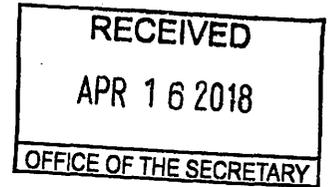


UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION



In the Matter of the:

Cboe BZX Exchange, Inc.

File No. SR-BatsBZX-2017-34

**STATEMENT IN OPPOSITION TO THE DIVISION'S ORDER APPROVING A
RULE TO INTRODUCE CBOE MARKET CLOSE**

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NYSE Group, Inc. (“NYSE Group”)¹ respectfully submits this statement in opposition to the Division of Trading and Market’s (the “Division’s”) January 17, 2018 order (the “Order”) approving a proposed rule change (the “Proposal”) by Cboe BZX Exchange, Inc. (“BZX”) to adopt a “Cboe Market Close” process.

PRELIMINARY STATEMENT

The Securities and Exchange Commission (the “Commission”) should set aside the Order and disapprove the Proposal because the Proposal fails to satisfy the requirements of the Securities Exchange Act of 1934 (the “Act”). The Proposal would promote unfair competition, undermine the price discovery process, increase the potential for manipulation, cause BZX to violate Regulation SHO, and otherwise disrupt the end-of-day auction closing process conducted by primary listing exchanges without any benefit to the U.S. equities market or the vast majority of market participants.

This is the second time that BZX or affiliated exchanges have proposed a rule that would permit an exchange to reap the benefits of its competitors’ closing auctions at the expense of fair competition and the integrity of the financial markets. In 2012, EDGX Exchange, Inc. (“EDGX”) made a similar proposal but withdrew it in the face of fierce opposition.² BZX’s current Proposal is substantially similar to EDGX’s, and unsurprisingly, market participants of all types—including those whom the Proposal would supposedly benefit—again oppose it strenuously. Opponents include S&P Dow Jones Indices, Procter & Gamble Company, FedEx

¹ NYSE Group submits this statement on behalf of itself and New York Stock Exchange LLC (“NYSE”), NYSE Arca, Inc. (“NYSE Arca”), and NYSE American LLC (“NYSE American”). Throughout this statement, NYSE Group will refer to NYSE, NYSE Arca, and NYSE American collectively as the “NYSE Exchanges.”

² Securities Exchange Act Release No. 68189 (November 8, 2012), 77 FR 68182 (November 15, 2012) (SR-EDGX-2012-33). EDGX was subsequently acquired by BZX’s then-parent company.

Corporation, T. Rowe Price Associates, Incorporated, and numerous others who have concluded that the Proposal would benefit at most BZX and some of its broker-dealer customers, at the expense of issuers, investors, and market integrity. The unified nature of opposition to the Proposal by entities involved in various aspects of the capital markets, including issuers, broker-dealers, market makers, investment funds, and the largest equity indexer in the United States, cannot be ignored. This opposition is well-founded, and the Commission should disapprove the Proposal.

BZX proposes to sell closing price executions priced at the official closing price determined by the primary listing exchange, but at a lower cost than the listing exchanges can offer by misappropriating the efforts and avoiding the expenses incurred by the primary listing exchanges in running the process that generates those closing prices. Specifically, BZX would accept and hold outside its order book unexecuted market-on-close (“MOC”) orders throughout the day, at 3:35 p.m. match an equal number of purchase and sell MOC orders and cancel any unmatched orders, publish the number of matched shares without a price, and then wait until the primary listing exchange conducts its closing auction. Only once the primary listing exchange has conducted its own closing auction and announced the official closing price would BZX price the matched orders at the closing price determined by the primary listing exchange. BZX would do nothing else in connection with this process. It would not conduct or improve any other auctions or engage in any price discovery, nor would it be subject to the rules applicable to listing exchanges actually operating an auction. Rather, BZX would free-ride on the primary listing markets’ efforts to operate auctions and offer market-on-close executions at cut-rate fees.

Notably, the only purported benefit of the Proposal is that it would permit BZX to charge lower fees. But that is no benefit at all. To be sure, BZX’s fees would likely be lower than those

of listing exchanges because BZX would not have to cover the operational and regulatory costs of actually *operating the closing auction*. It would externalize the costs of generating the closing prices onto the primary listing markets, and profit by simply taking the results of the primary listing exchanges' investment. Moreover, BZX's lower fees would not inure to the benefit of ordinary investors or issuers, but rather to the broker-dealers who pay those fees, as observed by various market participants who oppose the Proposal, including those noted above. The Proposal serves no legitimate purpose and conflicts with fundamental principles of fair competition.

More specifically, and as explained in further detail below, the Proposal fails to satisfy the requirements of the Act in at least four ways. *First*, the Proposal would burden competition by permitting BZX to free-ride on the backs of primary listing markets that operate closing auctions that actually conduct price discovery, permitting BZX to take advantage of the lack of commensurate costs to underprice MOC executions. While BZX and listing exchanges would technically be "competing," this type of competition is no more legitimate than the competition between movie studios and film pirates, both of which offer the same product, but one (the pirate) at a steeply discounted price because it does not actually create the product. This form of "competition" is unfair and undesirable; that the free-rider can offer the same product for a lower fee comes with significant costs in the form of discouraged investment and innovation.

Second, siphoning orders from the primary listing exchange would both adversely affect the price discovery process that is so crucial to closing auctions and increase market complexity. As NYSE Group's data and analyses demonstrate, a loss of orders submitted to the primary listing exchanges would deprive the closing auctions of key market data necessary to the accurate determination of closing prices, and the proliferation of new information feeds that would result from Cboe Market Close would substantially increase costs and burdens on market

participants. The Division summarily dismissed these concerns notwithstanding clear evidence of their validity.

Third, the Proposal would encourage and create new mechanisms for market manipulation. The Proposal contemplates that BZX would match its Cboe Market Close buy and sell orders to the extent possible and cancel any remaining unmatched orders. At 3:35 p.m., Eastern Time, market participants receiving cancellation messages that their orders were not matched in whole or part would learn material nonpublic information regarding the side of unmatched orders, which could be leveraged to that market participant's benefit. For example, an investor who places a sell order that is not fully matched will know that there was greater MOC interest to sell than buy in the Cboe Market Close. That may mean that the price of the security is likely to decrease, encouraging the investor to take a short position during the final 25 minutes of regular trading to profit from that material nonpublic information ahead of the primary listing market's closing auction. The Division summarily dismissed these concerns as well, despite the absence of any data, analyses, studies, or other showing by BZX that the concerns could be avoided or mitigated. In so doing, the Division endorsed a total abdication by BZX of its burden to establish affirmatively that the Proposal complies with the Act.

Fourth, the Proposal would cause BZX to violate Rule 201 of Regulation SHO. That Rule restricts the price at which a short sale order of a given stock may be executed when the stock's price has decreased by 10% from its closing price on the prior day—a scenario known as a "Short Sale Price Restriction." The NYSE Exchanges have adopted rules to ensure that they do not execute short sell orders at prices prohibited by Rule 201, but the Proposal contains no similar rule. Given Cboe Market Close's operation and timing, it would inevitably result in violations of Rule 201. BZX will not know at 3:35 p.m., the time at which it matches buy and

sell orders, whether a short sale MOC order subject to a Short Sale Price Restriction can legally be executed at the closing price or not. According to the Proposal as described, there is no mechanism for avoiding the potential impermissible execution that might result at the ultimate closing price, and no apparent viable variation of the Proposal that would avoid this problem.

In sum, the Proposal raises numerous concerns warranting the Commission's close scrutiny, particularly given the fundamental importance of closing prices to the securities markets. As the Commission itself has stressed, the integrity of the daily closing auction is "key to the establishment and maintenance of fair and orderly markets."³ Closing prices play various roles throughout all economic sectors, including to serve as benchmarks for market indices and to "value derivative contracts, and generate mutual fund net asset values."⁴ Virtually all market participants—whether or not they participate in closing auctions—rely upon the integrity of those auctions. The Proposal threatens to undermine this critical process. The Commission should disapprove it.

