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June 12, 2017

Via Electronic Delivery
Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Proposed Rule Change, File Number SR-BatsBZX-2017-34

Dear Mr. Fields:

Nasdaq, Inc. respectfully submits this comment to express its serious concerns about a proposal by Bats BZX Exchange, Inc. ("BZX") to amend its Rules 11.22(i), 11.23(a)(15), and 11.28, to add a new order type, Bats Market Close ("BMC").[1] As described in the BZX filing, a BMC order would be an order to buy or sell a security on BZX at the official closing price published by either the New York Stock Exchange LLC ("NYSE") or The NASDAQ Stock Market LLC ("Nasdaq"), depending on where the security is listed. In other words, BZX is seeking to execute orders at a reference price determined entirely through the interaction of orders and price discovery occurring elsewhere—in this case on exchanges other than BZX itself—and not engaging in or contributing to price discovery on its own exchange. With its proposal, Bats is not only failing in its responsibility to contribute to market transparency and price discovery, it is also impeding the ability of other national securities exchanges to do so.

Nasdaq is deeply committed to the Nasdaq Closing Cross because it is critically important to Nasdaq-listed issuers and to their shareholders. Issuers value the primary market close because it is the most widely-used reference price for their securities, and for trillions of dollars of mutual funds holding their shares. Nasdaq invented the all-electronic closing cross in 2002, and it has invested heavily and continually since then to refine, enhance, and strengthen the closing cross. The Nasdaq Closing Cross is a complex and robust ecosystem

[1] Nasdaq, Inc. is submitting this comment letter in its capacity as operator of three national securities exchanges that trade equities in the United States: The NASDAQ Stock Market LLC, NASDAQ PHLX LLC, and NASDAQ BX, Inc., as well as financial exchanges in other countries.

that receives and integrates millions of continuous market and cross-specific orders; disseminates certain carefully-considered and time-tested information about those orders while withholding other information that could be used to distort or disrupt the outcome; all aimed at facilitating a matching of diverse interests, business models, and strategies. The result is, in Nasdaq's view, one of the finest successes of modern electronic markets on behalf of issuers and investors.

If approved, the Bats proposal would undermine the Nasdaq Closing Cross, harming publicly traded issuers and their shareholders that rely upon it. As Nasdaq explained in *The Promise of Market Reform: Reigniting America's Economic Engine*, U.S. equity markets exist in large part to serve the needs of publicly traded issuers and their shareholders, and the decade-long trend towards market fragmentation has not benefitted all issuers, particularly small and medium sized issuers.[2] The Commission, through a long series of regulatory decisions designed to increase inter-market competition, has cultivated market fragmentation and diminished competition between orders as liquidity has spread across 15 exchanges and over 40 alternative trading systems. Fragmentation has added complexity to the market and increased the cost of sourcing liquidity. The primary market close is a rare remaining instance where liquidity remains largely consolidated and where orders interact and compete vigorously. The Bats proposal would undermine the primary market close with no aim or hope of creating a better closing cross and with no apparent regard for the impact on issuers or their shareholders. Perhaps this is unsurprising since Bats lists no operating company – other than itself -- that would be impacted by its own proposal.

BZX's proposal is virtually identical to a proposal by its predecessor exchange, EDGX Exchange, Inc. ("EDGX"), which sought approval from the Commission in 2012 to introduce an order known as Edge Market Close. Like the BMC, Edge Market Close would have been an order to buy or sell a security on EDGX at the official closing price published by the security's listing exchange.[3] Nasdaq submitted a comment letter in opposition to the EDGX proposal, which EDGX ultimately decided to withdraw before the Commission could act upon it.[4] BZX's proposal is nearly indistinguishable from the EDGX proposal and does nothing to remedy the serious flaws identified in Nasdaq's 2012 comment letter other than to disseminate a new data point at 3:35 p.m., that, far from resolving the wide range of transparency issues that BZX's proposal creates, would introduce a new risk of potential gaming. If anything, it is even clearer now than in 2012 that a proposal by an exchange to execute orders at the closing price determined by a different exchange is at odds with the

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[2] Available at: http://business.nasdaq.com/media/Nasdaq%20Blueprint%20to%20Revitalize%20Capital%20Markets_tcm5044-43175.pdf.

[3] Securities Exchange Act Release No. 67598 (Aug. 6, 2012), 77 FR 47899 (Aug. 10, 2012).

[4] Securities Exchange Act Release No. 68189 (Nov. 8, 2012), 77 FR 68182 (Nov. 15, 2012).

