

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-78014; File No. SR-NASDAQ-2016-035)

June 8, 2016

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Amendment No. 1, and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Establish Secondary Contingency Procedures for the Exchange's Closing Cross

I. Introduction

On March 2, 2016, The Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to establish Secondary Contingency Procedures for its Closing Cross. The proposed rule change was published for comment in the Federal Register on March 11, 2016.³ The Commission received one comment letter on the proposed rule change.⁴ On April 21, 2016, the Commission extended the time period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.⁵ On June 6, 2016, the Exchange filed Amendment No. 1 to the proposed rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 77309 (March 7, 2016), 81 FR 13007.

⁴ See Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, to Brent J. Fields, Secretary, Commission, dated April 5, 2016 (“SIFMA Letter”). The Commission notes that this comment letter was also submitted in response to a similar filing by New York Stock Exchange LLC (“NYSE”). See Securities Exchange Act Release No. 77305 (March 7, 2016), 81 FR 12977 (March 11, 2016) (SR-NYSE-2016-18).

⁵ See Securities Exchange Act Release No. 77678, 81 FR 24909 (April 27, 2016).

change.⁶ The Commission is publishing this notice to solicit comments on Amendment No. 1 from interested persons, and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

II. Description of the Proposed Rule Change

The Exchange states that it currently has three systems that are designed to ensure the orderly execution and dissemination of the Nasdaq Official Closing Price: (1) the Nasdaq Closing Cross; (2) the Auxiliary Procedures; and (3) the Primary Contingency Procedures.⁷ The Exchange now proposes to add Rule 4754(b)(8) to establish Secondary Contingency Procedures, and to amend Rule 4754(b)(7) to provide additional details regarding the operation of the Primary and Secondary Contingency Procedures.⁸

⁶ In Amendment No. 1, which replaced the original filing in its entirety, the Exchange: (1) amended Rule 4754(b)(7) to specify the situations in which the Exchange would employ the proposed Secondary Contingency Procedures; (2) amended Rule 4754(b)(7)(A) to specify that the Exchange will publicly announce its determination to employ its Primary or Secondary Contingency Procedures and that such announcement will be made at or before 3:00 p.m. if the Exchange determines to designate an alternate exchange under proposed Rule 4754(b)(8)(A); (3) amended proposed Rule 4754(b)(8)(A)(ii) and (B)(i) to state that the VWAP (as defined below) calculation would take into account any trade breaks or corrections up to the time the VWAP is processed; (4) amended proposed Rule 4754(b)(8)(A) and (B) to provide that the Exchange would not publish an Official Closing Price if the Official Closing Price cannot be determined under proposed Rule 4754(b)(8)(A)(i)-(iv) or (B)(i)-(iii); (5) added proposed Rule 4754(b)(8)(C) to provide that under the Secondary Contingency Procedures, the Exchange will cancel all open interest designated for the Nasdaq close; (6) specified an implementation date for the proposal; (7) responded to the SIFMA Letter; and (8) made non-substantive clarifying and corrective changes to its proposed rule text. Amendment No. 1 is available at: http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2016/SR-NASDAQ-2016-035_Amendment_1.pdf.

⁷ See Nasdaq Rule 4754. See also Amendment No. 1 at 4.

⁸ The Commission notes that NYSE and NYSE MKT LLC (“NYSE MKT”) have also filed similar proposed rule changes with the Commission. See Securities Exchange Act Release Nos. 77305 (March 7, 2016), 81 FR 12977 (March 11, 2016) (SR-NYSE-2016-18); 77306 (March 7, 2016), 81 FR 12986 (March 11, 2016) (SR-NYSEMKT-2016-31).

Under the proposal, if a disruption occurs that prevents the execution of the Nasdaq Closing Cross, Nasdaq would use either the Primary Contingency Procedures or the Secondary Contingency Procedures to determine the Nasdaq Official Closing Price, which would be published by the SIP.⁹ The determination to use the Primary or Secondary Contingency Procedures would be made by the President of Nasdaq or any Senior Executive designated by the President.¹⁰ Nasdaq would publicly announce at the earliest possible time the initiation of the Primary or Secondary Contingency Procedures via system status alerts, Equity Trader Alerts, and email notification directories.¹¹ If Nasdaq publicly announces that it will employ its Secondary Contingency Procedures, it would cancel all open interest designated for the Nasdaq close residing in Nasdaq's systems in order to give members the opportunity to route their orders to alternative execution venues.¹²

Under the proposal, if Nasdaq publicly announces at or before 3:00 p.m. that it will employ the Secondary Contingency Procedures for one or more securities, it would designate an alternate exchange for those securities,¹³ and the Nasdaq Official Closing Price for each security would be determined based on the following hierarchy:

⁹ See proposed Rule 4754(b)(7) and (8). See also Amendment No. 1 at 4-6.