BACKGROUND

I. Closing Auctions

Before the close of trading at 4:00 p.m., Eastern Time, listing exchanges undertake an auction process that results in the publication of a final closing price for each security listed on the exchange. Exchanges receive two primary types of closing auction orders: (1) MOC orders that are filled at the final closing price, whatever that may be; and (2) limit-on-close ("LOC") orders that are filled if the closing price meets a certain level. To reduce volatility and maximize

³ Securities Exchange Act Release No. 73639 (November 19, 2014), 79 FR 72251 (December 5, 2014) (S7-01-13) ("Regulation SCI Adopting Release"), at 72278.

⁴ *Id.* at 72278.

the number of shares that match at the close, in advance of the auction, the listing exchange disseminates information to the public, including (1) the size of any imbalance between buy and sell orders and (2) the volume of shares of each security that have been paired off.⁵ This information allows the marketplace to understand the supply and demand for each security and encourages participation to offset any imbalance.

Investors interested in placing orders at the close consider both the size of the imbalance and the volume of matched orders, as the matched volume contextualizes the size of the imbalance (i.e., the size of an order imbalance is more or less meaningful depending on how large the matched volume is). In addition, the presence of both MOC and LOC orders in the auction is important because closing prices may be determined differently based on the types of orders received, with potentially significant differences.⁶ For example, the number of market participants trying to execute MOC orders and the size of MOC orders relative to one another can affect both trading at the end of the day and the corresponding closing price.

II. The Proposal

On May 5, 2017, BZX filed the Proposal to adopt the Cboe Market Close closing process.⁷ Cboe Market Close would accept MOC orders in securities listed on other national

⁵ See, e.g., NYSE Rule 123C(1)(d) (providing for mandatory MOC/LOC imbalance publication and Order Imbalance Information Data Feed).

⁶ See Letter to Brent J. Fields, Secretary, SEC, from Elizabeth K. King, General Counsel and Corporate Secretary, NYSE Group, dated June 13, 2017 (“NYSE Letter 1”), at 4–5; see also Corrie Driebusch et al., *What’s the Biggest Trade on the New York Stock Exchange? The Last One*, WALL ST. J. (March 14, 2018) (“*What’s the Biggest Trade*”), <https://www.wsj.com/articles/at-closing-time-the-stock-market-heats-up-like-a-bar-at-last-call-1521038300> (explaining that “[b]ig investors like the closing auction because market liquidity is the greatest”).

⁷ Securities Exchange Act Release No. 80683 (May 16, 2017), 82 FR 23320 (May 22, 2017) (SR-BatsBZX-2017-34) (“BZX Rule Filing”).

securities exchanges until 3:35 p.m., Eastern Time. In contrast, the NYSE accepts MOC and LOC orders until 3:45 p.m., Eastern Time (and, under certain conditions, for another fifteen minutes), with the closing auction process and the determination of the official closing price beginning at 4:00 p.m., Eastern Time.⁸ At 3:35 p.m., Eastern Time, BZX would match an equal number of purchase and sale MOC shares, provide an unpriced execution message to those paired orders, and any excess buy or sell interest in the relevant security would be cancelled. BZX would only price the executions after 4:00 p.m. once the primary listing exchange had conducted its closing auction and determined the closing price. BZX would disseminate through its proprietary data feed information regarding the paired-off volume at 3:35 p.m., Eastern Time, but would not publicly disclose any information regarding the size or side of cancelled orders. However, market participants whose orders were cancelled would receive notice of such cancellation, and would therefore know the side of the Cboe Market Close imbalance for those securities.

Notably, the extent of BZX's involvement in the close under the Proposal would consist exclusively of diverting MOCs from the primary listing exchanges to itself, informing the market of the size of any MOCs it matches, and returning unmatched MOCs to the entities that sent the orders. BZX would not conduct any type of independent auction, or actively engage in price discovery. As a result of the Proposal, BZX would be held to no additional substantive regulatory obligations. This limited role would allow BZX to charge reduced fees and simply take the closing price that primary listing exchanges calculate, based on their capital investment

⁸ See NYSE Rule 123C. NYSE American and NYSE Arca perform similar closing auction processes, with NYSE American accepting MOC and LOC orders until 3:50 p.m., Eastern Time and NYSE Arca accepting MOC and LOC orders until 3:59 p.m., Eastern Time. See NYSE American Rule 7.35E; NYSE Arca Rule 7.35-E.

and compliance with regulatory obligations applicable to operating closing auctions, in order to execute those MOCs matched on the Cboe Market Close.

III. Comment Letters and the Commission's Order Instituting Proceedings

The Proposal elicited a large, generally negative, response from a diverse range of market participants. Forty-three entities submitted letters opposing the Proposal, while eight, including BZX, wrote in support.⁹ Those opposed to the Proposal represented a wide swath of the economy, including large-cap blue chip issuers like the Procter & Gamble Company, FedEx Corporation, and Southern Company, as well as mid- and small-cap issuers such as CA Technologies.¹⁰ Not a single issuer wrote in support of the Proposal. Indeed, issuers so overwhelmingly opposed the Proposal that two Congressmen lent their voices to that position, noting serious reservations about Cboe Market Close's potential impact on market functions.¹¹

⁹ Securities Exchange Act Release No. 82522 (January 17, 2018), 83 FR 3205 (January 23, 2017) (SR-BatsBZX-2017-34) ("Order"), at 3206 (stating that "the Commission received sixty-three comment letters from fifty-two commenters on the proposal"). The fifty-second commenter was a professor at the McDonough School of Business, Georgetown University, who did not express an opinion on whether the Proposal should be approved.

¹⁰ See Letter to Brent J. Fields, Secretary, SEC, from Jon R. Moeller, Vice Chair and Chief Financial Officer, and Deborah J. Majoras, Vice Chair and Chief Financial Officer, The Procter & Gamble Company, dated July 12, 2017; Letter to Brent J. Fields, Secretary, SEC, from Mickey Foster, Vice President, Investor Relations, FedEx Corporation, dated July 14, 2017; Letter to Brent J. Fields, Secretary, SEC, from Daniel S. Tucker, Senior Vice President and Treasurer, Southern Company, dated July 5, 2017; Letter to Brent J. Fields, Secretary, SEC, from Michael Gregoire, Chief Executive Officer, CA Technologies, dated August 17, 2017.

The Equity Dealers of America also wrote to express their concern regarding the Proposal's impact on pricing for small- and mid-cap issuers, and GTS Securities' letter quoted small- and mid-cap issuers' concerns with the Proposal. See Letter to Brent J. Fields, Secretary, SEC, from Christopher A. Iacovella, Chief Executive Officer, Equity Dealers of America, dated July 15, 2017; Letter to Brent J. Fields, Secretary, SEC, from Ari M. Rubenstein, Co-Founder and Chief Executive Officer, GTS Securities LLC, dated June 22, 2017 ("GTS Letter 1"), at 3-4.

¹¹ See Letter to the Honorable Jay Clayton, Chairman, SEC, from Reps. Sean P. Duffy and Gregory W. Meeks, Members of Congress, dated August 9, 2017.

Other players in the wider equity markets also voiced their disapproval of the Proposal. Several broker-dealers and market makers—those who would ostensibly benefit from Cboe Market Close’s lower fee structure—opposed the Proposal. For example, IMC Financial Markets expressed concerns about further market fragmentation, price discovery, and information asymmetries arising out of Cboe Market Close.¹² Quite notably, S&P Dow Jones Indices (“S&P”), the largest equity indexer in the United States, opposed the Proposal and advised the Commission to exercise “great caution” in changing any aspect of closing auctions, noting that those auctions “function as the central liquidity pool and price discovery mechanism for listed securities.”¹³ While S&P noted its general approval of “any measure[s] that decrease costs, increase transparency and generally result in greater utility for investors[,]”¹⁴ it still could not support the Proposal in light of the “unintended negative consequences” that introduction of Cboe Market Close could bring, including with respect to market fragmentation, complexity, and potential manipulation.¹⁵ These concerns were similarly echoed by T. Rowe Price Associates, Incorporated, a major investment fund manager.¹⁶

¹² See Letter to Brent J. Fields, Secretary, SEC, from Andrew Stevens, General Counsel, IMC Chicago, LLC d/b/a IMC Financial Markets s, dated June 30, 2017 (“IMC Financial Markets Letter”); see also Letter to Brent J. Fields, Secretary, SEC, from Jonathan D. Corpina, Senior Managing Partner, Meridian Equity Partners, dated June 16, 2017 (expressing similar concerns); Letter to Brent J. Fields, Secretary, SEC, from John M. Bowers, Bowers Securities, dated June 14, 2017 (same).

