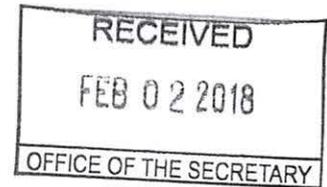




February 2, 2018



Brent J. Fields
Secretary
Securities and Exchange Commission
100 F. Street N.E.
Washington, D.C. 20549-1090

RE: Petition for Review of Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Introduce Cboe Market Close, a Closing Match Process for Non-BZX Listed Securities under New Exchange Rule 11.28; Securities Exchange Act Release No. 82522, File No. SR-BatsBZX-2017-34

Dear Mr. Fields:

Enclosed please find an original and three copies of a corrected Petition for Review regarding the above-captioned matter. NYSE Group, Inc. ("NYSE Group"), on behalf of New York Stock Exchange LLC ("NYSE"), NYSE Arca, Inc., and NYSE American LLC, submits this Petition for Review. Pursuant to Rule 154(c) of the Securities and Exchange Commission's Rules of Practice, NYSE Group certifies that the enclosed Petition for Review is 6,889 words in length, exclusive of table of contents and table of authorities, and comports with the requirements of 17 C.F.R. § 200.154(c). The original Petition for Review was timely filed on January 31, 2018, and this corrected Petition for Review is being hand delivered on February 2, 2018. Also enclosed, please find a Certificate of Service.

Any questions concerning this matter can be directed to me at (212) 656-2475.

Sincerely,

A handwritten signature in black ink that reads "Elizabeth K. King". The signature is written in a cursive style with a large initial "E" and a stylized "K".

Elizabeth K. King

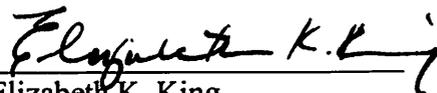
CERTIFICATE OF SERVICE

I, Elizabeth K. King, General Counsel & Secretary of NYSE Group, Inc., hereby certify that on February 2, 2018, I served copies of the attached corrected Petition for Review of the Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Introduce Cboe Market Close, a Closing Match Process for Non-BZX Listed Securities under New Exchange Rule 11.28; Securities Exchange Act Release No. 82522, File No. SR-BatsBZX-2017-34, as indicated below:

Brent J. Fields
Secretary
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Joanne Moffic-Silver
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(via Federal Express Overnight Mail)

Dated: February 2, 2018


Elizabeth K. King
General Counsel & Secretary
NYSE Group

**Before the
SECURITIES AND EXCHANGE COMMISSION**

)	
In the Matter of the Petition of:)	File No. SR-BatsBZX-2017-34
)	
)	
NYSE Group, Inc.)	
)	

PETITION FOR REVIEW

(Corrected Version)

Table of Contents

	<u>PAGE</u>
TABLE OF AUTHORITIES	ii
Applicable Legal Requirements	1
Preliminary Statement	2
Background and Description of the Rule Filing	3
Basis for Commission Discretionary Review of the Order	5
I. Commission Review of the Order is Warranted in View of the Significant Policy Consideration and Questions of Law	5
II. The Proposal Imposes an Unnecessary and Inappropriate Burden on Competition by Misappropriating the Official Closing Price Established by the Listing Exchange	6
III. The Proposal Creates Impediments to, and Fails to Perfect, Mechanisms of a Free and Open Market and National Market System, by Risking Unnecessary Volatility and Disrupting Price Discovery in the Listing Exchange’s Closing Auction	14
IV. The Proposal Is Not Designed to Prevent Fraudulent and Manipulative Acts and Practices, and Creates New Opportunities for Manipulation of the Closing Price	21
CONCLUSION.....	23

TABLE OF AUTHORITIES

STATUTES & RULES

15 U.S.C. 78f(b)(5).....	<i>passim</i>
15 U.S.C. 78f(b)(8).....	3, 6, 14, 23
15 U.S.C. § 78s(b)(2)(C)	6
15 U.S.C. § 78s(b)(2)(C)(ii)	23
17 C.F.R. § 201.411(b)(2)	2, 5
17 C.F.R. § 201.411(b)(2)(C)	5
17 C.F.R. § 201.430.....	1
17 C.F.R. § 201.431.....	1, 2
17 C.F.R. § 201.431(b)(2)	5
17 C.F.R. § 201.700(b)(3)	18
17 C.F.R. § 242.1000.....	9
17 C.F.R. § 242.1001(a)(2)(v).....	9
17 C.F.R. § 242.1002(c)(3).....	9
NYSE Rule 123C.....	4

OTHER AUTHORITIES

Securities Exchange Act Release No. 82522 (January 17, 2018), 83 FR 3205 (January 23, 2018) (order).....	<i>passim</i>
Securities Exchange Act Release No. 81437 (August 18, 2017), 83 FR 40202 (August 24, 2017) (SR-BatsBZX-2017-34)	15, 17
Securities Exchange Act Release No. 81150 (July 14, 2017), 82 FR 33534 (July 20, 2017) (SR-NYSE-2016-71).....	23
Securities Exchange Act Release No. 80683 (May 16, 2017), 82 FR 23320 (May 22, 2017) (SR-BatsBZX-2017-34)	4, 7, 12