¹⁰ The Exchange proposes to specify that it will employ the Primary Contingency Procedures if at all possible, and will employ the Secondary Contingency Procedures only if it determines that both the standard closing procedures and the Primary Contingency Procedures are unavailable. See proposed Rule 4754(b)(7). See also Amendment No. 1 at 4-5, 30.

¹¹ The proposal would clarify the interaction between the Primary Contingency Procedures and the proposed Secondary Contingency Procedures, but it would not change the operation of the Primary Contingency Procedures.

¹² See proposed Rule 4754(b)(8)(C). See also Amendment No. 1 at 9, 32.

¹³ The Exchange proposes to designate NYSE Arca as its official back-up exchange because, according to the Exchange, NYSE Arca and Nasdaq membership substantially overlaps and NYSE Arca already operates a closing cross that it can use to execute a closing cross in Nasdaq-listed securities. See Amendment No. 1 at 5-6. The Exchange

- The Nasdaq Official Closing Price would be the official closing price established for the security under the rules of the designated alternate exchange.¹⁴
- If there is no official closing price in the security on the designated alternate exchange, the Nasdaq Official Closing Price would be the volume-weighted average price (“VWAP”) of the consolidated last-sale-eligible prices of the last five minutes of trading during regular trading hours as calculated by the SIP, including any closing transactions on an exchange and any trade breaks or corrections up to the time the VWAP is processed.¹⁵
- If there were no consolidated last-sale-eligible trades in the last five minutes of trading during regular trading hours, the Nasdaq Official Closing Price would be the last consolidated last-sale-eligible trade for the security during regular trading hours on that trading day.¹⁶
- If there were no consolidated last-sale-eligible trades during regular trading hours on that trading day, the Nasdaq Official Closing Price would be the prior day’s Nasdaq Official Closing Price.¹⁷

If a security’s Nasdaq Official Closing Price cannot be determined based on this hierarchy, Nasdaq would not publish an Official Closing Price for the security.¹⁸

states that Nasdaq members that are also NYSE Arca members should be technically prepared to transfer liquidity to NYSE Arca in the event Nasdaq is unable to execute a closing cross. See id.

¹⁴ See proposed Rule 4754(b)(8)(A)(i).

¹⁵ See proposed Rule 4754(b)(8)(A)(ii).

¹⁶ See proposed Rule 4754(b)(8)(A)(iii).

¹⁷ See proposed Rule 4754(b)(8)(A)(iv).

¹⁸ See proposed Rule 4754(b)(8)(A)(v). See also Amendment No. 1 at 8, 32.

Under the proposal, if Nasdaq publicly announces after 3:00 p.m. that it will employ the Secondary Contingency Procedures for one or more securities, it would not designate an alternate exchange. Rather, the Nasdaq Official Closing Price of each security would be determined based on the following hierarchy:

- The Nasdaq Official Closing Price would be the VWAP of the consolidated last-sale-eligible prices of the last five minutes of trading during regular trading hours as calculated by the SIP, including any closing transactions on an exchange and any trade breaks or corrections up to the time the VWAP is processed.¹⁹
- If there were no consolidated last-sale-eligible trades in the last five minutes of trading during regular trading hours, the Nasdaq Official Closing Price would be the last consolidated last-sale-eligible trade for the security during regular trading hours on that trading day.²⁰
- If there were no consolidated last-sale-eligible trades during regular trading hours on that trading day, the Nasdaq Official Closing Price would be the prior day's Nasdaq Official Closing Price.²¹

If a security's Nasdaq Official Closing Price cannot be determined based on this hierarchy, Nasdaq would not publish an Official Closing Price for the security.²²

As with the Primary Contingency Procedures, if Nasdaq employs the Secondary Contingency Procedures, after hours trading would begin either as scheduled at 4:00 p.m. or

¹⁹ See proposed Rule 4754(b)(8)(B)(i).

²⁰ See proposed Rule 4754(b)(8)(B)(ii).

²¹ See proposed Rule 4754(b)(8)(B)(iii).