Exchange Act and would undermine the free, open, and orderly operation of the national market system.

As further discussed below, we believe that the BZX proposal: (a) is contrary to the Securities Exchange Act of 1934 (the "Act"), (b) is harmful to investors and to the operation of the national market system for securities, (c) is incomplete in several respects as it omits specific critical information regarding the BMC, and (d) would establish a dangerous precedent. We urge the Commission to reject the BZX proposal.

A. The Strength Behind the Nasdaq Closing Cross

Nasdaq takes its responsibilities as a primary listing exchange seriously and it designs, implements, and continually invests in market solutions that fulfill key exchange functions such as capital formation, price discovery, displayed price formation, and the free flow of capital. The Nasdaq Closing Cross is one of these key functions in which Nasdaq has invested significantly to ensure that the close of the market is effective, robust, and resilient. The close of the market is a unique moment in the trading day that is of paramount importance. The Nasdaq Closing Cross generates a value used throughout the world as a reference price for indices, funds, investment decisions, measures of economic well-being and much more. As a listing exchange, perhaps the most important aspects of the close are the integrity of the process, promoting investor confidence, and providing stability and reliability to Nasdaq's issuer community, an often overlooked constituency in discussions among market structure experts rarely drawn from the issuer community itself. Nasdaq is reminded daily that the capital markets exist to provide a safe, well-regulated ecosystem for innovative companies to raise capital and for average investors to participate in the risks and rewards of business ownership while saving for their futures.

The Nasdaq Closing Cross is an auction that aggregates liquidity from many different participants, including those that engage in continuous price formation on the Nasdaq order book and those focused on the closing auction itself. The Closing Cross integrates these two streams -- the Closing Cross and the continuous market -- to find a unified clearing price that optimizes and maximizes supply and demand. Each and every order plays a key role in finding that optimal price, whether it be a Market On Close order, Limit On Close Order, Imbalance Only order, or a displayed market maker quotation, a reserve order, or any other order residing in Nasdaq's order book.

After determining that all trading interest must play a role in forming a robust and reliable price, Nasdaq labored over the details of order entry and interaction. First, there is a precise prioritization of trading interest to reflect the unique contributions of different trading interests (*i.e.*, displayed versus non-displayed and priced versus unpriced). There are multitiered tie-breakers reserved for instances where the prioritization algorithm yields multiple prices at which trading interest can be maximized. There are also carefully considered deadlines for entering and cancelling certain order types to limit behaviors and strategies that could be used to undermine the process or outcome of the Closing Cross.

Nasdaq also labored over the timing and content of transparency in the Closing Cross. Nasdaq engaged in a lengthy, vigorous industry discussion to determine what information should be made available to the markets and at what times indicative information for the

closing cross should be distributed. Ultimately, Nasdaq determined to disseminate the Net Order Imbalance Indicator or NOII described below between 3:50p.m. and 4:00p.m. to allow the market to efficiently react to supply, demand, and any imbalances that may exist:

- **Current Reference Price -** Price at or within the Nasdaq Best Bid and Offer at which the most shares can be matched.
- **Paired Shares** –Number of shares that are paired at the current reference price.
- **Near Price** – Price at which the Closing Cross would occur at the moment of the NOII dissemination. This includes both Closing Cross orders and orders in the continuous market.
- **Far Price** – Price at which the cross would occur at the moment of NOII dissemination excluding orders in the continuous market.
- **Imbalance Shares** – Excess number of shares to buy or sell at the Current Reference Price.
- **Imbalance direction** – Direction of any imbalance (*e.g.* a buy imbalance would exist if there were more shares to buy than sell at the Current Reference Price).

Notably, Nasdaq does not disclose either MOC or LOC shares matched. Instead it reflects all interest that is matched at the current reference price. Nasdaq considered and rejected the idea of providing segmented information in a piece-meal fashion at a more granular level, such as would result from the Bats proposal, because releasing segmented information would lead to unintended consequences and undermine the price discovery that occurs in the closing cross.

At one time, Nasdaq attempted to compete with other primary markets by offering its patented Nasdaq Closing Cross in non-Nasdaq securities as an *alternative* price discovery process. While Nasdaq was unsuccessful in attracting trading interest, that effort nonetheless strengthened the market because Nasdaq's innovation spurred other primary markets to improve their own closing processes. Nasdaq failed due to the vital role that the primary market has in determining a meaningful securities closing price. Today, exchanges that attempt to compete in the primary listing space have largely copied Nasdaq's process, a testament to the quality of the process Nasdaq created.[5] Nasdaq applauds innovation that improves the markets and fosters efficient price discovery and transparency. However, as discussed more fully below, we fail to understand how the Bats proposal does anything to further innovation and price discovery.