¹³ See Letter to Brent J. Fields, Secretary, SEC, from Alexander J. Maturri, Chief Executive Officer, S&P Dow Jones Indices, dated July 18, 2017 (“S&P Letter”), at 2.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ See Letter to Brent J. Fields, Secretary, SEC, from Mehmet Kinak, Head of Global Equity Market Structure & Electronic Trading, et al., T. Rowe Price Associates, Incorporated, dated July 7, 2017 (“T. Rowe Price Letter”).

The support for the Proposal was substantially more limited. Other than BZX, only seven entities wrote in support of Cboe Market Close, presenting the same flawed argument advanced by BZX that free-riding on the efforts of listing exchanges constitutes appropriate “competition.”¹⁷ Tellingly, one of the letters of support came from another national securities exchange that, at present, is not the primary listing exchange for any issuer, and has indicated an interest in creating its own version of Cboe Market Close.¹⁸ Like BZX, this exchange therefore stands to profit at the market’s expense from approval of the Proposal.

In response to the comments received, on August 18, 2017, the Commission issued an Order Instituting Proceedings¹⁹ that requested that “interested persons,” including BZX, “provide specific data, analyses, or studies” regarding eight topics, including the Proposal’s effect on competition, price discovery, and manipulation.²⁰ BZX’s response to this request was extremely limited. BZX ultimately submitted data and analyses relevant to only three of the eight topics, none of which addressed competition or manipulation.²¹ NYSE Group, on the other hand, responded with data and analyses, including an expert report, regarding all eight questions the

¹⁷ The people/entities supporting the Proposal were (1) Securities Industry and Financial Markets Association; (2) Donald Bollerman, a private citizen; (3) ViableMkts; (4) Investors Exchange LLC, (5) Virtu Financial; (6) The Clearpool Group; and (7) PDQ Enterprises, LLC.

¹⁸ See Letter to Brent J. Fields, Secretary, SEC, from John Ramsay, Chief Market Policy Officer, Investors Exchange LLC, dated June 23, 2017 (“IEX Letter”), at 1 (explaining that “IEX is considering filing a similar proposal in the near future”).

¹⁹ Securities Exchange Act Release No. 81437 (August 18, 2017), 82 FR 40202 (August 24, 2017) (SR-BatsBZX-2017-34) (“Order Instituting Proceedings”).

²⁰ *Id.* at 40210–11.

²¹ Letter to Brent J. Fields, Secretary, SEC, from Joanne Moffic-Silver, Executive Vice President, General Counsel, and Corporate Secretary, Bats Global Markets, dated October 11, 2017 (“BZX Letter 2”), at 4–5, 10, 13; Letter to Brent J. Fields, Secretary, SEC, from Joanne Moffic-Silver, Executive Vice President, General Counsel, and Corporate Secretary, Bats Global Markets, dated January 3, 2018 (“BZX Letter 3”), at 3–4.

Commission raised.²² Those data and analyses illustrated and supported NYSE Group's concerns about the Proposal's compliance with the Act.

IV. The Division's Order

The Division, acting pursuant to delegated authority, issued the Order on January 17, 2018 approving the Proposal.²³ The Order dismissed the numerous concerns noted above, concluding that NYSE Group and various other commenters had not adequately established that the predicted negative consequences of the Proposal would in fact materialize. The Order departed from Commission precedent in various ways, including by finding appropriate "competition" between Cboe Market Close and primary listing exchange closing auctions notwithstanding that they are subject to markedly disparate costs and regulatory obligations, and by demanding proof of negative consequences from the proposed rule's opponents rather than holding the rule's proponent to its own burden of demonstrating compliance with the Act.

For example, in the Order Instituting Proceedings, the Division requested that BZX submit "data, analyses, or studies" concerning whether "the [P]roposal [would] affect the potential for manipulation and, if so, what types of manipulative activity might result from, or be decreased by, the [P]roposal."²⁴ BZX offered the Division not a single data point, analysis, or

²² See, e.g., Letter to Brent J. Fields, Secretary, SEC, from Elizabeth K. King, General Counsel and Corporate Secretary, NYSE Group, dated November 3, 2017 ("NYSE Letter 3"); Letter to Brent J. Fields, Secretary, SEC, from Elizabeth K. King, General Counsel and Corporate Secretary, NYSE Group, attaching Assessment of DERA Study, dated January 12, 2018 ("NYSE Letter 4"). Unless otherwise noted, all citations to NYSE Letter 4 are citations to the Assessment of DERA Study.

²³ Order, *supra* note 9.

²⁴ Order Instituting Proceedings, *supra* note 19, at 40211.

study regarding that topic or four others that the Division posed.²⁵ The Division nonetheless approved the Proposal in the face of substantial data, analyses, and studies provided by NYSE and other commenters substantiating the stated concerns.

V. Procedural History

NYSE Group and The Nasdaq Stock Market LLC (“Nasdaq”) petitioned for review of the Order on January 31, 2018,²⁶ which the Commission granted on March 1, 2018.²⁷ NYSE Group and Nasdaq jointly moved for an extension of time to file their statements in opposition to the Order by April 12, 2018,²⁸ which the Commission granted on March 16, 2018.²⁹ On March 27, 2018, notwithstanding the Commission’s order granting the petitions for review and the Proposal being subject to a stay pending the Commission’s review, BZX announced that it intends, subject to Commission approval, to launch Cboe Market Close on August 20, 2018.³⁰

ARGUMENT

The Commission may approve a proposed rule change only if it finds that the proposed change “is consistent with the requirements of [the Act] and the [applicable] rules and

²⁵ BZX Letter 2, *supra* note 21, at 1–3, 6–12; BZX Letter 3, *supra* note 21, at 1–3, 5–10.

²⁶ NYSE subsequently filed a corrected Petition for Review on February 2, 2018. See Letter to Brent J. Fields, Secretary, SEC, from Elizabeth K. King, General Counsel and Corporate Secretary, NYSE Group, dated February 2, 2018.

²⁷ Securities Exchange Act Release No. 82794 (March 1, 2018), 83 FR 9561 (March 6, 2018) (SR-BatsBZX-2017-34).

²⁸ Joint Motion for Extension of Time, dated March 9, 2018.

²⁹ Securities Exchange Act Release No. 82896 (March 16, 2018), 83 FR 12633 (March 22, 2018) (SR-BatsBZX-2017-34).

³⁰ Press Release, Cboe Global Markets, Cboe Global Markets Announces Launch Date for Cboe Market Close (March 27, 2018), available at <http://ir.cboe.com/~media/Files/C/CBOE-IR-V2/press-release/2018/cboe-cmc-launch-03-27-18.pdf>.

regulations.”³¹ If the Commission is unable to make such a finding, it must disapprove the proposed rule.³² The Act requires that the rules of an exchange, *inter alia*, “not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter,” “remove impediments to and perfect the mechanism of a free and open market and a national market system,” and be “designed to prevent fraudulent and manipulative acts and practices.”³³ As the proponent of the proposed rule, BZX bears the “burden to demonstrate that [the Proposal] is consistent with the Exchange Act and the rules and regulations issued thereunder.”³⁴ Merely asserting that the proposed rule is consistent with the Act is insufficient.³⁵ BZX must provide “sufficiently detailed and specific” information on the proposed rule’s purpose, operation, and effect, as well as a legal analysis of the proposed rule’s consistency with applicable requirements.³⁶ Where, as here, the Division has acted pursuant to delegated authority, the Commission reviews the Division’s decision on a *de novo* basis.³⁷

As explained below, BZX has failed to demonstrate that the Proposal complies with the Act. Accordingly, the Commission should set aside the Order and disapprove the Proposal.

