

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-80683; File No. SR-BatsBZX-2017-34)

May 16, 2017

Self-Regulatory Organizations; Bats BZX Exchange, Inc.; Notice of Filing of a Proposed Rule Change to Introduce Bats Market Close, a Closing Match Process for Non-BZX Listed Securities Under New Exchange Rule 11.28

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 5, 2017, Bats BZX Exchange, Inc. (the “Exchange” or “BZX”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange filed a proposal to introduce Bats Market Close, a closing match process for non-BZX Listed Securities³ under new Exchange Rule 11.28.

The text of the proposed rule change is available at the Exchange’s website at www.batstrading.com, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ A BZX Listed security is a security listed on the Exchange pursuant to Chapter 14 of the Exchange’s Rules and includes both corporate listed securities and Exchange Traded Products (“ETPs”).

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to introduce Bats Market Close, a closing match process for non-BZX Listed Securities under new Exchange Rule 11.28. In sum, all buy and sell Market-On-Close Orders (“MOC”)⁴ designated for participation in Bats Market Close would be matched at the official closing price for such security published by the primary listing market, as further described below. The Exchange proposes Bats Market Close in response to interest from market participants who seek an alternative to participation on the primary listing market’s closing auction while still receiving an execution at the official closing price.

Over recent years, the total volume executed in the primary listing markets’ closing auctions has increased over 70% from 200 million shares per day in 2012 to almost 350 million shares per day in 2016.⁵ Over that same period of time, continuous trading volume has increased

⁴ The term “Market-On-Close” or “MOC” means a BZX market order that is designated for execution only in the Closing Auction. See Exchange Rule 11.23(a)(15). The Exchange proposes to amend the description of Market-On-Close orders to include orders designated to execute in the proposed Bats Market Close.

⁵ Based on BZX’s internal data.

13% from 6.11 billion shares per day in 2012 to 6.93 billion shares per day in 2016.⁶ Closing auctions on the primary listing markets amounted to almost 5% of the total executed volume in 2016.⁷ The official closing price for any listed security is generally determined by the closing auction for that security held at the primary listing market. Market participants seeking to transact at the official closing price must, therefore, participate in the listing market's closing auction to receive the official closing price, as evidenced by recent marketing materials⁸ from the New York Stock Exchange, Inc. ("NYSE") stating that their closing auction receives 100% of the market share in all Tape A securities (NYSE listed). The NYSE and the Nasdaq Stock Market LLC ("Nasdaq") have taken advantage by charging higher fees for participation in their respective closing auctions than for trading conducted during the trading day. Both the NYSE and Nasdaq assess a fee on both sides of the transactions that occur in their closing auction.⁹ As

⁶ Id.

⁷ Id.

⁸ See *NYSE Open and Closing Auctions*, available at https://www.nyse.com/publicdocs/nyse/markets/nyse/NYSE_Opening_and_Closing_Auctions_Fact_Sheet.pdf.

⁹ Over the last few years, both the NYSE and Nasdaq have increased their closing auction fees considerably – NYSE's base rate has gone up by 16% to \$.0011 per share (or a capture of \$.0022 per matched share). See Tier F under Execution Fees for the Nasdaq Closing Cross in the Nasdaq fee schedule available at <http://www.nasdaqtrader.com/Trader.aspx?id=PriceListTrading2>; and Liquidity Indicator 7 in the NYSE fee schedule available at <https://www.nyse.com/markets/nyse/trading-info/fees>. Nasdaq has also increased its fee by a much larger 60% margin to \$.0016 per share (or a capture of \$.0032 per share). Id. See Securities Exchange Act Release No. 68150 (November 5, 2012), 77 FR 67431 (November 9, 2012) (SR-NYSE-2012-56). The capture from the top tier for closing auction would be \$.0012 for NYSE and \$.0018 for Nasdaq while that for continuous trading would be \$.00055 for NYSE and \$.00005 for Nasdaq, which are much lower than the capture for their respective closing auctions. See Securities Exchange Act Release No. 63852 (February 7, 2011), 76 FR 8791 (February 15, 2011) (SR-Nasdaq-2011-017). Using \$.00275 as the removal rate and \$.0022 as the top tiered rebate for non-market makers and non-Supplemental Liquidity Providers. See NYSE fee schedule available at <https://www.nyse.com/markets/nyse/trading-info/fees>. Using \$.0030 as the removal rate

volume executed in the primary listing markets' closing auctions has increased, a disproportionate increase in fees has occurred.

