulatory requirements apply to Participants who avail themselves of the special provisions under Rule 201. In this regard, CHX’s Market Regulation Department will continue to employ surveillance, and conduct reviews and examinations concerning these special requirements and Participants’ overall compliance with Regulation SHO requirements.

II. Match Trade Prevention Considerations

CHX’s existing MTP functionality enables CHX Participants to better manage their order flow and prevent unintended executions with resting orders which they previously submitted to the CHX Matching System. MTP functionality is designed to prevent a submitted market or limit order, which is designated with the appropriate MTP modifier, from executing against a resting order that was submitted with the same MTP Trading Group designations as defined under CHX Article 1, Rule 1(mm).

Pursuant to proposed CHX Article 18, Rule 1(b)(2)(D), the following modifiers, will be deactivated for all orders in a security during both the Participant-initiated and Exchange-initiated SNAP cycles in that security, but will be reactivated prior to resuming normal automated trading:

- (i) CHX Only;
- (ii) Post Only;
- (iii) Do Not Route;
- (iv) Match Trade Prevention;
- (v) Always Quote; and
- (vi) Reserve Size.

Participants are reminded that, when entering orders that may participate in Participant-initiated or Exchange-initiated SNAP functionalities, including those initially entered with any of the above-referenced modifiers, a Participant must take reasonable measures, beyond reliance on CHX’s MTP functionality and, consistent with its supervisory obligations pursuant to CHX Article 6, Rule 5, to ensure that its trading activity does not result in improper wash trades, matched orders or fraudulent, deceptive or manipulative trading practices.⁵ Therefore, Participants who are relying on the existing MTP functionality to prevent inadvertent self-trades should strongly consider entering orders marked “Cancel On SNAP,” so that resting orders will be cancelled when either SNAP cycle is activated.⁶ Participants are further advised that the “Cancel On SNAP” order modifier is **not** available for SNAP Auction Only (“AO”) Orders; as such, a Participant must be particularly vigilant in discharging its supervisory responsibilities in connection with its use of SNAP AO Orders, including the maintenance of supervisory procedures which address their

⁴ See <https://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm>.

⁵ For more information about CHX’s MTP functionality, see MR-13-10, “Match Trade Prevention’ Order Modifier Available for Use on CHX,” (November 22, 2013).

⁶ If CHX receives a request to cancel any order during a Participant-initiated or Exchange-initiated SNAP cycle, the cancel is queued until the end of the cycle. CHX has also developed the “Cancel On SNAP” order modifier to provide order senders the ability to submit an order to CHX, including one with any of the above-referenced modifiers, which is only eligible to match during open trading (see Article 1, Rule 2(h)(2)). If a SNAP cycle occurs, CHX will automatically cancel a resting order marked “Cancel On SNAP” so that it is not captive to a SNAP auction. A CHX Participant may set a firm default for this “Cancel On SNAP” parameter. If the Participant does not elect this modifier, the default order modifier will apply to the order, so that a resting order will not be automatically cancelled and cannot be cancelled after the start of a SNAP auction cycle.

unique nature and monitoring of these orders to ensure that their execution in a SNAP cycle does not result in inadvertent wash or self trades, matched orders or other fraudulent, deceptive or manipulative trading practices.⁷

III. Manipulative and or Anti-Competitive Order and Trade Activity Considerations

The implementation of Participant-initiated and Exchange-initiated SNAP functionalities does not preclude a Participant from pursuing a bona fide trading strategy in the normal course of its business. However, in all cases, a Participant must ensure that its use of Participant-initiated SNAP functionality is for a bona fide economic purpose. In this regard, Participants shall refrain from entering orders, individually or in concert, in an attempt to: (1) improperly initiate the SNAP Cycle functionality; (2) improperly influence the theoretical price of an auction; or (3) participate in such auctions with little or no market risk to improperly extract auction information. Participants are advised that CHX will monitor Participants' order initiation and trading activities to identify this type of activity occurring on CHX. Such activity may be deemed anti-competitive conduct, manipulative conduct and/or conduct inconsistent with just and equitable principles of trade and the maintenance of a fair and orderly market in violation of CHX Article 9, Rules 2 (Just and Equitable Trade Principles), 9 (Fictitious Transactions) and 11 (Price Manipulation). Activity of this nature may also be deemed contrary to Article 8, Rule 2 (Acts Detrimental to Interest or Welfare of Exchange).

Please note that, while CHX makes an effort to remind Participants of their regulatory obligations through the publications of Notices such as this, it is each Participant's responsibility to ensure that its order initiation and trading activities do not result in fraudulent, deceptive or manipulative practices. Participants are further reminded that they must have appropriate systems, written supervisory procedures and internal controls to ensure compliance with general trading rules articulated in CHX Article 9 and the applicable federal securities laws. Failure to establish and implement such measures may result in possible disciplinary action being taken against the Participant for violation of general trading rules and Article 6, Rule 5 concerning supervisory responsibilities of Participants.

For any regulatory questions concerning this Notice, please contact the undersigned at (312) 663-2402.

Peter D. Santori
Executive Vice President
Chief Regulatory Officer

⁷ In such cases, Participants using SNAP Auction Only Orders who wish to prevent inadvertent self-trades should strongly consider using the "SNAP AOO – Pegged" limit order modifier (see Article 1, Rule 2(h)(3)(C)) with a pricing option that will reprice SNAP AOO orders on both sides of the market to an unlocked or uncrossed state.