³¹ 15 U.S.C. § 78s(b)(2)(C)(i).

³² 15 U.S.C. § 78s(b)(2)(C)(ii).

³³ 15 U.S.C. § 78f(b)(5), (b)(8).

³⁴ 17 CFR § 201.700(b)(3).

³⁵ *See id.*

³⁶ *Id.*

³⁷ *See* Securities Exchange Act Release No. 82727 (February 15, 2018), 83 FR 7793 (February 22, 2018) (SR-CHX-2016-20), at 7795 (explaining that “the Commission set aside the [Division’s] Delegated Order and conducted a *de novo* review”); Securities Exchange Act Release No. 77112 (February 11, 2016), 81 FR 8294-01 (February 18, 2016) (SR-OCC-2015-02), at 8295 (same).

I. The Proposal Would Impose an Unnecessary and Inappropriate Burden on Competition

The Proposal fails to meet the requirements of Section 6(b)(8) of the Act³⁸ because it would unfairly burden competition. Cboe Market Close would improperly authorize BZX to undercut listing exchanges' fees by bearing none of the related costs, to the benefit of itself and a few dozen broker-dealers, but at the expense of issuers, investors, and market integrity. Permitting this conduct would undermine, rather than enhance, competition. The Division did not analyze this issue correctly and its decision should be set aside.

A. BZX would Unfairly Undercut Listing Exchanges' Fees on MOC Orders

Any competition as to MOC order pricing between BZX and listing exchanges would be unfair, counterproductive, and the benefits largely invisible to anyone other than a limited number of broker-dealers. There is no dispute that it would cost BZX less to execute MOC orders with Cboe Market Close than it costs listing exchanges to do so because those exchanges have an additional, central role to play in filling those orders—operating their closing auctions.³⁹ It therefore comes as no surprise that BZX expects to offer lower fees in connection with the Cboe Market Close than exchanges offer in connection with executing MOC orders placed with them.⁴⁰ But BZX's predatory pricing scheme is materially different from standard fee competition among competitors: BZX will offer a lower fee by relying on listing markets to operate their auctions, not by developing a better or cheaper way to operate such auctions. Cboe Market Close would not be the result of innovation or investment, but merely the misappropriation of the listing exchanges' auction-related efforts. Indeed, Cboe Market Close is

³⁸ 15 U.S.C. § 78f(b)(8).

³⁹ See NYSE Letter 1, *supra* note 6, at 9 & n.16.

⁴⁰ BZX Rule Filing, *supra* note 7, at 23321 n.18.

totally reliant on and could not be offered without the auctions operated by other listing exchanges. This form of “competition” does not promote innovation; it undermines it.⁴¹

The costs associated with operating an auction, including those necessary to comply with the Commission’s regulations governing such operations, preclude true competition between listing exchanges and BZX. As described in NYSE Group’s comment letters, there are significant regulatory resources, technology resources, and costs dedicated to operating an auction, such as providing the systems used by the designated market makers (“DMMs”), developing systems for entering and managing investor interest in the closing process, and developing and maintaining surveillance tools necessary to monitor the DMM, floor broker, and electronic order book activity leading up to and during the closing process.⁴² The Commission has also promulgated its own rules and regulations to ensure that auctions are run correctly, safely, and reliably. Most recently, in 2014, the Commission adopted Regulation SCI to strengthen the infrastructure of the U.S. securities markets, requiring exchanges and other “SCI entities” to greatly enhance the robustness and resiliency of their technological systems.⁴³ Regulation SCI considers systems used by a primary listing exchange to support the exchange’s closing process to be “critical SCI systems”⁴⁴ and thus subject to heightened standards, including

⁴¹ This distinction is borne out by BZX’s own price levels for MOC and LOC orders of BZX-listed securities, which are higher on average than the fees charged by NYSE for such orders of NYSE-listed securities (and BZX will not be offering the discounted Cboe Market Close for securities listed on BZX, for which BZX must operate a costly closing auction).

⁴² See, e.g., Letters to Brent J. Fields, Secretary, SEC, from Elizabeth K. King, General Counsel and Corporate Secretary, NYSE Group, dated August 9, 2017, at 2 (describing various functions and costs of operating closing auctions).

⁴³ Regulation SCI Adopting Release, *supra* note 3, at 72253.

⁴⁴ 17 CFR § 242.1000 (definition of “critical SCI system”).

“more rigorous policies and procedures for monitoring”⁴⁵ and “the most robust controls”⁴⁶ as compared to an SCI entity’s other SCI systems.

These regulations and requirements impose significant costs on the NYSE Exchanges and other listing exchanges that BZX would be able to avoid. Given these cost constraints on listing exchanges, they could not compete on an even playing field with BZX’s proposed Cboe Market Close, which would operate more cheaply and with fewer regulatory obligations, because it would not have to comply with the same rules applicable to listing exchanges.⁴⁷

These and other obligations, including compliance with a listing exchange’s own closing auction rules—which the Commission closely monitors given the fundamental importance of closing auctions—would be inapplicable to Cboe Market Close. Unlike exchanges that operate an actual closing auction, the Cboe Market Close would impose few obligations on BZX because it is structured to simply misappropriate listing exchanges’ closing prices. Permitting MOC orders by BZX, on the one hand, and the NYSE Exchanges, on the other, would sanction competition on an unfair and unequal basis.

⁴⁵ Regulation SCI Adopting Release, *supra* note 3, at 72298.

⁴⁶ *Id.* at 72302.

⁴⁷ As discussed in Section II.A below, NYSE Group has concerns that the Proposal would disrupt the price discovery mechanism performed by listing exchanges. Remarkably, the Division suggests that if the Cboe Market Close has the effect of disrupting the listing exchange’s closing mechanism such that it no longer reflects an appropriate closing price, the listing exchange could propose to change the manner in which it calculates the closing price. *See* Order, *supra* note 9, at 3213. In this manner, the Proposal would not only burden competition by misappropriating the listing exchange’s closing price without incurring any of the costs of generating it, but actually impose additional costs on listing exchanges to monitor and analyze the negative impact of the Cboe Market Close on price discovery and invest in new solutions to address and counteract the disruption it causes.

This same concern animated a 2013 order by the Commission rejecting Nasdaq's proposed Benchmark Order rule (the "2013 Nasdaq Order").⁴⁸ In that order, the Commission found that the proposed Benchmark Order Rule would result in Nasdaq's undertaking functions normally undertaken by broker-dealers, and the Commission cited the disparate regulatory regimes faced by broker-dealers and Nasdaq in support of its determination that the proposed rule inappropriately burdened competition in violation of Section 6(b)(8) of the Act.⁴⁹ Specifically, Nasdaq was not subject to the Market Access Rule,⁵⁰ which applies to any broker-dealer that offers order execution services similar to the proposed Benchmark Order Rule. The Commission noted that this regulatory disparity would create an "inappropriate advantage" based on Nasdaq's not being subject to the Market Access Rule, and concluded that Nasdaq had failed to demonstrate that the proposed Benchmark Order Rule did not inappropriately burden competition.⁵¹

Application of the same principle leads to the same conclusion here. Cboe Market Close would create a disparate regulatory regime in two regards: in operating the Cboe Market Close, BZX would neither be subject to the heightened standards placed on primary listing exchanges that operate critical SCI systems, nor would it be required to make or enforce rules relating to a closing auction. BZX's "competitive" edge would derive from unfairly avoiding the Commission's mandates for primary listing exchanges, just as the Commission found that

⁴⁸ Securities Exchange Act Release No. 68629 (January 11, 2013), 78 FR 3928 (January 17, 2013) (SR-NASDAQ-2012-059) ("2013 Nasdaq Order"), at 3931.

