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September 18, 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:

On August 18, 2017, the U.S. Securities and Exchange Commission (“SEC” or “Commission”) instituted proceedings with respect to the above-captioned proposal in order to address eight critical questions about the impact of Bats’ proposal on publicly-listed issuers and their shareholders.¹ While each of the Commission’s questions highlights a deficiency in the Bats proposal, in Nasdaq’s view the eighth is notable in signaling a shift in market structure away from simply promoting competition among and between trading venues and towards a closer focus on issuers and their unique concerns:

What are the potential impacts of the proposal for listed issuers? For example, would the proposal impact the liquidity of an issuer’s stock? If so, how? Would the proposal affect an issuer’s decision as to whether to list their securities on a national securities exchange? If so, how? Would any impacts of the proposal affect small and mid-sized listed companies differently from larger listed companies?

The Commission’s recognition that the Bats proposal could – and in Nasdaq’s view does – impact small and mid-sized issuers differently than larger listed companies also moves the market structure debate in the right direction, away from a one-size-fits-all framework.

It is important to understand precisely what Bats’ proposal does and does not do. Bats proposes a price-matching order type; it does not propose to operate a competing auction. Bats proposes to free-ride on investments by Nasdaq and other exchanges; it does

¹ Order Instituting Proceedings to Determine Whether to Approve or Disapprove SR-BATS-2017-034, Exchange Act Release No. 81437 (Aug. 18, 2017), 82 F.R. 40202 (Aug. 24, 2017) (the “Order”).

not propose to innovate. Bats proposes to siphon market orders away from the primary markets; it does not propose to enhance price discovery. Nasdaq appreciates the opportunity to assist the Commission in assessing the true nature of Bats' proposal.

I. Approval of Bats' Proposal Will Negatively Impact Current and Potential Public Issuers, and the U.S. Economy They Help to Grow

The evidence is overwhelming: public markets have reached an inflection point where the burdens of becoming and remaining a public company are causing many eligible companies to stay private longer or even to eschew public listings entirely. As highlighted in Nasdaq's paper, *The Promise of Market Reform: Reigniting America's Economic Engine*,² the one-size-fits-all U.S. market structure has benefitted larger listed companies and their investors, but the small and mid-sized companies whose shares are less liquid have not benefitted equally. As a result of fragmentation, these smaller companies are more susceptible to abrupt and disruptive price swings. Heavy disclosure burdens, high litigation risk and costs, and adverse tax treatment compound these market structure challenges. The adverse impact on the nation's economy, on job growth, and on average investors cannot be overstated.

Thirty listed issuers representing over \$320 billion of total market capitalization have taken the important step of filing comment letters concerning the potential harms of the Bats proposal. S&P Dow Jones Indices, which calculates over 1 million indices to which trillions of dollars of average investors' funds are tied, also commented, emphasizing the importance of primary market closing auctions and the risks of further fragmenting the market close. Neither Nasdaq nor the Commission can ignore the view of index providers and issuers representing trillions of dollars of capital and millions of average investors who spoke univocally on the importance of a single-priced closing auction and the potential fragmentation that could result from Bats' proposal.

As issuers and index providers highlighted, the primary auction closing auctions are critically important to issuers, investors, and to the U.S. economy. In 2017 alone, \$778 billion in notional value has traded in the Nasdaq Closing Cross, and over \$5.4 trillion in the last ten years. Since Nasdaq pioneered the electronic closing auction, the thirty largest single-day closing auction days each involved more than 320 million shares and over \$10 billion of notional value. These figures only represent the notional value traded and not the much larger impact on the millions of investors that hold listed securities either directly or through mutual funds and exchange traded products that hold these assets. The Commission should be cautious before adding risk here.

The rarity with which issuers and index providers file such comments, not to mention the extrinsic value of the closing auctions, demands that the Commission carefully analyze

² See <http://business.nasdaq.com/revitalize>.

those concerns and reach independent conclusions about their validity.³ The Commission must pause and ask whether the public markets and issuers can bear any more burdens.

II. Reducing MOC Orders in Nasdaq's Closing Auction Could Impact Hundreds of Closing Auctions and Millions of Dollars Annually

Bats does not even claim that its proposed price-matching order will improve price discovery. Instead, the proposal asserts, incorrectly, that removing MOC Orders from the primary market close will not impact price discovery. In reality, the fragmentation of MOC orders directly impacts the closing cross every time Nasdaq conducts a closing cross with only MOC orders.

Markets that list operating companies⁴ must develop a closing process that encourages the widest array of participation to “discover” the price that most accurately reflects closing value. Nasdaq’s closing auction maximizes price discovery by aggregating closing liquidity via MOC, LOC, and Imbalance Only Orders, while also interacting with liquidity from the continuous market. With this innovative method, Nasdaq believes it is encouraging the most robust competition possible as orders compete in the continuous market to form the best continuous price while they also compete with orders in the closing auction to form the best closing price.