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[5] Nasdaq continues to offer the Closing Cross in non-Nasdaq listed securities but we do not currently encourage its use and rather keep it in operation as a utility for the importance of market resiliency. Today, Nasdaq's ability to operate away market center auctions serves only to bolster systemic redundancy in the national market system. The same cannot be achieved by the market order matching application that Bats proposes.

B. The BZX Proposal Is Contrary To The Act

1. The BZX Proposal Impedes Free And Open Markets

Section 6(b) of the Act provides that the rules of a national securities exchange must "not impose any burden on competition not necessary or appropriate" and must be designed "to remove impediments to and perfect the mechanism of a free and open market and a national market system."[6] Far from removing such impediments, the BZX proposal would create them by interfering with the ability of other national securities exchanges to fulfill their duties within the national market system.

As envisioned under the Act and Commission rules, a national securities exchange exists to make markets more transparent and efficient by promoting price discovery and by collecting orders, executing orders, and disseminating market information about those orders and executions. Price discovery in a given security occurs through the interaction of orders on exchanges, and the quality of price discovery depends, in part, on the depth of the market. Given the role of national securities exchanges, the Commission has been disinclined to approve proposed rule changes in which the exchange cannot clearly articulate how a proposal to offer a service is consistent with the policy goals of the Act with respect to national securities exchanges.[7]

BZX has offered no such explanation as to how its actions here are consistent with the Act. To the contrary, with BMC orders, BZX is ignoring its obligation to facilitate price discovery. By its nature, BMC orders would be incapable of contributing to price discovery at the time of market close[8] and, worse, may lead to a reduction in the number of limit-on-close orders that do contribute to price discovery. The BMC order would increase the amount of risk and uncertainty associated with trading during the auctions by netting market orders, thereby concealing from auction participants the gross amount of liquidity demand during the auction process. Eroding investor confidence in the primary market closing price could create a vicious cycle in which liquidity is diverted from the primary market closing cross, reducing its effectiveness, leading to further reductions in orders to the primary market close.

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[6] 15 U.S.C. 78f(b).

[7] Securities Exchange Act Release No. 68629 (Jan. 11, 2013), 78 FR 3928, 3931 (Jan. 17, 2013).

[8] Exchanges regularly rely upon the price discovery created by the entire market, for example by "pegging" orders to the National Best Bid or Offer. Exchanges also rely upon price discovery solely from their own market, such as the Nasdaq Closing Cross. Bats' current proposal differs from either of these because Bats would contribute nothing to the price discovery of the Nasdaq Closing Cross. Bats has no responsibility to contribute to Nasdaq's Closing Cross, that is Nasdaq's responsibility as a primary listing market; however Nasdaq believes that Bats is obligated to avoid affirmatively undermining price discovery.

Rather than innovating to compete, Bats is free-riding on the substantial investment that the listing markets have made in their closing auctions and listings business. For example, Nasdaq expended considerable time and effort to develop the world's first completely electronic closing cross that interacts with the continuous market. Nasdaq spent the next decade and a half investing in improvements to the closing cross, enhancing its efficacy and resilience substantially along the way. Most recently, the Commission encouraged Nasdaq and NYSE to invest in mutual back-up technology to protect their successful efforts to consolidate closing trading interest.[9] Previously, Bats largely copied Nasdaq's successful investment in its own closing cross. No longer content to free-ride by simply copying Nasdaq's closing cross, Bats is proposing also to free-ride on the success of Nasdaq's closing cross by diverting liquidity away from the primary market close without in any way improving the quality of the close itself.

Bats is also attempting to free-ride on the primary markets' investments and innovations in their listings programs. For example, every year, Nasdaq invests millions of dollars on technology and a professional regulatory staff to monitor listed issuers to ensure they comply with applicable requirements and investors are protected. A notable aspect of our investor protection efforts is our filing review program: using state-of-the-art, proprietary technology, regulatory personnel review nearly 50,000 SEC filings every year for compliance with our listing standards. We have also allocated significant resources in developing and enhancing our Listing Center web portal where listed companies can submit required documentation and notifications to Nasdaq electronically and securely.[10] The Listing Center includes a reference library that contains abundant resources for listed companies to ensure they understand our rules and that our program is fair and transparent, including hundreds of FAQs, rule interpretations and other resources.[11] Recently, we launched a Governance Clearinghouse webpage to highlight topical issues and promote dialog and debate around matters relevant to public companies.[12] Issuers also depend on Nasdaq staff and tools to understand the intricacies of trading in their securities, as well as receiving expert analysis of