Securities Exchange Act Release No. 79284 (November 10, 2016), 81 FR 81222 (November 17, 2016) (SR-NYSE-2016-71).....	23
Disclosure of Order Handling Information, Securities Exchange Act Release No. 78309 (July 13, 2016), 81 FR 49431 (July 27, 2016).....	11
Regulation Systems Compliance and Integrity, Securities Exchange Act Release No. 73639 (November 19, 2014), 79 FR 72251 (December 5, 2014).....	2, 9, 10
Securities Exchange Act Release No. 68629 (January 11, 2013), 78 FR 3928 (January 17, 2013) (SR-NASDAQ-2012-059).....	13
Memorandum to File from DERA to File, Bats Market Close: Off-Exchange Closing Volume and Price Discovery 2 (December 1, 2017).....	16
Frank Chaparro, <i>NYSE and Nasdaq Pump the Brakes on a Proposal to Shake Up Trading at the End of the Day</i> , BUSINESS INSIDER (January 25, 2018)	11

PETITION FOR REVIEW

On January 17, 2018, the Division of Trading and Markets (the “Division”) of the Securities and Exchange Commission (the “Commission”) issued an order (the “Order”)¹ pursuant to delegated authority approving a proposed rule change (the “Proposal”) by Cboe BZX Exchange, Inc. (“BZX”) to adopt a “Cboe Market Close” process. NYSE Group, Inc. (“NYSE Group”), on behalf of New York Stock Exchange LLC (“NYSE”), NYSE Arca, Inc. (“NYSE Arca”), and NYSE American LLC (“NYSE American”), petitions for review of the Order, which would permit a non-listing exchange to (i) unfairly burden competition by misappropriating the closing price determined through the extensive efforts of, and investment by, listing exchanges, (ii) undermine investor confidence in the integrity of the official closing price by disrupting the listing exchange’s closing price-discovery mechanism, and (iii) open up new avenues for potential manipulation of a critical reference price for investors and issuers.

Applicable Legal Requirements

Rules 430 and 431 of the Rules of Practice² provide for Commission review of Division action taken by delegated authority upon request by a person aggrieved by the Division’s action. NYSE, NYSE Arca, and NYSE American are national securities exchanges registered with the Commission and are negatively affected by the Division’s approval of the Proposal. NYSE Group has complied with the procedural requirements contained in Rule 430.³

¹ See Securities Exchange Act Release No. 82522 (January 17, 2018), 83 FR 3205 (January 23, 2018).

² 17 C.F.R. § 201.430-431.

³ NYSE had actual notice of the action on January 17, 2018 and filed a notice of its intent to petition for review on January 24, 2018. See Letter to Brent J. Fields, Secretary, SEC, from Elizabeth K. King, General Counsel and Corporate Secretary, NYSE Group, dated January 24, 2018.

In determining whether to grant review in response to a petition, Rule 431 provides that the Commission must look to the standards set forth in Rule 411(b)(2) of the Rules of Practice, which require the Commission to consider whether the petition for review makes a reasonable showing that (i) a prejudicial error was committed in the conduct of the proceedings or (ii) the decision embodies: (A) a finding or conclusion of material fact that is clearly erroneous; (B) a conclusion of law that is erroneous; or (C) an exercise of discretion or decision of law or policy that is important and that the Commission should review.⁴

Preliminary Statement

As acknowledged by the Division,⁵ the Commission has regularly emphasized the importance of the closing auction conducted by a security's listing exchange, regarding it as "key to the establishment and maintenance of fair and orderly markets," in part because closing prices established in the listing exchange's auction are "commonly used as benchmarks, such as to value derivative contracts and generate mutual fund net asset values."⁶ Because of the importance of this price, it must be accurate and the process through which it is reached must be robust. Further, significant volume seeks to trade at the closing price, with NYSE closing auctions accounting for an average of 6.6% of consolidated volume in NYSE-listed securities in 2017. The Commission, therefore, has great interest in assuring investors that closing prices remain the result of an efficient price discovery mechanism with limited risk of manipulation.

The Proposal would significantly impact the market structure surrounding closing

⁴ 17 C.F.R. § 201.411(b)(2).

⁵ *See, e.g.*, Order, *supra* note 1, at 3211.

⁶ Regulation Systems Compliance and Integrity, Securities Exchange Act Release No. 73639 (November 19, 2014), 79 FR 72251 (December 5, 2014) ("Regulation SCI Adopting Release").

auctions by disrupting the closing auctions conducted by the listing exchange and risking the integrity of those closing auctions, thereby undermining investor and issuer confidence in the closing price. The Proposal would do so while allowing a non-listing exchange to burden competition by selling, as its own, the price resulting from the listing exchange's efforts in conducting closing auctions. As a result, the Proposal raises legal and policy considerations that are important for the Commission to itself consider, rather than delegate to the Division. Further, in finding the Proposal to be consistent with the Securities Exchange Act of 1934 (the "Act"), the Division adopted erroneous conclusions of fact and law warranting Commission review. As outlined in NYSE Group's comment letters,⁷ the Proposal fails to meet several of the standards required of rules of a national securities exchange, as set forth in Sections 6(b)(8) and 6(b)(5) of the Act,⁸ as the Proposal (i) imposes a burden on competition not necessary or appropriate in furtherance of the Act, (ii) is not designed to remove impediments to and perfect the mechanism of a free and open market and a national market system, and (iii) is not designed to prevent fraudulent and manipulative acts and practices.