The order interaction needed to determine the best auction price is particularly critical when multiple prices would meet the requirement to maximize matched shares as explained under Nasdaq Rule 4754(b)(2). One such situation where these numerous steps may be needed in order to determine a price would be when all MOCs are evenly paired. In this situation LOCs can help set the price or the Nasdaq best bid and offer in the continuous market may help determine the price – or both. In either case, removing the MOCs from the Nasdaq closing cross would result in no auction on Nasdaq and the resulting closing price will therefore shift from a price determined through a thoughtfully designed point-in-time price discovery process to a last sale price. In Trading of small and mid-sized issuers’ shares, the last sale can occur at prices that differ from the Nasdaq Best Bid and Offer at the time of the Closing Cross – depending on the dynamics of the individual security.

This fact pattern can occur regularly. In fact, Nasdaq has identified 1,653 Closing Crosses between January 1, 2016 and August 31, 2017 that could have this effect by removing all MOC orders from the Nasdaq market. Nasdaq then determined the closing auction price without MOC orders in all such instances. The removal of all MOC orders would have changed closing prices and changed the closing valuation of Nasdaq issuers by nearly \$870,000,000 of aggregate impact.

³ The U.S. Court of Appeals for the D.C. Circuit would expect the same. *See Susquehanna International Group et al v. Securities and Exchange Commission*, Case No. 16-1061, D.C. Cir. (Aug. 8, 2017).

⁴ Bats does not list operating companies. Bats lists Exchange Traded Products, which have a fundamentally different price discovery process.

Impact of Removing MOC Orders on Nasdaq Closing Cross Jan 2016 - Aug 2017

Month-Year	Cases	Average Closing Price Change	Average Change in Market Capitalization	Maximum Change in Market Capitalization	Total Change in Market Capitalization
Jan-16	102	\$0.06	\$781,582	\$12,622,534	\$79,721,318
Feb-16	118	\$0.10	\$746,609	\$27,637,759	\$88,099,841
Mar-16	88	\$0.04	\$486,982	\$2,991,878	\$42,854,408
Apr-16	73	\$0.05	\$585,039	\$6,619,468	\$42,707,830
May-16	219	\$0.06	\$563,377	\$16,742,461	\$123,379,507
Jun-16	128	\$0.04	\$497,907	\$6,619,468	\$63,732,087
Jul-16	107	\$0.03	\$373,838	\$5,892,291	\$40,000,625
Aug-16	81	\$0.02	\$322,307	\$1,998,993	\$26,106,893
Sep-16	50	\$0.03	\$355,118	\$2,107,538	\$17,755,892
Oct-16	64	\$0.06	\$463,403	\$3,586,241	\$29,657,803
Nov-16	69	\$0.03	\$328,661	\$1,160,580	\$22,677,610
Dec-16	55	\$0.04	\$540,902	\$11,550,000	\$29,749,597
Jan-17	103	\$0.05	\$461,121	\$8,762,781	\$47,495,500
Feb-17	35	\$0.02	\$188,142	\$883,000	\$6,584,977
Mar-17	49	\$0.05	\$452,131	\$3,409,510	\$22,154,436
Apr-17	41	\$0.03	\$255,346	\$5,673,071	\$10,469,198
May-17	88	\$0.06	\$613,009	\$12,829,978	\$53,944,825
Jun-17	71	\$0.11	\$1,045,899	\$17,825,721	\$74,258,862
Jul-17	52	\$0.08	\$557,477	\$3,771,351	\$28,988,780
Aug-17	60	\$0.02	\$320,984	\$1,296,452	\$19,259,061
Total	1,653	\$0.05	\$526,073	\$27,637,759	\$869,599,052

Three of the 1,653 examples amply demonstrates the issue:

- In May of 2016, a closing auction in Viper Energy Partners LP (symbol: VNOM) executed at a price of \$18.07. If MOC orders were removed from that cross, the Nasdaq Official Closing Price would shift from \$18.07 to \$18.28, a difference of \$0.21 per share. With Total Shares Outstanding of over 79 million, the aggregate impact to those seeking to invest would be \$16,742,461.
- In January of 2017, a closing auction price of Elbit Systems Ltd (symbol: ESLT) would have moved from \$102.70 to \$102.90 if the MOC orders were removed from its closing auction. With Total Shares Outstanding of 42

million, the aggregate impact to shareholder portfolios of such a shift would amount to \$8,762,781.