⁴⁹ *Id.*

⁵⁰ 17 CFR § 240.15c3-5.

⁵¹ 2013 Nasdaq Order, *supra* note 48, at 3931.

Nasdaq’s proposed Benchmark Order Rule would unfairly permit it to avoid a different regulatory regime.⁵²

B. The Division Erred in Its Analysis of Competition

The Division disregarded the above concerns and concluded, without support, that “the availability of Cboe Market Close will inject competition into the closing process to the ultimate benefit of market participants generally, which could include price and execution quality competition.”⁵³ This was erroneous for various reasons.

First, the expected lower fees resulting from the Proposal would *not* be expected to benefit market participants generally, but rather would benefit—at most—certain intermediary broker-dealers. As the Commission is aware and has recently reiterated, fees “typically are not passed through the broker-dealer to its customers.”⁵⁴ The Commission’s view is further supported by market analysts who have reviewed the Proposal and predicted that the savings

⁵² The Division improperly discounted NYSE Group’s reliance on the 2013 Nasdaq Order by explaining that the 2013 Nasdaq Order did not articulate a *per se* rule against exchanges providing services similar to those provided by broker-dealers. Order, *supra* note 9, at 3223. NYSE Group does not rely on the 2013 Nasdaq Order for any purported *per se* rule, but rather for the proposition that competition may be rendered unfair and undesirable when it is based on disparate regulatory application—precisely the situation here. Indeed, the 2013 Nasdaq Order is particularly applicable here because the Proposal—like the rejected Benchmark Order rule—also involves a proposed service traditionally performed by a broker-dealer, as the Division recognized. *Id.*, *see also* Letter to Brent J. Fields, Secretary, SEC, from Joanne Moffic-Silver, Executive Vice President, General Counsel, and Corporate Secretary, Bats Global Markets, dated August 2, 2017 (“BZX Letter 1”), at 10 (explaining that “[t]he Proposal simply states that broker-dealers currently offer the same service” of matching MOC orders). BZX would thus unfairly avoid not only the regulations applicable to listing exchanges but also those applicable to broker-dealers.

⁵³ Order, *supra* note 9, at 3222.

⁵⁴ Securities Exchange Act Release No. 82873 (March 14, 2018), 83 FR 13008 (March 26, 2018) (S7-05-19), at 13010; *see also* Securities Exchange Act Release No. 78309 (July 13, 2016), 81 FR 49431 (July 27, 2016) (S7-14-16), at 49439 (noting that “broker-dealers . . . pay fees to, and receive rebates from, the venue for each order . . . but generally do not directly pass those fees or rebates back” to their customers).

created by reduced fees “are highly unlikely to be passed along to the end institutional or retail investor.”⁵⁵ As one issuer additionally wrote, “[w]hile the proposal may save a few pennies for brokers that trade our stock, those pennies do not flow back to us, our shareholders or the economy in general.”⁵⁶ Thus, to the extent that BZX argues that reduced fees cure any potential burdens on competition created by Cboe Market Close, the Commission has already recognized that that reduction likely only benefits a limited set of broker-dealers and will not aid the market generally.

Second, rather than recognize the illegitimacy of price “competition” based on misappropriation and avoidance of listing exchanges’ regulatory and other obligations, the Division mischaracterized the Proposal as merely a “commonplace” example of exchanges competing for order flow by “mimic[king] or build[ing] upon various functionality of their competitors.”⁵⁷ For the reasons explained above, that is not what the Proposal would accomplish. The hallmark of genuine competition is improvement of a product that benefits the market as a whole by, for example, improving product quality, increasing product range, or decreasing costs. The “competition” that BZX seeks is entirely different. Cboe Market Close is a new product in name only, as it will not offer investors access to anything that they cannot already access. It does not improve upon MOC order execution in any respect. To the contrary, Cboe Market Close is designed to provide investors with the *exact same* execution price as those sending

⁵⁵ Frank Chaparro, *NYSE and Nasdaq Pump the Brakes on a Proposal to Shake Up Trading at the End of the Day*, BUSINESS INSIDER (January 25, 2018), available at <http://www.businessinsider.com/nyse-and-nasdaq-appeal-cboe-market-close-sec-ruling-2018-1> (quoting Raymond James research).

⁵⁶ See Letter to Brent J. Fields, Secretary, SEC, from Steve Paladino, Executive Vice President and Chief Financial Officer, Henry Schein, Inc., dated August 16, 2017.

⁵⁷ Order, *supra* note 9, at 3222.

MOCs to the listing exchange.⁵⁸ And, for the reasons explained, there is no genuine cost savings—only unfair avoidance of the costs applicable to listing exchanges. The Division improperly viewed competition solely through the lens of the final fee charged by an exchange to its broker-dealer members, without considering the true nature of the supposed “competition.”⁵⁹

Third, it was unsupported speculation for the Division to suggest—without any supporting evidence or analysis—that Cboe Market Close might enhance competition with respect to “execution quality.”⁶⁰ BZX has never argued that,⁶¹ and for the reasons explained below, precisely the opposite is true: the Proposal would reduce the amount of MOCs placed with primary auction exchanges, thereby *reducing* the quality of the closing price and inhibiting competition.⁶² At a minimum, there is certainly no support for the opposite conclusion, and the Commission should not credit it.

⁵⁸ BZX Rule Filing, *supra* note 7, at 23323.

⁵⁹ Contrary to BZX’s position, the competing auctions operated by exchanges other than NYSE, such as Nasdaq and NYSE Arca, are examples of legitimate, appropriate competition because they provide investors with the option to either (1) place an order on the listing exchange that will be guaranteed to trade at that listing exchange’s closing price or (2) place an order on a competing closing auction and receive that auction’s closing price. There is no merit to BZX’s view that a price-setting function should be offered only by the listing exchange. *See generally* BZX Letter 1, *supra* note 52. Unlike investors who would use the Cboe Market Close, investors who send their orders to a competing auction understand that they are not participating in the official closing and are not guaranteed an execution at the official closing price. Investors who specifically want their orders to be part of the process that determines the official closing price send their orders to the listing exchange.

⁶⁰ Order, *supra* note 9, at 3222.

⁶¹ Indeed, BZX has argued the opposite by claiming that the Proposal would have no effect on the execution price. *See, e.g.*, BZX Rule Filing, *supra* note 7, at 23322 (explaining that “[Cboe] Market Close would not disrupt price discovery”).

⁶² *See* this Statement’s discussion on the Proposal’s impact on price discovery, *infra* Section II.A.

In short, the Division erred in its analysis, and it should not guide the Commission's review of the Proposal.

II. The Proposal Would Disrupt Price Discovery and Increase Market Complexity and Operational Risk

The Proposal should also be disapproved because it fails to satisfy Section 6(b)(5) of the Act, which requires that a Proposal be “designed . . . to remove impediments to and perfect the mechanism of a free and open market and a national market system.”⁶³ NYSE Group and others submitted substantial evidence demonstrating that—far from improving or perfecting markets—the Proposal would undermine price discovery and increase market complexity. BZX, on the other hand, offered little data or analysis on this issue whatsoever. The Commission should credit the evidence submitted by NYSE Group and others, but certainly at a minimum, the Commission should find that BZX failed to sustain its affirmative burden of demonstrating compliance with Section 6(b)(5) of the Act.

A. The Proposal Will Negatively Impact Price Discovery

The ability of a closing auction to produce a reliable, accurate closing price depends on market transparency, including full information regarding the volume of buy and sell orders and the extent of any imbalances between the supply and demand for a security at the close. Currently, the primary listing exchange makes this information available to all market participants in the lead-up to a closing auction. For example, market participants have access to the price at which the greatest amount of buy and sell interest will match and the size and direction of any imbalance. Market participants rely on this information for whether they will buy or sell in the continuous market before the close, and take this information into account

⁶³ 15 U.S.C. § 78f(b)(5)

when determining the price, size, and type of on-close orders to enter. These pre-closing trading decisions ultimately determine the closing price.