The Exchange believes there are two solutions by which one could address the adverse conditions caused by the existing closing auction and official closing price process, but only one is viable. First, one could create a closing auction to directly compete with the primary listing market for order flow and price discovery. As discussed below, the Exchange believes this solution is not optimal as it further fragments the market and impedes the closing auction's price discovery process. Further, there are exchanges that currently offer closing auctions in non-listed securities with minimal success.¹⁰ Second, one could provide investors with alternative venues for securing the primary closing print price, as proposed herein. The Exchange believes this is a viable alternative as it does not fragment the market or impact the price discovery process performed by the primary listing market's closing auction.

The Exchange proposes to adopt Bats Market Close in response to requests from market participants, and buy-side firms in particular, for an alternative to the primary listing markets' closing auction that also provides an execution at the security's official closing price. As described in proposed Exchange Rule 11.28, for non-BZX Listed securities only, the System¹¹ would seek to match buy and sell MOC orders designated for participation in Bats Market Close at the official closing price for such security published by the primary listing market.¹²

and \$0.00305 as the top tiered rebate for non-market makers. See Tier F under Execution Fees for the Nasdaq Closing Cross in the Nasdaq fee schedule available at <http://www.nasdaqtrader.com/Trader.aspx?id=PriceListTrading2>.

¹⁰ See infra note 21 and accompanying text.

¹¹ The term "System" is defined as "the electronic communications and trading facility designated by the Board through which securities orders of Users are consolidated for ranking, execution and, when applicable, routing away." See Exchange Rule 1.5(aa).

¹² The Exchange notes that the official closing price may be published by another exchange

Members¹³ would be able to enter, cancel or replace MOC orders designated for participation in Bats Market Close beginning at 6:00 a.m. Eastern Time up until 3:35 p.m. Eastern Time (“MOC Cut-Off Time”).¹⁴ Members would not be able to enter, cancel or replace MOC orders designated for participation in the proposed Bats Market Close after the MOC Cut-Off Time.

At the MOC Cut-Off Time, the System would match for execution all buy and sell MOC orders entered into the System based on time priority.¹⁵ Any remaining balance of unmatched shares would then be cancelled back to the Member(s). The System would then disseminate, via the Bats Auction Feed,¹⁶ the total size of all buy and sell orders matched per each security via Bats Market Close. All matched buy and sell MOC orders would then remain on the System until the publication of the official closing price by the primary listing market. Upon publication of the official closing price by the primary listing market, the System would execute all

in the case the primary listing market suffers an impairment and is unable to perform its closing action process. See e.g., Securities Exchange Act Release No. 78015 (June 8, 2016), 81 FR 38747 (June 14, 2016) (SR-NYSE-2016-18) and (SR-NYSEMKT-2016-31) (“OCP Approval Order”). See also Nasdaq Rule 4754(b)(8) and NYSE Arca Rule 1.1(ggP) [sic].

¹³ The term “Member” is defined as “any registered broker or dealer that has been admitted to membership in the Exchange.” See Exchange Rule 1.5(n).

¹⁴ Currently, the NYSE designates the cut-off time for the entry of Market At-the-Close Orders as 3:45 p.m. Eastern Time. See NYSE Rule 123C. Nasdaq, in turn, designates the “end of the order entry period” as 3:50 p.m. Eastern Time. See Nasdaq Rule 4754.

¹⁵ As set forth in proposed Interpretation and Policy .02, the Exchange would cancel all MOC orders designated to participate in Bats Market Close in the event the Exchange becomes impaired prior to the MOC Cut-Off Time and is unable to recover within 5 minutes from the MOC Cut-Off Time. This would provide Members time to route their orders to the primary listing market’s closing auction. Should the Exchange become impaired after the MOC Cut-Off Time, it would retain all matched MOC orders and execute those orders at the official closing price once it is operational.