- On June 30, 2016, the closing auction in BeyonDSpring, Inc. (symbol: BYSI) included only MOC orders and it established a closing price of \$42.88. Had MOC orders not been entered, Nasdaq would not have executed a closing auction and would have set the closing price at \$42.50, the last reported sale price. With nearly 22,800,000 shares outstanding, the aggregate market capitalization impact of this shift would have been \$8,515,472.

The impact of price shifting caused by removing MOC orders would be exacerbated when affected securities are included in an index and with structured products tied to that index. The securities involved in these 1,653 crosses are currently included in 380 exchange-traded products with \$1.2 trillion of assets under management. The impact of removing MOC orders is also potentially compounded at the end of a calendar quarter when a change in the high, low, and last price of a security could impact issuers' quarterly financial statements. During the study period, 15 closing auctions fitting this fact pattern occurred on the end of a calendar quarter, representing a potential aggregate shift in market capitalization of \$12,132,955 had the MOC orders been removed from those closing auctions.

Bats chooses to dismiss the possibilities that exist, but Nasdaq and its issuers take these outcomes very seriously.

III. Reducing MOC Orders in Nasdaq's Closing Auction Will Impact the Behavior of Limit Orders, Which are Critical to Price Discovery⁵

As stated previously, the Nasdaq closing cross is designed to determine the price that best reflects supply and demand in both the continuous and closing cross auctions. If market orders gravitate away from the primary market auction process it would impact the price discovery and formation process by reducing the ability of continuous book limit orders and

⁵ Question 3 in the Order asks: To what extent, if at all, would the availability of the Bats Market Close impact market participants' use of limit-on-close orders in the closing auction processes on the primary listing exchanges, including with respect to size and price? Please explain. Would market participants use MOC orders in the Bats Market Close as a substitute for using limit orders to participate in the closing auction processes at the primary listing exchanges? Would any such impacts be the same for each of the primary listing exchanges? Are there differences between the closing auction processes at each of the primary listing exchanges whereby the proposed Bats Market Close would have differing effects on each primary listing exchange? If so, please explain. How does information available in the closing auction process affect market participants' order submissions and/or determination of the closing price? Would the proposed rule change affect market participants' trading strategies in closing auctions? If so, how? If commenters believe the proposal would impact the use of limit-on-close orders in closing auctions, to the extent possible please provide specific data, analyses, or studies for support.

LOC orders to compete with each other and to interact with MOC orders. As explained above, this interaction and competition is essential to an efficient closing auction as designed by Nasdaq. Limiting such competition undermines the entire design of the Nasdaq Closing Cross and will result in less trading in the continuous market, leading to a less robust price discovery mechanism both through the continuous market and in the closing auction. True auctions seek the best price, not just any price.

Consider several examples. In the first, Nasdaq publishes Nasdaq Order Imbalance Information (NOII) data indicating 50,000 shares of stock ABCD paired at 3:50 p.m. at a given price. This information establishes the first indication of the closing auction price and encourages continued price competition in the continuous market via limit orders and in the closing cross via Imbalance Only orders. Nasdaq purposely publishes auction information that combines MOC and LOC orders to encourage robust competition to interact with the existing auction orders therefore supporting a competitive process to arrive at the best possible price that reflects all forms of supply and demand. In addition to establishing price, these orders can also participate against the paired and any imbalance shares. As described earlier, price discovery and formation for the closing cross continues until the closing cross occurs at 4:00 p.m.

In the second example, Bats indicates at 3:35 p.m. that 50,000 shares of stock ABCD shares were paired and Nasdaq subsequently publishes little or no paired or imbalance shares. In that case, there would be little ongoing price discovery and formation during the time period leading up to the 4:00 p.m. closing cross. Unlike the above example where the Nasdaq NOII dissemination starts and continues the price formation process, the lack of a large paired share or imbalance number will discourage participation both in the continuous market and the closing cross itself. Removing the ability to interact with closing cross market orders will impair the ongoing price formation process that occurs right up until 4:00 p.m.

Not only does the Bats proposal undermine and potentially degrade the Nasdaq closing auction, in this third example, the proposal will introduce a closing facility that disadvantages its own members by potentially creating the appearance of “trading through” their own market at the close. This can occur where Bats accepts offsetting Market Close Orders to buy and to sell 1,000 shares of the same security with the intent to match the Nasdaq closing auction price. Nasdaq then executes the closing auction at 4:00 p.m. at a price of \$10.00, including all resting limit order interest on the Nasdaq book. The Bats Best Bid and Offer at 4:00 p.m. was \$10.05 x \$10.10. After the Nasdaq close, Bats then executes the offsetting Market Close Orders at \$10.00, effectively failing to protect the 10.05 bid resting on its own limit order book. As previously explained, the Nasdaq process brings together the continuous and closing auctions to form one price which encourages competition in both auctions. In contrast, the Bats proposal will bifurcate the two auction processes and discourage interaction with the continuous market and the price discovery and protection that comes with it.