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[9] In addition, the BZX proposal is contrary to the Commission's recent decision to approved Amendment 12 to the Limit Up Limit Down plan in which all exchanges agreed that consolidating orders at the primary markets for halts and resumptions best protects and promotes price discovery at a critical time for the market. *See* Securities Exchange Act Release No. 80549 (April 28, 2017). The Commission also approved rules by each exchange that non-primary markets would not accept orders during a halt in order to encourage firms to route orders to the primary market for participation in the reopening auction.

[10] Listing Center is available here: https://listingcenter.nasdaq.com/Show_Doc.aspx?File=listing_information.html.

[11] The Reference Library is also available as an App for iPhones and Android devices.

[12] The Governance Clearinghouse is available here: https://listingcenter.nasdaq.com/ClearingHouse.aspx

economic and geo-political events and trends that impact their companies and securities. Rather than invest and innovate to benefit issuers and investors as Nasdaq and NYSE have done, Bats opts to free ride on those efforts in a way that undermines the quality of trading to the detriment of issuers and investors.

To be clear, Nasdaq, Inc. is not opposed to exchanges' performing certain functions that may not have been historically associated with the exchange operations. We believe, however, that this type of functionality must be incidental to, and not at the expense of, the exchange's core functions, and it certainly must not interfere with the core responsibilities of other national securities exchanges. Under Section 6 of the Act, the Commission should not and would not register a firm as a national securities exchange if the firm's proposed market structure envisioned merely matching orders at last sale prices reported by other exchanges. If so, then a rule change by an existing exchange to implement such a scheme would likewise be contrary to the Act.

2. The BZX Proposal Does Not Promote Fair And Orderly Markets

The BZX proposal is also contrary to the Act because it does not promote "fair and orderly markets" as contemplated by Sections 6(f) and 11A(a)(1)(C) of the Act.[13] Congress enacted the Act to facilitate "fair and orderly markets" through, among other things, economically efficient execution of securities transactions, competition, and transparency with respect to quotations and transactions.[14] The Commission has further elaborated that the promotion of "fair and orderly markets" requires an exchange to ensure sufficient "depth and liquidity" in its listed securities, and has emphasized that "[a] critical aspect of assuring fair and efficient exchange trading is the widespread availability of timely and reliable information that will directly impact the price of the listed security."[15] For example, where transactions are not "reported on a real time basis," "increased potential exists for market fragmentation and for the creation of hidden markets, with the further potential for decreased pricing efficiency and continuity."[16]

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[13] 15 U.S.C. 78f(f), 78k-1(a)(1)(C).

[14] *See* 15 U.S.C. 78k-1(a)(1)(C); *accord* 17 CFR 240.11b-1(a)(2)(iii); S. Rep. No. 94-75, 94th Cong., 1st Sess. 30, at 3 (1975) ("The basic goals of the Exchange Act [are] . . . to provide fair and honest mechanisms for the pricing of securities, to assure that dealing in securities is fair and without undue preferences or advantages among investors, to ensure that securities can be purchased and sold at economically efficient transaction costs, and to provide, to the maximum degree practicable, markets that are open and orderly.").

[15] Securities Act Release No. 64700 (June 17, 2011), 76 FR 36947, 36948 (June 23, 2011); *see also* Securities Act Release No. 80199 (Mar. 10, 2017), 82 FR 13905, 13907 (Mar. 15, 2017) (maintenance of "fair and orderly markets" requires that a security "meet the exchange's standards for market depth and liquidity").

[16] Securities Act Release No. 19609 (Mar. 17, 1983), 1983 WL 402067, at *3.

The BZX proposal does not promote "orderly markets" within the meaning of the Act. Whereas the competition that occurs during a closing auction promotes both price discovery and transparency, BMC orders would contribute nothing to price discovery. In addition, BMC orders would further fragment the market by drawing quotations and orders away from the primary markets' centralized closing auctions, undermining the mechanisms by which closing list prices are set. Nor can the BZX proposal be characterized as promoting "fair" markets in any sense of the word. To the contrary, BZX would be free-riding on NYSE's and Nasdaq's closing auctions, profiting from those exchanges' price-discovery efforts and the intellectual property used to operate their auctions in order to execute BZX's own trades.