This picture would change dramatically under Cboe Market Close. Fewer MOC orders placed on the listing exchange necessarily means that market participants would have less information for their late-day trading and less information from which to price and size their closing orders. One particularly critical piece of missing information would be the MOC imbalances experienced by the Cboe Market Close. Under the rules of Cboe Market Close, this information would not be disclosed and would remain hidden from market participants. Participants in the closing auction process would thereby be deprived of core data necessary to its normal functioning.

NYSE Group supported its concerns with data and analyses illustrating in detail how the reduced information flow would adversely impact price discovery. For example, data demonstrated that where a majority of the MOCs were paired-off outside of the primary market, the closing price slippage was consistently higher than when those MOCs were paired-off on the primary market.⁶⁴ As another example, while knowing the volume of paired-off MOCs is relevant to determining closing price, understanding exactly how many market participants submitted MOCs, and the size of the MOCs submitted, provides critical information to facilitate the DMM's establishment of a stable closing price.⁶⁵

The Division's stated reasons for disregarding the above concerns were incorrect and should not be adopted by the Commission. *First*, the Division disregarded NYSE Group's arguments on price discovery based on its belief that MOC orders do not contribute to price

⁶⁴ NYSE Letter 3, *supra* note 22, at 3–4.

⁶⁵ NYSE Letter 1, *supra* note 6, at 4.

discovery.⁶⁶ But, as explained above and as substantiated by the data and analyses submitted by NYSE Group and other entities, MOC orders play a critical role in price discovery.⁶⁷ The Division improperly concluded, without supporting evidence, that only LOC orders materially impact a closing auction's determination of an accurate closing price.

Second, the Division discounted price discovery concerns based on the observation that those concerns are most acute in the context of less-liquid stocks.⁶⁸ That is a reason to be *more* concerned, not less concerned, by the Proposal. Less-liquid stocks are precisely the area where the price discovery process is most important, and where disruptions will be most acutely felt. The Commission should be particularly concerned about, rather than dismissive of, the Proposal's impact on price discovery for less-liquid stocks.

Third, the Division improperly discounted NYSE Group's price-discovery analysis because it believed the analysis relied on an assumption that *all* MOC orders would migrate to Cboe Market Close under the Proposal, whereas the Division believed that "the more likely scenario" is that the Proposal would draw away some, but not all, MOC orders.⁶⁹ The Division erred in its consideration of this point. The evidence submitted was *not* limited to a scenario in which all MOC orders were redirected to Cboe Market Close, but rather encompassed a range of scenarios in which portions of the MOC order population were no longer flowing through the

⁶⁶ Order, *supra* note 9, at 3211–12.

⁶⁷ See, e.g., NYSE Letter 4, *supra* note 22, at 23 (explaining that "[a] decrease in the expected number of MOC orders routed to the primary exchanges might then affect the decision of liquidity providers to participate in the closing auction using LOC orders. Also, if the fees for the Bats closing session are set lower than the fees charged by the primary exchanges, it might induce some market participants who otherwise would submit LOC orders to use MOC orders").

⁶⁸ Order, *supra* note 9, at 3213.

⁶⁹ *Id.* at 3212.

listing exchange's closing auction.⁷⁰ This evidence demonstrated a substantial likelihood that any appreciable redirection of MOC orders to Cboe Market Close would negatively impact price discovery, and that the degree of the adverse impact would increase with the quantity of redirection.⁷¹ While it is true that the impact on price discovery would be less severe under scenarios where Cboe Market Close received only a small portion of MOC orders, it would be nonsensical to consider the risks posed by the Proposal only under that scenario—i.e., under a scenario in which the Proposal did not meet its stated commercial goals. BZX obviously hopes to draw as many MOC orders from listing exchanges as possible, and the Commission should evaluate the Proposal on the assumption that it succeeds, including the probability that a successful Cboe Market Close would encourage follow-on analogous offerings that would further increase the redirection of MOC orders from primary listing exchange.⁷²

Fourth, the Division improperly relied on a study conducted by the Commission's Division of Economic and Risk Analysis ("DERA"), which expressly warned that its analysis would "not allow [it] to predict how the proposed rule change would affect price discovery in the

⁷⁰ NYSE Letter 3, *supra* note 22, at 3–4 (explaining the impact on pricing for lower liquidity securities in the event that more than 75% of MOC orders were paired off outside of the primary listing exchange).

⁷¹ *See also* NYSE Letter 4, *supra* note 22, at 11 & n.15, 13 (citing to a study that "provides evidence that higher levels of off-market trading under certain market structures can harm market quality" and explaining that "any change in the information set [provided to primary auction exchanges] could lead to changes in price discovery and liquidity").

⁷² *See* BZX Rule Filing, *supra* note 7, at 23323 ("[BZX] also notes that other exchanges may file proposed rule changes with the Commission seeking to adopt alternatives to the auction the Exchange conducts in BZX-listed securities should they feel they can offer improved price discovery or lower transaction costs without further fragmenting the market."); IEX Letter, *supra* note 18, at 1 (explaining that "IEX is considering filing a similar proposal in the near future").

closing auction process.”⁷³ Given this hugely significant caveat, the Division should not have accorded DERA’s analysis any weight in evaluating the Proposal. Moreover, DERA’s study analyzed the wrong question. It attempted to estimate the impact of the Cboe Market Close on price discovery by analyzing the impact that MOC orders that are *not* placed with exchanges, but are placed in off-exchange environments (like broker-dealers), have on price discovery. This is an apples-to-oranges comparison, ill-suited to predicting how many investors would move their MOC business to a competing, single national securities exchange, as opposed to the services of disparate broker-dealers.

NYSE Group submitted comments, including economic analysis, noting the significant deficiencies in DERA’s study.⁷⁴ While acknowledging these criticisms, the Division dismissed them because “the DERA Analysis was explicit regarding the limited scope of its analysis and does not assert that BZX’s proposal would have no negative impact on price discovery of official closing prices.”⁷⁵ That is no answer at all. The fact that DERA’s analysis was “limited” and “not dispositive”—to say nothing of DERA’s express warning that the study “did not allow [it] to predict” the answer to the relevant question—is precisely why the Division should not have relied on it in concluding that “there is no strong evidence” that the Proposal would negatively

⁷³ Memorandum to File from DERA, Bats Market Close: Off-Exchange Closing Volume and Price Discovery, dated December 1, 2017, at 2, *available at* https://www.sec.gov/files/bats_moc_analysis.pdf. The Division’s reliance on DERA’s limited analysis, despite DERA’s warning, is not a sufficiently independent determination to support the Division’s approval of the Proposal. *Susquehanna Int’l Grp., LLP v. Sec. and Exchange Comm’n*, 866 F.3d 442, 446 (D.C. Cir. 2017).

⁷⁴ See NYSE Letter 4, *supra* note 22.

⁷⁵ Order, *supra* note 9, at 3215.

impact price discovery.⁷⁶ There is no reliable support for that assumption, which means BZX has not carried its burden.

B. The Proposal Will Increase Market Complexity and Operational Risk

Cboe Market Close would also complicate the closing-auction order market. BZX proposes to disseminate information regarding the volume of matched orders at 3:35 p.m., Eastern Time, so that investors can consider that information in their trading strategies.⁷⁷ But BZX will disseminate this information on its own subscription-based, proprietary data feed, to which large numbers of investors may not subscribe. Many commenters have raised concerns about having to ingest and analyze information from yet another source in furtherance of their trading strategies.⁷⁸

The Division disregarded those concerns, assuming that the addition of one additional data point would not materially affect market complexity because it would only require “one exchange to disseminate information on one data feed.”⁷⁹ But that conclusion ignores the reality that Cboe Market Close would almost certainly lead to similar offerings by other exchanges.⁸⁰

⁷⁶ Order, *supra* note 9, at 3216.

⁷⁷ See BZX Letter 2, *supra* note 21, at 2.

⁷⁸ See IMC Financial Markets Letter, *supra* note 12; T. Rowe Price Letter, *supra* note 16.