In a fourth example, likely to disproportionately impact smaller securities, the Bats proposal will cause it to trade at a stale closing price. Specifically, this occurs where Bats

accepts two offsetting Market Close Orders to buy and sell 5,000 shares of the same symbol and Nasdaq has no crossing interest with which to conduct a cross. If the Nasdaq last sale in that security occurs at \$9.90 at 3:55 p.m. and the Nasdaq BBO at 4:00 p.m. is \$10.05 x 10.10, the Bats Market Close would execute at \$9.90 as the closing print reference. Doing so, however, would result in a trade through the current market price and a stale, disadvantageous price for the seller at \$9.90. Had those 5,000 shares been sent to Nasdaq, the auction would have included the Nasdaq continuous market which would allow for a more robust price discovery event which would more fairly represent the price which gathers supply and demand from both the continuous and closing auctions on Nasdaq.

The harm caused by the above examples will be magnified if multiple markets offer price-matching mechanisms at different times, which approval of Bats' proposal would trigger. The possibilities for gaming are also magnified. For example, market participants can enter MOC orders into the Bats close, then use LOC orders on Nasdaq (or other markets at different times) to impact the price in their favor or break up their imbalanced MOC orders into both MOC and LOC orders when sending to Nasdaq. This outcome will create fragmentation, the costs of which will outweigh any benefits created by lower exchange transaction fees. The end result will be a loss of market efficiency that is costly to publicly-traded companies and millions of their shareholders. The additional fragmentation and complexity will degrade market quality in the long term.

IV. If Approved, the Proposal Would Harm Competition by Elevating Free-Riding and Discouraging Innovation

Competition and innovation are in Nasdaq's DNA.⁶ Nasdaq launched as an upstart and pioneering all-electronic exchange in 1971, and it has been innovating ever since. Nasdaq developed the first all-electronic stock market order delivery and auto execution trading systems, innovative dual-listing programs, and pioneering market information products. Most importantly, Nasdaq invented (and later patented) the all-electronic closing cross auction in 2004. Nasdaq has been investing in enhancing, and expanding the electronic

⁶ Question 5 of the Order queries: Would the proposal have a positive, negative, or neutral impact on competition? Please explain. How would any impact on competition from the proposal benefit or harm the national market system and/or the various market participants? Please describe and explain how, if at all, aspects of the national market system and/or different market participants would be affected. What are the current costs associated with a primary listing market developing and operating a closing auction, and to what extent (and if so, how) are these costs passed on to market participants today? How do the fixed costs associated with developing closing auctions compare to the variable costs of conducting closing auctions? How do the revenues collected from closing auctions compare to these costs? Would the proposal impact the current fees charged by the primary listing markets for participation in their closing auctions? If so, how? If commenters believe the proposal would impact competition, to the extent possible please provide specific data, analyses, or studies for support.

auction ever since, adding the opening, halt, and IPO auctions along the way, and it continues to invest today.⁷

Nasdaq absolutely supports competition but Bats' price competition offers a one-dimensional facsimile of competition that has prevailed for too long and at too high a cost. Competition can benefit investors by tightening spreads, reducing costs, and enhancing execution quality. And yet, exchange fee competition is but one form of competition. Innovation is another and arguably more important form of competition, bringing change and efficiency to the market. Price competition between and among venues often lacks innovation, and in this case actually undermines it. This price competition may benefit banks and brokers, but it can harm issuers much more. This type of competition elevates fragmentation, and sacrifices quote and order interaction at the heart of fulsome, reliable price discovery.

Bats is simply and admittedly free-riding on the innovation of primary listing markets that invest in issuer relationships, real-time regulation, and closing cross technology, and it does so without hope or aim of actually improving price discovery or issuer experiences. Bats concedes that its proposal "may reduce the number of market orders pooled together at the primary listing market" but asserts that it does not "impact," "compromise," or "disrupt" the price discovery process. This position is incorrect and incomplete. As described in multiple comments and below, the Bats proposal would increase fragmentation without a congruent benefit to investors or issuers while also negatively impacting, compromising, and disrupting price discovery.

V. If Approved, Bats' Proposal Will Harm Issuers and Investors By Increasing Price-Matching and By Further Fragmenting Closing Volume

Question 4 of the Order queries whether the Bats proposal would impact the amount of volume executed away from the primary market, including in competing exchange auctions and off-exchange broker price-matching. The answer, definitively, is yes, price-matching on the Bats Exchange would harm issuers, their shareholders, and the national market system. Bats answer to this risk is to say that the damage has already been done. Nasdaq believes the damage can get worse and will, if Bats' proposal is approved.