²² See proposed Rule 4754(b)(8)(B)(iv). See also Amendment No. 1 at 9, 32.

upon resolution of the disruption that triggered Nasdaq to operate the Secondary Contingency Procedures.²³

The Exchange states that the Operating Committees for the Nasdaq UTP Plan and the Consolidated Quote/Consolidate Tape Plan have already voted to modify the SIPs to support this proposal.²⁴ According to the Exchange, the Nasdaq SIP has announced plans to implement a new platform in the fourth quarter of 2016, and Nasdaq intends to implement the proposed rule change within 120 days of the date of implementation of that new SIP platform.²⁵ The Exchange states that a delay of 120 days will permit market participants to test and launch the new SIP platform, and then to separately test and launch the new backup closing functionality.²⁶

III. Summary of Comments

As noted above, the Commission received one comment letter on the proposed rule change.²⁷ The commenter generally supports the proposal but suggests certain modifications to the proposal.²⁸

First, the commenter suggests that the Exchange's rules should specify that any designation of an alternate exchange would be publicly announced at or before 3:00 p.m. and that the announcement would be made through the SIP feed in addition to any other forms of communication.²⁹ According to the commenter, if a determination is made at 3:00 p.m., then the

²³ See proposed Rule 4754(b)(8)(D).

²⁴ See Amendment No. 1 at 6.

²⁵ See id. at 9.

²⁶ See id.

²⁷ See SIFMA Letter, supra note 4.

²⁸ See id. at 1. The commenter also encourages NYSE and Nasdaq to continue to work with industry participants on this issue and to refine the backup mechanism as a next step. See id. at 3.

²⁹ See id. at 2-3.

time between 3:00 p.m. and when member firms actually receive notice of the designation would cut into the time needed to re-direct closing interest to the designated alternate exchange.³⁰ The Exchange agreed with the commenter's suggestion that it should publicly announce any determination to invoke the Secondary Contingency Procedures.³¹ As a result, the Exchange amended its proposal to specify that any determination to invoke the Secondary Contingency Procedures will be publicly announced, and that an announcement to designate an alternate exchange would be made at or before 3:00 p.m.³²

Second, the commenter suggests that if the Exchange determines not to carry out its own closing transaction, it should expressly assume responsibility for the cancellation of all closing interest that the Exchange has already received.³³ According to the commenter, this would allow market participants to treat their closing interest as canceled even if they have not received an official notification of the cancellation.³⁴ The commenter also suggests that the Exchange's rule should state that the official closing transaction will be canceled once the Exchange determines that it is unable to conduct its own closing transaction, so as to avoid uncertainty regarding whether the exchange might change course if it determines before 4:00 p.m. that it can, in fact, conduct its own closing transaction.³⁵ The Exchange agreed with the commenter's suggestion that it provide members with certainty that their open interest will not be executed if the

³⁰ See id.

³¹ The public announcement of an alternate exchange designation, however, would not be disseminated through the SIP feed.

³² See proposed Rule 4754(b)(8)(A) and (B). See also Amendment No. 1 at 5, 13, 31-32.

³³ See SIFMA Letter, supra note 4, at 3. The commenter also asserts that, if the Exchange executes the closing interest despite canceling the closing transaction, the Exchange should be responsible under its own rules for any resulting losses to the member firms. See id. The Exchange has not revised its proposal to assume this liability.

³⁴ See SIFMA Letter, supra note 4, at 3.

³⁵ See id.

Exchange invokes the Secondary Contingency Procedures. As a result, the Exchange amended its proposal to expressly state that it would cancel all open interest designated for the Nasdaq close if it determines to employ the Secondary Contingency Procedures.³⁶ The Commission also notes that, under the proposal, once Nasdaq publicly announces that it will employ the Secondary Contingency Procedures, it will not revert to its ordinary closing procedures, and the Nasdaq Official Closing Price would be determined according to the hierarchies discussed above.³⁷

Third, the commenter suggests that, when using the VWAP methodology, the Exchange not include any other exchange's closing transaction in the calculation.³⁸ According to the commenter, a five-minute VWAP methodology should result in a price that is largely tradable and achievable.³⁹ However, according to the commenter, if a VWAP used as the official closing price included auction prints from other exchanges' closing transactions, the ability to trade and achieve the official closing price process would be reduced.⁴⁰ The Exchange disagreed with this comment. As the Exchange noted, the VWAP calculation should include the maximum liquidity available.⁴¹ Accordingly, the Exchange has not amended the proposal to exclude closing transactions from the VWAP calculation.