The Commission should assume, as Nasdaq does, that following the hypothetical approval of the BZX proposal, multiple national securities exchanges would emulate BZX by establishing similar mechanisms to free ride on the closing cross of the primary exchanges. This would have multiple negative effects. First, it would further fragment the market at a time when consolidation is desirable and currently clearly effective. Second, it would add complexity and systemic risk at a critical time of the trading day where the Commission has recognized the importance of security and resilience. Third, it could open this facility to gaming and other issues that are raised with continuous market trading. This risk is exacerbated because competing exchanges may propose to offer different times for pairing of orders and disseminating data, i.e, at 3:30 p.m., 3:25 p.m., or 3:15 p.m., further complicating investors' decisions and programming requirements.

In reality, the BZX proposal actually undermines fair and orderly markets by introducing a new and novel data point, the number of matched shares at BZX, that creative market participants can game to their own benefit. For many years, Nasdaq has worked diligently and carefully to balance the amount and timing of data released about the closing auction. This care and caution is required to balance the needs and ability of market participants to contribute to the closing cross against the risk of gaming that exists surrounding any disclosure of information. Market participants can, for example, use the new 3:35 p.m. dissemination about paired shares to gauge the depth of the market, the direction of existing imbalances, and the likely depth remaining at Nasdaq.

For example, consider a market participant that enters both buy and sell Market On Close orders into the BMC; that the buy order is paired for later execution in the BZX BMC; and that the sell order is not paired. At 3:35 p.m. the market participant will get an execution for the buy order and a cancellation for the sell order. The market participant then knows that a sell imbalance exists, a fact known only to parties entering sell orders in the BZX BMC process. Those market participants obtain a tradable piece of information not known to others that exists from 3:35 p.m. until 3:50 p.m., when Nasdaq begins disseminating indicative information about the Nasdaq closing cross. Next consider that multiple exchanges could be permitted to disseminate similar market information about their own copycat closes at 3:30 p.m., 3:25 p.m. and 3:15 p.m. It is impossible to fully anticipate the gaming opportunities that this scenario could create.

The BZX proposal does not acknowledge this risk, much less weigh the risk against the potential benefits of the proposal. Given that the BZX proposal cannot improve the

efficacy of the Nasdaq closing price and can only undermine it, Nasdaq believes that the risk of gaming around the new 3:35 p.m. market data dissemination from BZX far outweighs its potential benefits. In short, the consequences of BZX's proposal would undermine the transparency and efficient execution of securities transactions that are essential to sustaining fair and orderly markets, and simultaneously create meaningful gaming and resilience risks.

3. The BZX Proposal Undermines Intra-Market Competition

Rather than defend BMC's effect on fair, open, and orderly markets, BZX contends that its proposal should be approved because it promotes competition among exchanges with respect to market-on-close orders at the official closing price. But "the enhancement of competition is only one of many Congressional goals exchange regulations are required to pursue."[17] The "legislative history to the 1975 Amendments to the Securities Exchange Act makes explicit Congress' intent that competitive impact be one factor among many to be considered in making regulatory decisions and that the goal of enhancing competition should not become 'paramount to the great purposes of the Exchange Act.'"[18] Indeed, the Commission itself has recognized that competition "for order flow in the same stock" necessarily may "lead to the fragmentation of order flow in that stock," which "can inhibit the interaction of investor orders and thereby impair certain efficiencies and the best execution of investors' orders."[19] Similarly, "[c]ompetition among trading centers to provide specialized services" can "lead to practices that may detract from public price transparency."[20] When considering whether to approve a proposed rule change, the Commission therefore must balance the benefits of competition against any adverse effects on transparency and pricing efficiency. Here, that balance tips decisively in favor of disapproving BZX's proposal because any benefits of increased competition would be dwarfed by the increased costs to liquidity and price discovery.

Bats' claim to be introducing competition for closing auctions is a chimera. Intra-market competition already exists in several forms. First, issuers choose between listing exchanges based, in part, on the quality of trading and executions at a given exchange, especially the quality of trading at the open and close of the market. Issuers that become dissatisfied can, and often do, switch listing venues to capture potential market quality benefits for their investors. Second, competition already exists for closing auctions because, as Bats acknowledges, multiple markets offer closing auctions in Nasdaq stocks, including Bats and Arca. Bats' efforts to operating a meaningful closing cross have failed to capture sufficient customer interest.