A. Bats is Proposing Price Matching Which Increases Fragmentation, Not a Competing Single-Priced Auction which Brings Liquidity Together

Bats repeatedly defends its proposal by arguing that it is a competing auction just like those that Nasdaq, NYSE, and NYSE Arca operate today. This is false. Bats is not proposing to operate an auction at all, not in any material way comparable to the single-priced auctions on Nasdaq and other exchanges that list actual operating companies. Bats is

⁷ The Commission recently approved Nasdaq's proposal to modify the time of entry of Limit on Close Orders, and other enhancements. See Securities Exchange Act Release No. 81556 (Sept. 8, 2017), 82 F.R. 43264 (Sept. 14, 2017) (SR-NASDAQ-2017-061).

not offering competitive bidding or price negotiation, two essential elements of a true single-price auction.

In reality, Bats is offering a price-matching order type like those offered by many brokers that matches orders at prices derived by true auctions conducted on other markets. Thus, when Bats notes that other regulators have approved competing auctions, this is irrelevant to the Bats proposal because Bats is not proposing a competing auction. The fact that Nasdaq and NYSE themselves operate competing auctions, this too is irrelevant because, again, Bats is not proposing a competing auction. Bats works diligently to obscure the difference between a true single-priced auction and what Bats is proposing, and with good reason: the difference is fatal to its proposal.

The differences between a true single-price auction and what Bats is proposing are important because single-price auctions offer valuable and well-understood benefits that price-matching does not. Nasdaq's single-priced auctions offer price discovery, the process of using open bidding and negotiation to determine the value of an asset. Single-priced auctions encourage and attempt to maximize order interaction that enables a wide variety of investors using a wide variety of strategies to compete to set the most reliable and accurate price. Nasdaq continuously works to enhance auction price discovery by disseminating better data, developing new auction types, revising order entry times, and augmenting liquidity collection. In contrast, the Bats proposal will do nothing to improve price discovery and nothing to benefit issuers. In fact, price-matching offer no functionality that, as Bats notes, is not already available elsewhere (though not on U.S. exchanges).

When considering Nasdaq's closing auction in non-Nasdaq stocks, it is useful to understand the context in which those crosses were initially developed and in which they currently operate. Nasdaq introduced a fully automated closing auction for Nasdaq stocks in 2004 to improve the closing price discovery process on Nasdaq. Up to that point, the Nasdaq closing price was set by the last executed trade prior to the close, in other words with no auction at all. Nasdaq was innovating and competing by demonstrating that automated technology could effectively handle manual auction tasks.

Nasdaq brought that same innovation and competition to securities listed on NYSE and Amex in 2007. At the time, those markets executed manual closing crosses. The introduction of Nasdaq's automated process was an advance over existing manual processes, specifically in enhancing price discovery and transparency. Nasdaq's introduction of a competing closing process was an attempt to improve price discovery for issuers, not simply to free ride or siphon orders away from the primary market with no hope or aim of improving price discovery. Over time, competing primary markets have embraced automation to handle nearly all auction functionality, driven by Nasdaq's innovation and competition.

Bats offers no such innovation, no enhancement to transparency, and no improvement in price discovery.

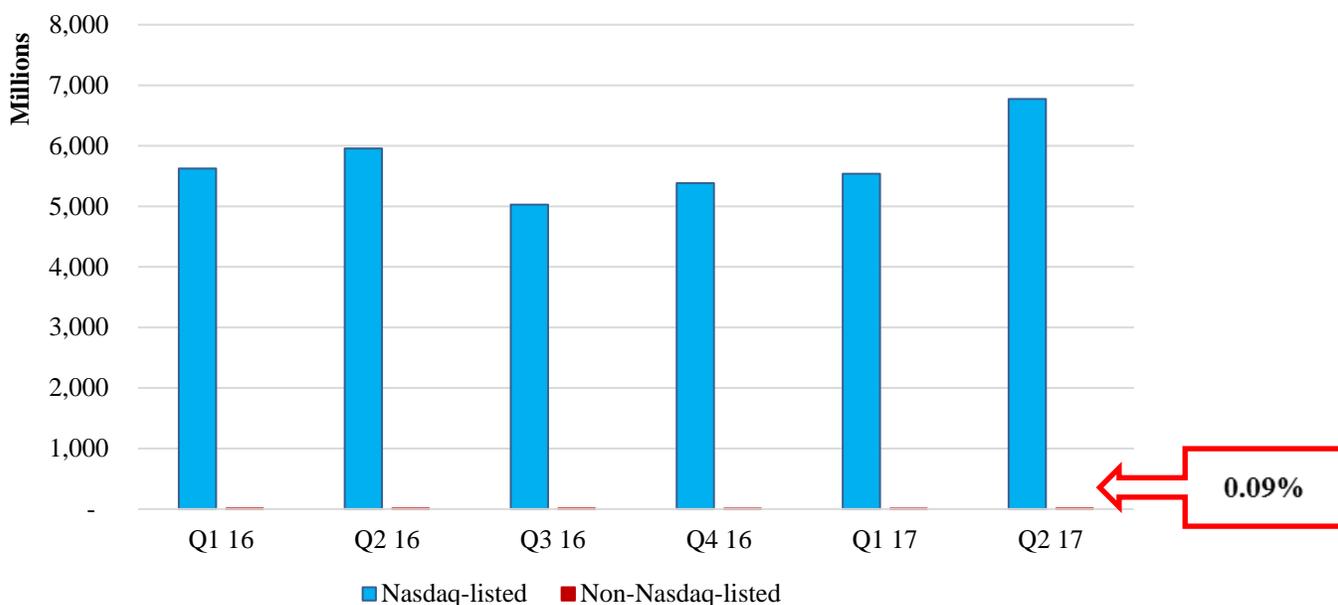
B. Competing Auction Cause Minimal Fragmentation Today