¹⁶ The Bats Auction Feed disseminates information regarding the current status of price and size information related to auctions conducted by the Exchange and is provided at no charge. See Exchange Rule 11.22(i). The Exchange proposed to amend Exchange Rule 11.22(i) to reflect that the Bats Auction Feed would also include the total size of all buy and sell orders matched via Bats Market Close.

previously matched buy and sell MOC orders at that official closing price.¹⁷

The Exchange has designed Bats Market Close to provide an alternative means to obtain an execution at the official closing price without compromising the price discovery function performed by the primary listing market's closing auctions. By matching only MOC orders, and not limit orders, and executing those matched MOC orders that naturally pair off with each other and effectively cancel each other out, the Exchange believes the proposed Bats Market Close would avoid an impact on price discovery. The Exchange believes it is important to provide market participants an alternative venue to obtain executions at the official closing price.¹⁸

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of

¹⁷ The Exchange would report the execution of all previously matched buy and sell orders to applicable securities information processor and will designate such trades as “.P”, Prior Reference Price. See e.g., Section 4.8, Trade Condition Table, of the *UTP Participant Input Specifications*, available at <http://www.utpplan.com/DOC/UtpBinaryInputSpec.pdf>. See also Section 408, Prior Reference Price Transactions, of FINRA's *Trade Reporting Frequently Asked Questions*, available at <http://www.finra.org/industry/trade-reporting-faq#408>.

As set forth in proposed Interpretation and Policy .01, the Exchange will utilize the official closing price published by the exchange designated by the primary listing market in the case where the primary listing market suffers an impairment and is unable to perform its closing action process. See *supra* note 12. As set forth in proposed Interpretation and Policy .03, up until the closing of the applicable securities information processor at 8:00 p.m. Eastern Time, the Exchange intends to monitor the initial publication of the official closing price, and any subsequent changes to the published official closing price and adjust the price of such trades accordingly. If there is no initial official closing price published by 8:00 p.m. Eastern Time for any security, the Exchange would cancel all matched MOC orders in such security.

¹⁸ It is the Exchange's intention, upon the Commission's approval of the proposed rule change, to file a separate proposal to offer executions of MOC orders at the official closing price, to the extent matched on the Exchange, at a rate less than the fee charged by the applicable primary listing market. It is further the Exchange's intention that such fee would remain lower than the fee charged by the applicable primary listing market.

the Act,¹⁹ in general, and furthers the objectives of Section 6(b)(5) of the Act,²⁰ in particular, in that it is designed to promote just and equitable principles of trade, and to remove impediments to and perfect the mechanism of a free and open market and a national market system because it will provide for a competitive alternative to sending orders to the primary listing market's closing auction. The proposed rule change would further remove impediments to and perfect the mechanisms of a free and open market and a national market system by promoting competition among national securities exchanges in the execution of MOC orders at the official closing price without disrupting the price discovery process of the primary listing markets' respective closing processes.

The Exchange understands that other exchanges have implemented closing auction processes for securities listed on other markets. For example, Nasdaq and NYSE Arca LLC ("NYSE Arca") perform closing auction processes for securities listed on other exchanges.²¹ In the Exchange's view, conducting auctions in non-listed securities does not offer true competition to the primary listing markets' closing auctions, since a separate auction creates its own auction price which can differ meaningfully from the primary market's official closing price which conflicts with industry desires and expectations. Thus, Nasdaq's and NYSE Arca's attempts to offer closing auctions in non-listed securities do not provide useful market competition to the primary listing markets,²² because Nasdaq and NYSE Arca are not offering viable product

¹⁹ 15 U.S.C. 78f.

²⁰ 15 U.S.C. 78f(b)(5).

²¹ See Nasdaq Rule 4754 and NYSE Arca Rule 7.35(d).

²² For example, on March 30, 2017, both Nasdaq and NYSE Arca executed 100 shares in Bank of America (BAC), a NYSE-listed security, at \$23.88 in their respective closing auctions. NYSE executed over 2.6 million shares of BAC in its closing auction at the official closing price of \$23.87.

alternatives (i.e., the product does not provide the official closing price, which is what investors and their intermediaries want). In order to truly introduce competition, any closing execution must be at the price generally accepted by investors as the official closing price. The Exchange, therefore, believes that an alternative venue must provide the ability to receive an execution at the official closing price.