IV. Discussion and Commission Findings

After careful review of the proposal, as modified by Amendment No. 1, and the comment letter, the Commission finds that the proposed rule change is consistent with the requirements of

³⁶ See proposed Rule 4754(b)(8)(C). See also Amendment No. 1 at 9, 14, 32.

³⁷ See supra notes 14-22 and accompanying text.

³⁸ See SIFMA Letter, supra note 4, at 3.

³⁹ See id.

⁴⁰ See id.

⁴¹ See Amendment No. 1 at 14.

the Act and the rules and regulations thereunder applicable to a national securities exchange.⁴² In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁴³ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission believes that the proposed rule change would provide transparency regarding how the Exchange would determine the Nasdaq Official Closing Price in Exchange-listed securities when the Exchange is unable to conduct a closing transaction due to a systems or technical issue. The Commission notes 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. As the Exchange notes, the proposed Secondary Contingency Procedures would provide a pre-determined, consistent solution that would result in the SIP disseminating an official closing price for listed securities on behalf of the Exchange within a reasonable time frame relative to the normal closing time; would minimize the need for industry participants to modify their processing of data from the SIP; and would provide advance notification of the initiation of a closing contingency plan to provide sufficient time for industry participants to route any closing interest

⁴² In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁴³ 15 U.S.C. 78f(b)(5).

to an alternate venue to participate in that venue's closing auction.⁴⁴ The Commission believes that the Exchange's proposal is reasonably designed to achieve these important goals and to prevent any issues that may result if the Exchange were unable to provide a closing price for its listed securities due to a systems or technical issue. For these reasons, the Commission finds that the proposed rule change is consistent with the Act.

V. Solicitation of Comments on Amendment No. 1

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 1 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2016-035 on the subject line.

Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2016-035. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications

⁴⁴ See Amendment No. 1 at 10-11.

relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASDAQ-2016-035 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1

The Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 1, prior to the 30th day after the date of publication of the notice of Amendment No. 1 in the Federal Register. As noted above, in Amendment No. 1, the Exchange specified the situations in which it would employ the proposed Secondary Contingency Procedures.⁴⁵ The Commission believes that this change would provide market participants with transparency regarding the Exchange's process for determining whether to employ its Primary or Secondary Contingency Procedures. In Amendment No. 1, the Exchange also specified that it will publicly announce its determination to use its Primary or Secondary Contingency Procedures; that such announcement will be made at or before 3:00 p.m. if the Exchange determines to designate an alternate exchange under proposed Rule 4754(b)(8)(A); and that under the Secondary Contingency Procedures, the Exchange would cancel all open interest designated for the Nasdaq

⁴⁵ See proposed Rule 4754(b)(7). See also Amendment No. 1 at 4-5, 30.

close.⁴⁶ As noted above, the Exchange made these amendments in response to comments received on the proposal. In addition, in Amendment No.1, the Exchange stated that the VWAP calculation would take into account any trade breaks or corrections up to the time the VWAP is processed, and that it would not publish an Official Closing Price if the Official Closing Price cannot be determined under the proposed process.⁴⁷ The Commission notes that these changes would harmonize Nasdaq's proposal with NYSE's and NYSE MKT's proposals. Finally, in Amendment No. 1, the Exchange specified an implementation date for the proposal, responded to the SIFMA Letter, and made non-substantive clarifying and corrective changes to its proposed rule text.⁴⁸

Because Amendment No. 1 provided additional transparency to the operation of the Secondary Contingency Procedures, harmonized Nasdaq's proposal to NYSE's and NYSE MKT's proposals, and responded to the comments received on the original proposal, the Commission finds good cause for approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis, pursuant to Section 19(b)(2) of the Act.⁴⁹

⁴⁶ See proposed Rule 4754(b)(8). See also Amendment No. 1 at 5, 9, 13-14, 31-32.

⁴⁷ See proposed Rule 4754(b)(8)(A)(ii) and (v); proposed Rule 4754(b)(8)(B)(i) and (iv). See also Amendment No. 1 at 7-8, 31-32.

⁴⁸ See Amendment No. 1 at 9, 13-14, 30-33.

⁴⁹ 15 U.S.C. 78s(b)(2).

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁵⁰ that the proposed rule change (SR-NASDAQ-2016-035), as modified by Amendment No. 1, be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵¹

Robert W. Errett
Deputy Secretary

⁵⁰ 15 U.S.C. 78s(b)(2).

⁵¹ 17 CFR 200.30-3(a)(12).