⁷⁹ Order, *supra* note 9, at 3218 n.186. The Division suggested lack of concern with this type of data proliferation because investors must already monitor several data feeds. *Id.* at 3218. But that does not mean that adding yet more data to the market will not increase market complexity and operational risk. To the contrary, BZX *admits* that it intends to add more data to the market, and similar rules adopted by other exchanges would further increase the amount of market data to monitor. See, e.g., BZX Letter 2, *supra* note 21, at 2 (“The total matched shares would be disseminated by [BZX] at 3:35 p.m. Eastern Time via the Bats Auction Feed, which is provided free of charge.”).

⁸⁰ Order, *supra* note 9, at 3222 (“[I]t is commonplace for exchanges to attempt to mimic or build upon various functionality of their competitors.”).

Indeed, Investors Exchange LLC, for example, has already stated that it is considering filing a “similar proposal in the near future.”⁸¹ With 13 equity exchanges, each of which could adopt rules similar to the Proposal, the number of data feeds that would need to be analyzed at the close, and thus the complexity of trading at the close, could grow exponentially. As one commenter noted, the complications caused by the Proposal would “put even more stress” on the closing auction process, which is perhaps the most important segment of each trading day.⁸²

Further, the Division baselessly assumed that closing auction participants are the same sophisticated investors who trade during the continuous session, and can therefore monitor sophisticated market data aggregation and analytics with little difficulty.⁸³ The opposite is likely the case. Professional traders continuously monitor multiple venues to best execute their trades. But closing auction participants place MOC orders to take advantage of the high level of liquidity at a single closing price. Unlike more active traders, these closing auction participants are not attempting to analyze disparate data sources in order to trade. By definition, these investors—often passive index funds rather than high-frequency traders—are passively seeking the closing price, whatever that may be.⁸⁴ Cboe Market Close would allow sophisticated investors to analyze multiple data feeds, in order to optimize their closing-auction trading

⁸¹ IEX Letter, *supra* note 18, at 1.

⁸² GTS Letter 1, *supra* note 10, at 6.

⁸³ Order, *supra* note 9, at 3218 (the Division “believes that those market participants that would plan to monitor information disseminated by BZX relating to Cboe Market Close would likely already maintain systems and software that are able to aggregate such feeds”). Much of the Division’s reasoning in this section of the Order mimics BZX’s “beliefs,” which are not, by themselves, a sufficiently independent basis to support approval of the Proposal. *Susquehanna*, 866 F.3d at 446.

⁸⁴ See, e.g., *What’s the Biggest Trade*, *supra* note 6 (“The ‘close’ . . . has grown in importance as investors pour into index-mutual funds and other vehicles that passively track various stock-market indexes, including exchange-traded funds, or ETFs.”).

(including potentially manipulating the closing price to their favor) at the expense of these ordinary passive investors—who previously had no need to invest in the technology to monitor and evaluate in real time all market data sources to optimize their otherwise passive trading.

III. The Proposal Is Not Designed to Prevent Fraudulent and Manipulative Acts and Practices

The Proposal also fails to satisfy Section 6(b)(5) of the Act because it is not “designed to prevent fraudulent and manipulative acts and practices.”⁸⁵ Rather, Cboe Market Close would *multiply* the opportunities to manipulate the critical closing price.⁸⁶ Commenters, including NYSE Group, offered the Division several examples of how investors could use Cboe Market Close to manipulate the closing price to their advantage.⁸⁷ The Division brushed those concerns aside without justification.

There are myriad ways in which investors could exploit Cboe Market Close to manufacture ill-gotten gains. Investors could employ a straightforward strategy of entering larger-than-desired orders into Cboe Market Close to manipulate the execution price for the desired number of shares. For example, as part of a strategy to purchase 10,000 shares, an investor could enter an order to purchase 100,000 shares into Cboe Market Close, and then wait to see what occurred by 3:35 p.m. If only 10,000 shares were paired off at that time, the remainder would be cancelled and the objective would be achieved with no downside. If, on the other hand, more shares were paired off at 3:35 p.m.—say all 100,000 or some other amount significantly above 10,000—the same objective could be obtained but with a potentially

⁸⁵ 15 U.S.C. § 78f(b)(5).

⁸⁶ See Order, *supra* note 9, at 3218 (discussing commenter’s concerns about manipulation).

⁸⁷ See, e.g., NYSE Letter 3, *supra* note 22; NYSE Letter 4, *supra* note 22; Letter to Brent J. Fields, Secretary, SEC, from Ari M. Rubenstein, Co-Founder and Chief Executive Officer, GTS Securities, LLC, dated August 17, 2017, at 5; S&P Letter, *supra* note 13, at 2.

significant upside. The investor could enter an order to sell the excess shares through the primary listing exchange's closing auction at 3:45 p.m., which would both achieve the desired net purchase of 10,000 shares, and, importantly, potentially artificially and unlawfully lower the purchase price for the already matched Cboe Market Close execution by moving the market downward in response to such a large sell order.⁸⁸ This strategy would be available because orders placed on the Cboe Market Close would be matched ten minutes earlier than those placed with the listing exchange. Thus, an investor wishing to purchase at the closing price could always place a larger order with Cboe Market Close, learn the results of its order, and, if its order paired to a greater extent than intended, sell that excess on the listing exchange, knowing that that sale could drive the stock price down. The reverse could be similarly achieved for sell orders, manipulating upward the official closing price by selling a large block in the Cboe Market Close and offsetting that with an upward manipulative purchase in the listing market's closing auction.

Another example of potential manipulation could result from information that the Cboe Market Close would reveal to some investors, but does not disseminate to the entire market. An investor who places an order with Cboe Market Close that is returned unmatched would know an order imbalance in that security may likely exist on the primary exchange as well.⁸⁹ With that nonpublic knowledge, the investor could take a position in the stock, knowing which direction

⁸⁸ See NYSE Letter 4, *supra* note 22, at 19; NYSE Letter 1, *supra* note 6, at 6–7 (detailing other potential manipulation scenarios that could result from the Proposal).

⁸⁹ Rather than obtaining this information incidentally as a result of legitimate trading, one could “sniff” out this information through a strategy of testing whether there are large imbalances. The trader could place orders on one side or the other of a number of stocks, and where some of those orders are cancelled because of an imbalance, the trader would then have nonpublic information with which to trade in the remaining minutes of the continuous session.

the price is likely to move due to the large imbalance.⁹⁰ Notably, even if many of the orders placed with Cboe Market Close were matched rather than cancelled, there would be little risk to deploying this strategy because orders matched on Cboe Market Close could always be “netted out” by placing a contra-side order with the listing exchange at any time from 3:35 p.m. until 3:45 p.m., as noted in the prior example.

As explained in detail in NYSE Group’s comment letters, detecting this type of manipulation presents unique challenges.⁹¹ Because the deadline for placing an order with Cboe Market Close is earlier than the deadline for placing an order with the listing exchange’s closing auction,⁹² an investor could place orders with both Cboe Market Close and the listing exchange for legitimate or illegitimate purposes, and determining the true purpose of particular trades would be difficult, if not impossible. It would be hard to tell, for example, whether a purchase with Cboe Market Close at 3:35 p.m. and then a sale on the listing exchange at 3:45 p.m. was the result of attempted manipulation, a bona fide change of investment strategy, a hedge, a mistake, or something else entirely. Given the structure of Cboe Market Close, there would be no reliable way to distinguish consistently between legitimate and illegitimate trading across exchanges.

In approving the Proposal, the Division improperly disregarded these significant risks of market manipulation. The Division based its conclusion on: (1) BZX’s commitment to “enhance” its surveillance mechanisms and work with other self-regulatory organizations to

⁹⁰ For example, an unmatched sell order would allow a participant in Cboe Market Close to profit by shorting that stock either during continuous trading or at the close on the primary market, as that participant would have nonpublic information that there were more sell orders than buy orders.

⁹¹ NYSE Letter 1, *supra* note 6, at 6.