Bats Market Close would not disrupt price discovery, as it would only execute matched contra-side MOC orders, and not limit orders, since limit orders are the basis from which price formation occurs.²³ MOC orders are recipients of that price formation, but do not contribute to the price formation process. By matching only MOC orders, and not limit orders, and executing those matched MOC orders that naturally pair off with each other and effectively cancel each other out, the Exchange believes the proposed Bats Market Close would avoid an impact on price discovery.²⁴ While the proposal may reduce the number of market orders pooled together at the primary listing markets, the Exchange seeks to remove any perceived adverse impact on the primary listing market's close by publishing the number of matched market order shares by

On the same trading day, Nasdaq executed 200 shares in the Financial Select Sector SPDR Fund (XLF), a NYSE Arca-listed security, at \$23.92 in its closing auction. NYSE Arca executed nearly 1.2 million shares of XFL at the official closing price of \$23.93.

On the same trading day, NYSE Arca executed 111 shares in Apple Inc. (AAPL), a Nasdaq-listed security, at \$143.92 in its closing auction. Nasdaq executed close to 1 million shares of AAPL at the official closing price of \$143.93.

²³ The Exchange recognizes limit orders as the basis from which price formation occurs reflected by its offering of functionality that enables Members to route their orders to participate in the opening, reopening, or closing process of the primary listing market. See Exchange Rule 11.13(b)(3)(m) and (n).

²⁴ In addition, NYSE offers after hours crossing session which permits the entry and execution after Regular Trading Hours of orders at the NYSE's official closing price. See NYSE Rule 902. One could argue that by permitting the entry of orders after the closing auction has occurred while guaranteeing the official closing price the crossing session could possibly siphon orders from the closing auction.

security in advance of the primary market's cutoff time. In this way, the Exchange seeks to provide a transparent tally to reflect the added auction depth from the MOC orders for which it is responsible and for which market participants may utilize in making their own order execution decisions. The Exchange notes that while market participants that typically send limit orders to participate in the primary listing market close could opt to send MOC orders to participate in the proposed Bats Market Close, such a decision involves the risk of receiving an execution without any limit price protection and is unlikely to be deployed except in stable market conditions.

An auction that competes with a primary listing market, while offering separate price formation, siphons limit orders from the primary listing market, which can harm the overall price discovery process. At the same time, these auctions further fragment the market and can produce bad auction prices on the non-primary market itself. In contrast, the proposed rule change does not seek to fundamentally alter the primary listing market's closing auction functionality. As such, the Exchange's proposed Bats Market Close provides the official closing price disseminated by the primary listing market, avoids siphoning limit orders from it, and may provide transaction fee competition to the ultimate benefit of Members and investors without distorting the auction's price formation. Drawing limit orders away from a primary listing market could create undesirable market fragmentation, and the proposed rule change is designed to avoid doing so.

While the Exchange recognizes that the proposed Bats Market Close's lack of price formation may be subject to regulatory challenge, it believes that on balance the proposed process provides value in a way that is materially better than competing price-formation auctions currently performed by Nasdaq and NYSE Arca. The Exchange believes that its proposal to offer Bats Market Close to satisfy market participants' requests for a fee competitive alternative

to the primary listing markets' closing auction, would not violate the Act or interfere with the Exchange's core responsibilities under the Act. In addition, the Exchange believes that it is a well-established practice for an exchange to price buy and sell orders based upon reference data, even where the price is based on quote or trade data not originating on that exchange itself. For example, the Exchange, Nasdaq, NYSE, and NYSE Arca, and other exchanges allow orders to be executed at the mid-point of the national best bid and offer (the "NBBO"), regardless of whether the current national best bid (the "NBB") or national best offer (the "NBO") exists on that particular exchange.²⁵ In addition, several pegged order types on various exchanges, including Bats EDGX Exchange, Inc. ("EDGX"), NYSE Arca, and Nasdaq, are set in some relationship to the NBBO, regardless of which exchange established or currently has liquidity at the NBB or NBO.²⁶ The Exchange also notes that in the event a primary listing market cannot perform a closing auction due to a systems issue, in some circumstances it may determine their official closing price pursuant to contingency procedures that do not utilize a closing auction process. In such case, the official closing price may be either the: (i) 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 applicable securities information processor; or (ii) the last consolidated last-sale-eligible trade for the security during regular trading hours on