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[17] *Belenke v. SEC*, 606 F.2d 193, 200 (7th Cir. 1979) (citing 15 U.S.C. 78k-1; *Gordon v. New York Stock Exchange, Inc.*, 422 U.S. 659, 689 (1975)).

[18] *Id.* (quoting S. Rep. No. 94-75, at 13-14).

[19] Securities Act Release No. 61358 (Jan. 14, 2010), 75 FR 3594, 3597 (Jan. 21, 2010).

[20] *Id.*

Competition with the Nasdaq Closing Cross must be viewed differently because the competition between and among orders on Nasdaq's continuous order book and cross-specific orders is essential for a successful auction. In other words, even if the BZX proposal would promote competition between exchanges, it undermines another important type of competition: competition between orders. Orders submitted to Nasdaq are competing to be executed with certainty in the Closing Cross at the best possible price. Competition among those orders and the orders on the exchange's book must reflect the depth and breadth of the market to effectively establish an accurate closing price. A deep book of buy and sell orders generates confidence in the exchange's price-discovery mechanism and ensures that the price at the bid/ask spread is at or close to where the orders will actually execute. Such intra-market competition thus ensures that Nasdaq can execute the largest possible number of shares at the most accurate price.

Nasdaq is aware of no regulator in any jurisdiction in the world that has sanctioned a diversion of orders from the primary market close such as Bats proposes here. By diverting orders away from NYSE and Nasdaq, the BZX proposal purports to promote inter-market competition between exchanges, but it does so at the expense of intra-market competition between orders that the Nasdaq Closing Cross depends upon to arrive at the most accurate closing price. There is simply no basis in the Act for the Commission to endorse one type of market competition over the other. To the contrary, the Commission has emphasized that the "competitive auction process" lies "at the heart of exchange trading."[21] Accordingly, the Commission has explained, any proposed rule that affects intra-market price competition will raise "serious concerns" under the Act.[22] For one thing, a "decrease in intramarket competition" can "diminish[] the quality of prices available to investors"—a result that would no doubt occur here were the Commission to approve BZX's proposal to siphon order flow away from closing auctions.[23] "Assuring that price competition remains vigorous" is also "crucial in ensuring that investors receive the best execution possible."[24]

By diverting orders away from NYSE and Nasdaq, the BZX proposal would compromise intra-market competition at one of the most crucial times of the day for executing orders, detracting from the robust price competition and discovery that closing auctions ensure. Nothing in the Act countenances that result.

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[21] Securities Act Release No. 43100 (July 31, 2000), 65 FR 48778, 48788 (Aug. 9, 2000).

[22] *Id.* at 48784; *see also, e.g.*, Securities Exchange Act Release Nos. 34109 (May 25, 1994), 59 FR 28570 (June 2, 1994); 41588 (July 1, 1999), 64 FR 37185 (July 9, 1999); 42455 (Feb. 24, 2000), 65 FR 11388 (Mar. 2, 2000); 42845 (May 26, 2000), 65 FR 35683 (June 5, 2000); *accord* Annette L. Nazareth, Director, Division of Market Regulation, Securities & Exchange Commission, Remarks Before the 2002 Options Industry Conference (May 3, 2002), 2002 WL 969177, at *3 (explaining the Commission's goal to "promote both intermarket and intramarket competition").

[23] Securities Act Release No. 49175 (Feb. 3, 2004), 2004 WL 210588, at *9.

[24] 65 FR at 48784.

C. The BZX Proposal Is Harmful To Investors And The National Market System

The Nasdaq closing price, which would be the basis for the BMC in Nasdaq-listed securities, is determined through an electronic closing auction conducted by the Nasdaq system. This auction was established in response to the need of many market participants to execute their orders at the close and at a price that is established within a relatively deep pool of orders. It follows that if the volume of orders participating in the closing auction is reduced, the value of the auction to market participants is correspondingly diminished. In other words, nothing about Bats' purported competition will enhance the efficacy of the closing auction, leading to a better closing price for customers or investors. To the contrary, by simply free-riding, the BZX proposal can only undermine the closing price for all, in the guise of saving money for some.

The BZX filing acknowledges the value of price discovery and anticipates the concern about the impact of the BMC. The filing attempts to dismiss this concern, however, by asserting that the BMC would be "matching only [market-on-call] orders, and not limit orders, and executing those matched [market-on-call] orders that naturally pair off with each other and effectively cancel each other out."[25] The question that the BZX filing does not even acknowledge is the impact of the BMC proposal on the use of limit-on-close orders that may be submitted to NYSE and Nasdaq. We believe that this issue needs to be properly studied and carefully analyzed. Indeed, Nasdaq raised the same concern about the 2012 EDGX proposal, but, like that proposal, BZX's submission provides no empirical support for its position.