⁹² *Id.* at 7.

detect and prevent inappropriate trading activity;⁹³ and (2) the obligations common to all self-regulatory organizations to surveil for manipulative activity.⁹⁴ These were insufficient bases to discount the substantial risk of manipulation. BZX must demonstrate affirmatively that its Proposal is designed to *prevent* fraudulent activity, not that fraud resulting from its Proposal can potentially be mitigated. Indeed, the Commission recently enforced this principle strictly in the context of a proposal by NYSE to eliminate certain restrictions on the trading activities of DMMs. Those restrictions had been designed to address the risk of DMM manipulative activity, but the restrictions had become obsolete in light of various changes, including NYSE’s other safeguards to detect manipulative activity.⁹⁵ The Commission nevertheless disapproved NYSE’s proposal because the elimination of a restriction—even if mitigated by other factors—could not itself have constituted a change “designed to prevent” fraud manipulation.⁹⁶ Similarly, a rule such as the Cboe Market Close that creates new opportunities for fraud and manipulation cannot itself be “designed to prevent” those outcomes, even if there are other claimed mechanisms for mitigating the resulting risks.

IV. The Proposal Would Cause BZX to Violate Regulation SHO

Finally, the Proposal would also cause BZX to violate Rule 201 of Regulation SHO.⁹⁷ Rule 201 requires that a trading center, such as BZX, maintain and enforce written policies and

⁹³ Order, *supra* note 9, at 3220.

⁹⁴ *Id.*

⁹⁵ Securities Exchange Act Release No. 79284 (November 10, 2016), 81 FR 81222 (November 17, 2016) (SR-NYSE-2016-71), at 81222–23.

⁹⁶ Securities Exchange Act Release No. 81150 (July 14, 2017), 82 FR 33534 (July 20, 2017) (SR-NYSE-2016-71), at 33537.

⁹⁷ 17 CFR § 242.201.

procedures reasonably designed to, *inter alia*, prevent the execution or display of a non-exempt short sale order of a covered security at a price that is less than or equal to the then-current national best bid (the “NBB”), if the market price of that covered security has decreased by 10% or more from the stock’s closing price on the prior day (a “Short Sale Price Restriction”).⁹⁸ This restriction must be maintained in effect for the remainder of the trading day and the following trading day.⁹⁹ In this way, Rule 201 acts like a “circuit breaker” by attempting to slow further decreases in the price of a stock that has already experienced a precipitous price decline. The Rule covers various types of short sale orders, including the MOC orders placed with listing exchanges that BZX hopes to attract to Cboe Market Close.

NYSE Exchanges have adopted rules to ensure compliance with Rule 201 in connection with closing auction short sale MOC orders.¹⁰⁰ Where a Short Sale Price Restriction is in effect as to a particular stock, NYSE will treat a non-exempt short sale MOC order of that stock as though it were an LOC order to sell at a price of no less than one minimum price variation above the NBB.¹⁰¹ For example, if the NBB at the time of the closing auction for a stock subject to a Short Sale Price Restriction is \$10.00, a short sale MOC order would be treated as though it were an LOC order priced at \$10.01. If the closing auction results in a closing price of \$10.00 or less for that stock, the short sale MOC order would not be filled (like any other LOC order priced at

⁹⁸ *Id.* § 242.201(b)(1)(i).

⁹⁹ *Id.*

¹⁰⁰ *See, e.g.*, NYSE Rule 123C Supplementary Material .20; NYSE Arca Rule 7.35-E Commentary .01; NYSE American Rule 7.35-E Commentary .01.

¹⁰¹ *Id.*

\$10.01 that would not be filled), as executing that order at the closing price would violate Rule 201.

Unlike the NYSE Exchanges, the Proposal includes no such mechanism for avoiding violations of Rule 201. To the contrary, given Cboe Market Close's design, its operation would inevitably lead BZX to violate Rule 201. For example, assume that at noon, a trader sends a short sale MOC order to the Cboe Market Close, and that stock becomes subject to a Short Sale Price Restriction at 3 p.m. If the NBB at the time of the listing exchange's closing auction is \$10.00 and the listing exchange's closing auction results in a price of \$10.00 (or less), the Cboe Market Close would execute the trader's short sale MOC order at \$10.00 (or less), in violation of Rule 201. That same order sent to an NYSE Exchange as a short sale MOC order would have been treated as an LOC at \$10.01, and—as required by Rule 201—would not have been executed. The Proposal fails to account for this and all other analogous scenarios.

Given the proposed timing and functioning of Cboe Market Close, there appears to be no version of its proposed rule that would avoid the above problem. BZX will not know at 3:35 p.m., the time at which it matches buy and sell orders, what a stock's ultimate closing price or NBB will be. It will therefore not know whether a short sale order in a stock subject to a Short Sale Price Restriction can legally be executed at the closing price, as order matching occurs 25 minutes before the closing auction and, of course, before publication of the closing price. This results in two untenable choices: (1) BZX would have to unlawfully execute orders in violation of Rule 201; or (2) BZX would have to cancel orders after 4 p.m., after already having notified participants at 3:35 p.m. that their orders had matched, at which point: (a) it would be too late for those participants, or their customers, to send their MOC orders to the listing exchange, and (b) BZX would have already disseminated inaccurate information regarding matched order volume

at 3:35 p.m., resulting in a false impression of the market and interference with price discovery by the primary listing exchange.

Moreover, the above defect cannot be resolved by prohibiting BZX from accepting stocks subject to a Short Sale Price Restriction, because BZX could accept an order for a stock at, say, noon, only for it to become restricted later in the day. And even if BZX were to cancel all short sale MOC orders subject to trading restrictions at 3:35 p.m. (the time at which it proposes to stop accepting orders), a Short Sale Price Restriction could be triggered between 3:35 p.m. and 4:00 p.m., after BZX has matched orders, but before the trading day is over.

For these reasons, the Proposal will inevitably violate Regulation SHO. This presents an additional, independent reason why the Proposal is inconsistent with the Act and why, under Section 19(b)(2)(C)(2), the Commission must disapprove the Proposal.

CONCLUSION

For the foregoing reasons, NYSE Group respectfully requests that the Commission set aside the Order and disapprove the Proposal as required under Section 19(b)(2)(C)(ii) of the Act,¹⁰² as the Proposal fails to satisfy the requirements for the rules of a national securities exchange under Sections 6(b)(5) and 6(b)(8) of the Act and the Commission's rules and regulations thereunder, including by virtually guaranteeing that Cboe would violate Rule 201 of Regulation SHO.¹⁰³

¹⁰² 15 U.S.C. § 78s(b)(2)(C)(ii).

¹⁰³ 15 U.S.C. § 78f(b)(5), (b)(8).

DATED: April 12, 2018

Respectfully submitted,

Davis Polk & Wardwell LLP

A handwritten signature in black ink, appearing to read "Paul S. Mishkin", written over a horizontal line.

Paul S. Mishkin
450 Lexington Avenue
New York, New York 10017
212-450-4000
paul.mishkin@davispolk.com

Counsel for NYSE Group, Inc.

**UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION**

In the Matter of the:

Cboe BZX Exchange, Inc.

File No. SR-BatsBZX-2017-34

CERTIFICATE OF SERVICE

I, Paul S. Mishkin, counsel for NYSE Group, Inc., hereby certify that on April 12, 2018, I caused to be served copies of the attached Statement in Opposition to the Division's Order Approving a Rule to Introduce Cboe Market Close on the individuals as indicated below:

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549
Facsimile: (202) 772-9324
(via facsimile and first class mail)

Eugene Scalia
Amir C. Tayrani
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036
Facsimile: (202) 467-0539
(via facsimile and first class mail)

Patrick Sexton
Executive Vice President, General Counsel,
and Corporate Secretary
Cboe BZX Exchange, Inc.
400 South LaSalle Street
Chicago, IL 60605
Facsimile: (312) 786-7919
(via facsimile and first class mail)

Dated: April 12, 2018



Paul S. Mishkin