²⁵ See Exchange Rule 11.9(c)(9) (Mid-Point Peg Order); see also Nasdaq Rule 4702(b)(5)(A) (Midpoint Peg Post-Only order); NYSE Arca Equities Rule 7.31(h)(3) (Mid-Point Passive Liquidity Orders); EDGX Rule 11.8(d) (MidPoint Peg Orders). What these order types have in common is that their execution prices are derived from the top of book prices of all "Protected Quotations", as such term is defined in Rule 600(b)(58) of Regulation NMS under the Exchange Act.

²⁶ See Exchange Rule 11.9(c)(8); EDGX Rule 11.6(j) (Pegged instruction); Bats EDGA Exchange, Inc. ("EDGA") Rule 11.6(j) (Pegged instruction); Nasdaq Rule 4703(d) (Pegging); and NYSE Arca Rule 7.31(h)(1) and (2) (Primary Pegged Orders and Market Pegged Orders).

that trading day.²⁷ Both of these calculations include executions that may occur on other exchanges, which could be utilizing a single execution reported by another exchange. Therefore, the Exchange believes executing trades at the official closing price disseminated by the primary listing market is consistent with the order types and practices discussed above and does not present any novel issues not already considered by the Commission when those orders types and practices were established.

The proposed rule change will also remove impediments to and perfect the mechanism of a free and open market and a national market system by providing a mechanism for market participants to execute their orders at the official closing price should a system disruption occur on the primary listing market that prevents them from entering orders prior to the Exchange's proposed MOC Cut-Off Time.²⁸ In such case, market participants may send MOC orders to the Exchange prior to the proposed MOC Cut-Off Time to participate in Bats Market Close. The Exchange would, in turn, execute those orders at the official closing price determined by the primary listing market's secondary contingency procedures.²⁹ Therefore, the Exchange believes the proposed rule change would benefit market participants seeking an execution at the official

²⁷ See Exchange Rule 11.23(i); see also Securities Exchange Act Release No. 78015 (June 8, 2016), 81 FR 38747 (June 14, 2016) (SR-NYSE-2016-18) and (SR-NYSEMKT-2016-31) ("OCP Approval Order"). See also Nasdaq Rule 4754(b)(8) and NYSE Arca Rule 1.1(ggP) [sic].

²⁸ For example, on March 20, 2017, NYSE Arca was unable to perform a closing auction in approximately 1,500 of their Exchange Traded Products and cancelled all orders. See *NYSE Arca Suffers Glitch During Closing Auction*, by Asjylyn Loder, Wall Street Journal, March 20, 2017. See also *Headaches for Traders with NYSE Glitch Near Market Close*, by Annie Massa, Bloomberg News, March 21, 2017. Had this systems issue occurred prior to the MOC Cut-Off time as set forth in this proposal, market participants whose orders were cancelled on NYSE Arca could have submitted MOC orders to participate in the proposed Bats Market Close and receive the official closing price determined by the primary listing market's secondary contingency procedures.

²⁹ Id.

closing price where they are unable to enter orders to participate in the primary listing market's closing auction due to a systems issue.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange believes its proposed rule change would not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange believes the proposal would increase competition by offering a competitive alternative to the primary listing markets' closing auction process as requested by market participants. The proposed rule change will promote competition among national securities exchanges in the execution of MOC orders at the official closing price without disrupting the price discovery process performed by the primary listing markets' closing processes. The Exchange 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.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments from Members or other interested parties.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will: (a) by order approve or disapprove such proposed

rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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-BatsBZX-2017-34 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-BatsBZX-2017-34. 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 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-BatsBZX-2017-34, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁰

Eduardo A. Aleman
Assistant Secretary

³⁰ 17 CFR 200.30-3(a)(12).