In Nasdaq's view, any attempt to divert trading interest from the primary market close, including Market-on-Close orders, will be detrimental to investors because it will reduce the interest available to set the closing price and the number of shares able to be executed at a single price. As described above, Nasdaq designed the algorithms and tie-breakers of the Nasdaq Closing Cross to maximize the number of shares of all orders to be executed at a single price. To accomplish this, Nasdaq integrates all trading interest from the continuous market order book with all close-specific trading interest. The presence of Market-on-Close interest absolutely impacts the number of shares able to be paired and the size of any trading imbalance. This impacts both the distributing indicative information as well as for executing the greatest number of shares at the close. In other words, if Nasdaq receives fewer or no Market-on-Close orders, the quality of Nasdaq's indicative information and of the execution of the Nasdaq Closing Cross will be impaired.

The Commission should also note that the notion of a "market order" in an auction is different from a market order during continuous trading, since a market order in an auction is, in fact, accepting a delayed execution. The execution price of such an order is bounded by the exchange's "clearly erroneous" safeguards. As BZX sets (or adjusts from time to time in the future) its "clearly erroneous" numerical thresholds applicable to the BMC, the distinction between the BMC and limit-on-close orders may become ever more evanescent.

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[25] Securities Act Release No. 80683 (May 16, 2017), 82 FR 23320, 23322 (May 22, 2017).

In this regard, the BZX filing—like the EDGX submission before it—ignores the possibility of there being no limit-on-close orders to be matched in particular securities. When this occurs in the Nasdaq process, the market-on-close orders are matched at the mid-point of the bid and ask. However, if all market-on-close orders in a particular security have been placed with BZX under the BMC, and there are no on-close orders in the Nasdaq system, then a potentially "stale" price of the most recent trade executed in the Nasdaq system would become the official closing price. In this scenario, both the quality of order executions received by BZX's BMC users and the quality of the official closing price used by all market participants could be negatively affected.

While Nasdaq has not had the opportunity to conduct an appropriate study of all of these issues, we believe that the burden to provide to the Commission credible economic evidence to support the proposed rule change lies with BZX. Under Section 19 of the Act, the Commission "shall disapprove a proposed rule change of a self-regulatory organization if it does not make a finding" that the proposal is consistent with the Act and applicable rules.[26] Given the clear risk of harm to at-close price discovery and without any evidence to mitigate this risk, we believe that a credible independent study would be essential for any further consideration of the BMC proposal.

The BZX filing contends that the NYSE and Nasdaq fees for on-close executions have "disproportionate[ly] increase[d]," and that BMC orders "will provide for a competitive alternative to sending orders to the primary listing market's closing auction."[27] Yet, instead of basing the claim of insufficient competition on economic studies, BZX relies on a handful of self-serving, out-of-context examples of fee increases by competitors and completely ignores the history and benefits of legitimate competition between exchanges for auction volume. If insufficient competition is the reason why the BMC is needed (and especially if it is the kind of reason that outweighs other concerns), then BZX must at a minimum demonstrate with credible evidence both the existence of competitive inadequacies and the BMC's potential to cure them. BZX did not produce evidence on either issue, despite Nasdaq having highlighted similar evidentiary deficiencies in the 2012 EDGX proposal.

The equities trading business in the United States today is intensely competitive; the entry barriers are low, and viewing any specific order type, such as on-close orders, as a distinct product market is not economically justified. Moreover, the NYSE and NYSE-Amex closing auctions are certainly subject to direct competitive discipline today from the Nasdaq closing auctions in those exchanges' listed securities, and IEX has filed a proposed rule change to create both a primary listings venue and a closing auction. The existence of all of these actual and potential competitive alternatives stimulates innovation, promotes cost efficiency, and promotes competitive fee levels.

Equally critical is the fact that the BMC would not actually enhance competition in any meaningful sense. Generally, a firm can be meaningfully regarded as a competitor if it

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[26] 15 U.S.C. 78s(b)(2)(C).

[27] 82 FR at 23321-22.

seeks to provide the same or similar product or service. The product in this case is the closing price that is generated by Nasdaq and NYSE in their respective closing processes. For example, Nasdaq offers a meaningfully competitive alternative to the NYSE and NYSE-Amex closing auctions. By contrast, BZX is not proposing to generate its own closing price.