Even if Bats were proposing to operate a competing auction, which it is not, Bats dramatically exaggerates the impact of competing auctions in today's markets. Bats claims

that the markets are already fragmented by competing auctions. Bats also claims that “NYSE and Nasdaq ignore the fact that fragmentation at the close exists today through their own competing closing auctions conducted daily on a broad base of non-primary listings” and that “NYSE Arca and Nasdaq currently conduct a significant number of competing closing auctions for non-listed securities on a daily basis.”

Contrary to Bats’ statistical mis-characterizations, the aggregate volume executed in competing closing auctions in the United States is minuscule. For June, July and August of 2017, *less than one tenth of one percent* of closing volume in Nasdaq-listed stocks was executed in competing auctions. While there are isolated exceptions in which a non-primary market executes an aberrant percentage of closing volume, in the month of August 2017, Nasdaq never executed over 90,000 shares in any auction of a non-Nasdaq stock.

Nasdaq Closing Cross volume, Nasdaq-listed vs. Non-Nasdaq-listed



In fact, for the securities that Bats identified as the 30 largest single-day competing closing auctions for June 2017, the average daily closing auction volume executed by the primary market in those securities for that month was heavily concentrated on the primary markets. Only five stocks’ closing auction volume was less than 98 percent concentrated on the primary market and only ten stocks were less than 99 percent concentrated on the primary market.

Bats claims that NYSE Arca and Nasdaq currently conduct over 3,000 competing closing auctions for NYSE-listed securities. In reality, the frequency (and volume) of competing closing auctions is insignificant. In the first six months of 2017, the combined Nasdaq and NYSE Arca closing volume in NYSE-listed securities is less than one-twentieth

of one percent of the total closing volume traded by NYSE. For the examples cited in Table 4, total volume in NYSE ARCA's competing auctions represents less than 1% of the volume traded in the corresponding Nasdaq auctions. For all competing auctions in Nasdaq-listed corporate securities in the month of June – not those cases cherry-picked by BATS – competing volume represents less than 0.5% of Nasdaq's closing volume.

Bats also claims that in June 2017, a large percentage of competing closing auctions conducted by Nasdaq for NYSE-listed securities, and by NYSE Arca in Nasdaq-listed securities resulted in closing prices different from the official closing price. In reality, examples of price dislocation in comparing competing closing auctions are rare and the volume on non-listing markets is less than 0.5 percent of that on the primary exchange. Also, many of Bats' examples are competing auctions in ETFs which have a fundamentally different price discovery process. Removing ETFs, less than half of Nasdaq-listed corporate issues see a price difference when closing on ARCA.⁸

C. Today's Competing Closing Crosses Serve Primarily as a Back-Up in the Event of a Primary Market Failure

As the Order indicates, the exchange systems supporting the primary market closing crosses have been designated pursuant to Regulation SCI as "critical SCI systems."⁹ The Commission stated that "reliable ... closings on the primary listing markets are key to the establishment of fair and orderly markets," and noting that "closing auctions at the primary listing markets attract widespread participation, and the closing prices they establish are commonly used as benchmarks."¹⁰

In recognition of the importance of the primary market closing auctions, in 2015 and 2016 the Commission staff worked actively to ensure that primary listing markets identified back-up systems in the event of a closing auction failure. In approving the establishment of the closing auction back-up plan, the Commission highlighted its critical value to market participant, noting that "the primary listing market's closing price for a security is relied upon by market participants for a variety of reasons, including, but not limited to, calculation of index values, calculation of the net asset value of mutual funds and exchange-traded products, and the price of derivatives that are based on the security."¹¹

⁸ Bats reliance on symbol FINQ is particularly empty. FINQ was an ETF that had few assets under management and traded infrequently; in fact, the fund was liquidated on July 31, 2017. Bats' subsequent comment letter failed to mention this.