In theory, BZX could also seek to compete "downstream" by reselling a Nasdaq or NYSE service to customers. However, BZX is not proposing that either. It is not seeking to buy a service from Nasdaq or NYSE, and so there is nothing for BZX to "resell." Again, to say that BZX's competitive analysis is "flawed" would be an understatement, since BZX has not presented any economic analysis.

D. The BZX Proposal Omits Specific Critical Information About The Functioning Of The BMC

As discussed above, the BZX proposal does not appear to be supported by any research regarding the possible impact of the BMC on the existing closing auctions, and it is based on flawed assumptions regarding the nature of competition in this space. Sound, professional research is needed with regard to both of these issues.

In addition, there are multiple scenarios that are not contemplated or explained by the Bats proposal. For example:

- Bats accepts two offsetting orders buy 1000 mkt sell 1000 mkt. Nasdaq has no crossing interest and does not conduct a cross. What price does Bats use?
- Bats accepts two offsetting orders -- buy 1000 mkt and sell 1000 mkt. Nasdaq has no crossing interest and does not conduct a cross. Nasdaq last sale is $10 <u>at 3:55 p.m.</u> but the inside Nasdaq NBBO <u>at 4:00 p.m.</u> is 10.05 x 10.10. Nasdaq would use the last sale $10 as the closing print reference. Using the last sale price would result in a disadvantageous price for the seller relative to what the seller would receive it were executed on Nasdaq.
- Bats accepts offsetting closing orders -- buy 1000 mkt and sell 1000 mkt -- and matches a closing cross print derived from the Nasdaq auction. Nasdaq executes the cross at 10 including all resting limit order interest on the book. The Bats BBO was 10.05 x 10.10. Can Bats execute a trade through its own resting 10.05 bid? The resulting closing cross price is executed at a price thru the Bats resting limit order book. Trading at the primary market ensures complete limit order book protection.

These and other edge cases demonstrate the complexity of the BZX proposal, and the failure of Bats to anticipate and account for that complexity.

In addition, the proposal does not adequately explain how it would avoid using a possibly "stale" price should there be BMC orders at BZX but no auction at NYSE or NASDAQ due to there being either no orders submitted to those auctions (among other reasons, this can happen when BMC orders are paired and so no BMC orders are sent to the listing market's auction) or no market clearing price at NYSE or Nasdaq. As noted above, market-order-to-market-order matches can constitute up to 100 percent of the closing cross

activity in particular securities. Given BZX's proposal, it is not implausible to expect that, on occasion, all such orders could find their way to BZX, leaving NYSE or Nasdaq with no orders in certain securities for their auctions and resulting in a "stale" reported official closing price based on the price of the last trade.

E. The BZX Proposal Would Create A Potentially Harmful Precedent

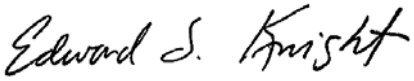
The fundamental issue with BZX's BMC proposal is creating a precedent that would jeopardize the transparent price discovery function that exists for issuers listed in the U.S. The key question for the Commission is whether national securities exchanges should be permitted to adopt order types that free-ride on price discovery performed solely by another exchange. This is the sort of development that may contribute to general degradation of the price discovery process.

Furthermore, BZX has not demonstrated any compelling long-term benefit of the BMC to the national market system. The BMC is not an innovative service that would enhance the quality or efficiency of our markets. Nor is it a different, competitive version of the existing at-close orders provided by Nasdaq or NYSE. It is a get-market-share-quick scheme, which would put at risk important existing services of BZX's competitors and jeopardize the fair, efficient, and orderly functioning of the national market system.

* * * *

Nasdaq respectfully urges the Commission to reject the Bats BMC proposal. Like its predecessor at DirectEdge, the current Bats proposal is contrary to the Act and harmful to the operation of the national market system for securities. If approved, the proposal would harm issuers and their shareholders by fragmenting and undermining the Nasdaq Closing Cross and other primary listing market closes. The proposal has no aim or hope of improving the primary market closing or of contributing to the quality of discovery of the all-important closing price for Nasdaq-listed securities. Rather, Bats is unabashedly free-riding on Nasdaq's sustained and substantial investment in the Nasdaq Closing Cross. While claiming to promote inter-market price competition, Bats would be harming intra-market order competition and interaction and reducing confidence in the primary market close to the detriment of the overall market. As described above, the Bats proposal is also incomplete in several respects as it omits critical information regarding the BMC. The Commission should resist establishing a potentially harmful precedent.

Sincerely,



Edward S. Knight