⁹ Order at fn. 130 and associated text.

¹⁰ *Id.*

¹¹ Securities Exchange Act Release No. 78014 (June 8, 2016); 81 F.R. 38755 (June 14, 2016) (SR-NASDAQ-2016-035); *see also* Securities Exchange Act Release Nos. 77305 (Mar. 7, 2016), 81 F.R. 12977 (Mar. 11, 2016) (SR-NYSE-2016-18); 77306 (Mar. 7, 2016), 81 F.R. 12986 (Mar. 11, 2016) (SR-NYSEMKT-2016-31). Bats also adopted

Still later, SEC Chair Mary Jo White highlighted the importance of these closing auction back-up procedures in one of her final market structure speeches in September of 2016.¹² Bats' claim that the proposed Market Close Order adds resilience to the system by backing-up the primary listing markets is belied by the fact that it is neither a competing price-discovering auction nor would not operate in the absence of the very auctions it is claimed to back-up.

The Operating Committee for the National Market System Plan to Address Extraordinary Market Volatility (commonly known as the Limit Up/Limit Down Plan), which Bats chairs, recently affirmed the importance of re-openings conducted via primary market single-priced auctions. During discussions of Amendment 12 to the Plan, committee members expressed a collective belief that concentrating liquidity at the primary market would improve the price discovery process for re-openings. In the cover letter to proposed Amendment 12, the Operating Committee stated:

The proposed Plan amendments are an essential component to Participants' goal of more standardized processes across Primary Listing Exchanges in reopening trading following a Trading Pause, and facilitates the production of an equilibrium Reopening Price by centralizing the reopening process through the Primary Listing Exchange, which would also improve the accuracy of the reopening Price Bands.

This representation was based on agreement among the exchanges of the Operating Committee and plan advisors that focusing activity in the primary markets and decreasing fragmentation during re-opening would benefit the market. The Commission approved Amendment 12 as proposed.¹³ To implement Amendment 12, the exchanges adopted coordinated rules prohibiting the acceptance of new orders during a primary market halt.

Bats' proposal to siphon auction order flow away from the primary markets at the critical close of the trading day is inconsistent with the action of the Limit Up/Limit Down Operating Committee.

D. The Bats Proposal Will Increase Price-Matching and Exacerbate Fragmentation

Bats claims that its price-matching proposal will not "introduce" fragmentation because price-matching already occurs among broker-dealers. While price-matching does occur in the over-the-counter market, and Bats will not "introduce" fragmentation there, Bats

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contingency closing procedures. See Securities Exchange Act Release No. 78527 (Aug. 10, 2016), 81 F.R. 54628 (Aug. 16, 2016) (SR-BZX-2016-47).

¹² See Mary Jo White, Equity Market Structure in 2016 and for the Future, Sept. 14, 2016, Securities Traders Association 83rd Annual Market Structure Conference.

¹³ Securities Exchange Act Release No. 79845; File No. 4-631 (Jan. 19, 2017).

is an exchange and not part of the over-the-counter market. Bats will be introducing a new category of price-matching venues, exacerbating the harm that fragmentation inflicts on issuers and their shareholders today.

As a primary market charged with fostering robust price discovery, Nasdaq does not facilitate over-the-counter price-matching. Nasdaq invests in its closing cross specifically to attract liquidity to the exchange, to aggregate the maximum liquidity possible, and to promote price formation on the exchange. While over-the-counter participants can choose to forego the Nasdaq closing auction and to match the closing auction price, it is not a function that supports Nasdaq issuers. Over-the-counter price-matching should not be considered a precedent for on-exchange price-matching which, as a neutral trading platform, is capable of attracting and aggregating far more liquidity than any broker dealer.

Additionally, over-the-counter trades that may appear to result from broker price-matching, are often also involved in the primary market closing process. For example a broker may accept a market on close order and trade as either agent or principal against that order by entering limit orders in the primary closing auction. The limit orders entered by the broker will contribute either to the continuous market price discovery process leading up to the primary market closing auction or to the closing auction itself. After receiving an execution in the primary market closing auction, the broker will then trade with the customer order at the price determined by the primary market closing auction, creating the appearance of additional price-matching activity.

Nasdaq fully respects the value to issuers and investors of the primary market close on other primary markets. Nasdaq offers order types that it routes to the primary market for the opening, halt, and closing auctions. One popular Nasdaq routing strategy is “LIST,” which permits Nasdaq members to enter orders into Nasdaq that are routed to the primary listing market to ensure that their limit prices are protected with respect to the closing auction on the primary market. On any given day, Nasdaq routes thousands of orders representing millions of shares to the primary listing exchanges at the open and the close. Additionally, on multiple occasions when Nasdaq has received closing interest from a member for securities listed on other exchanges, Nasdaq operations personnel have proactively contacted the affected firms to explain the inefficiency of their order entry practice and to encourage them to route such orders directly to the primary market. This is not the conduct of an exchange seeking to undermine the primary markets closing auction.

Finally, Bats’ reliance on pegged orders is misplaced. Pegged orders on exchanges are permitted because all exchanges are expected – in fact required – to contribute to the prices to which such orders are pegged. Nasdaq offers an order pegged to the midpoint of the National Best Bid and Offer, and Nasdaq is required to deliver a Best Bid and Offer that contributes to the NBBO. In its non-analogous example, Bats is pegging its Market Close Order to the Nasdaq closing auction price. Not only would the proposal fail to contribute to Nasdaq’s closing price, it would actually detract from it.

VI. The Bats Market Close Order May Lead to Manipulation.

Bats is introducing a new data point to the closing cross that does not currently exist and that can be misused to create asymmetric information around the close. Firms may use

the Bats Market Close data point to detect the direction of the Nasdaq cross and potentially trade against that information. In one example, a participant enters two orders - one to buy 100 shares and one to sell 100 shares - just prior to 3:35 order cutoff time. This will allow that participant to detect the side of any imbalance where one order is paired and another is not. This direction could then be used to trade against, prior to 3:50 p.m. when Nasdaq disseminates imbalance information. Using this order information, the proprietary trading firm could sell stock just before or concurrent with Nasdaq's dissemination of NOII data.

The earlier information has a potentially destabilizing effect on the continuous market and the closing auction. This cannot occur today because no imbalance data is known until after Nasdaq disseminates the NOII at 3:50 p.m. While asymmetric information currently exists where brokers match MOC orders away from the close, BATS, as a neutral platform, is more likely to gather orders from multiple brokers and allow a small number of participants to obtain actionable asymmetric information. Bats is potentially changing the Nasdaq close price that Bats would match. This weakens discovery process, creates a cycle of closing price deterioration, and increases volatility. This is in stark contrast to the Nasdaq process which encourages competition and as competition increases, the price discovery process strengthens, which leads to more competition, and so on.

To address this added fragmentation and the attendant risks of manipulation, Nasdaq and other exchanges will be compelled to develop new cross-market surveillance systems. For example, the offense of "marking the close" will likely become more complex to detect and address as market participants utilize the new Bats Market Close order in connection with continuous market trading and single-priced auctions. This challenge will be compounded if, as Nasdaq expects, multiple markets utilize varying iterations of price-matching orders.

Bats claims that the Nasdaq closing auction is subject to the same asymmetric information and risk because the "very nature of trading creates short term asymmetries of information to those who are parties to a trade" and "[b]oth the NYSE and Nasdaq disseminate imbalance information leading up to their auctions." Nasdaq disagrees. Nasdaq's auction process was designed to avoid disseminating asymmetric information by having the data dissemination and cutoff time occur simultaneously. All market participants know what the imbalance is at the same time.

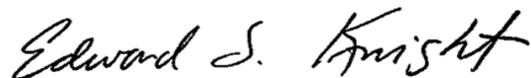
* * *

The Bats proposal differs in every way from a traditional primary market, price discovery, and single-priced auction. The Bats proposal does not innovate or otherwise improve the price formation process or encourage liquidity provision. Bats uses misleading characterizations to conflate a true single-priced auction with a simple price-matching order type, and then mischaracterizes statistics that exaggerate the impact of existing competing auctions. The proposal offers little benefit, and not enough to justify the costs and risk it would add to current market structure by fragmenting and complicating the market at the critical close of trading. If approved, Nasdaq expects competing venues to offer similar price-matching functionality, adding to fragmentation and complexity and further degrading

Brent J. Fields
September 18, 2017
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overall market quality. Nasdaq is compelled to observe that public markets are challenged enough already; the Commission should not worsen matters by approving the Bats proposal.

Sincerely,

A handwritten signature in black ink that reads "Edward S. Knight". The signature is written in a cursive, flowing style.

Edward S. Knight

cc: Hon. Jay Clayton, Chairman
Hon. Michael Piwowar, Commissioner
Hon. Kara Stein, Commissioner
Heather Seidel, Acting Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets
Jeffrey Harris, Director, Division of Economic and Risk Analysis