Background and Description of the Rule Filing

Prior to the close of trading at 4:00 p.m., Eastern Time, listing exchanges undertake an auction process that, at its highest level, involves receiving market-on-close ("MOC") orders that seek to execute at the final closing price, whatever that may be, and limit-on-close ("LOC") orders that seek to execute at the close if the closing price meets a stated price constraint. To

⁷ See Letters to Brent J. Fields, Secretary, SEC, from Elizabeth K. King, General Counsel and Corporate Secretary, NYSE Group: (1) dated June 13, 2017 ("NYSE Letter 1"); (2) dated August 9, 2017 ("NYSE Letter 2"); (3) dated November 3, 2017 ("NYSE Letter 3"); (4) dated January 12, 2018 ("NYSE Letter 4"), each of which are incorporated by reference herein.

⁸ 15 U.S.C. 78f(b)(8); 15 U.S.C. 78f(b)(5).

reduce volatility and maximize the number of shares that successfully match at the close, the listing exchange disseminates information leading into the auction that includes both the size of any imbalance between buy and sell orders and the volume of shares of the relevant security that have been paired off.⁹ Once publicized, this information allows the marketplace to understand the supply and demand for the security and encourages participation to offset any imbalance.

NYSE Group understands that investors, in determining whether to send at-the-close orders (and, for LOC orders, at what price), consider both the size of the imbalance and the volume of orders already matched, as the matched volume gives context to the size of the imbalance (i.e., the same-size 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.¹⁰

On May 5, 2017, BZX filed the Proposal to adopt the Cboe Market Close closing process.¹¹ Cboe Market Close would accept MOC orders in securities listed on other national securities exchanges until 3:35 p.m., Eastern Time. Rather than engage in an exchange function of price discovery or conduct its own auction, BZX would simply pair off an equal number of buy MOCs against sell MOCs and execute them at the official closing price later determined through the efforts and processes of the listing exchange. Any excess buys or sells that could not be paired off would be canceled. BZX would disseminate information regarding the paired-off

⁹ *See, e.g.*, NYSE Rule 123C.

¹⁰ *See, e.g.*, NYSE Letter 1, *supra* note 7, at 4–5.

¹¹ Securities Exchange Act Release No. 80683 (May 16, 2017), 82 FR 23320 (May 22, 2017) (SR-BatsBZX-2017-34) (“BZX Rule Filing”).

volume at 3:35 p.m., Eastern Time, on its proprietary data feed, but would not disclose whether the orders it cancels are on the buy or sell side, although a firm that receives a cancel will know the side of the BZX imbalance. Because its costs in operating Cboe Market Close would always be lower than those of the listing exchange actually performing the closing auction, BZX indicated that it expects to charge fees for Cboe Market Close orders that will, at all times, remain lower than the listing exchange's MOC order fees.¹²

Basis for Commission Discretionary Review of the Order

I. Commission Review of the Order Is Warranted in View of the Significant Policy Consideration and Questions of Law

Rule 431(b)(2) of the Rules of Practice provide that, in determining whether to grant review of an action taken by the Division pursuant to delegated authority, the Commission should consider the factors set forth in Rule 411(b)(2), including whether the Division's action (i) involves the exercise of discretion or decision of law or policy that is important and that the Commission should review, and (ii) reflects erroneous conclusions of fact and law.¹³

The standards for Commission review of the Order are clearly met. A new exchange-sponsored mechanism that is intended to disrupt the market structure of existing closing auctions and that risks undermining investor confidence in the closing price, while permitting a non-listing exchange to compete on fees but not costs, is such an important policy issue that the Commission, rather than the Division, should exercise discretion in determining whether the Proposal is consistent with the Act.¹⁴ This is particularly true given the importance of the

¹² *Id.* at 23321 n.18.

¹³ 17 C.F.R. § 201.431(b)(2).

¹⁴ *See* 17 C.F.R. § 201.411(b)(2)(C).

official closing price to investors and issuers. The significance of the Proposal is reflected in the large number of comment letters from various market participants, including issuers and investors, many of whom expressed concerns about the impact of the Cboe Market Close if it were to be approved.¹⁵

Under Section 19(b)(2)(C) of the Act,¹⁶ the Commission may approve the Proposal only if it is consistent with the requirements of the Act and the rules thereunder applicable to BZX as a national securities exchange. As detailed below, the Division's decision to approve the Proposal reflects erroneous conclusions of fact as to the expected impact of the Proposal, reflects erroneous conclusions of law regarding the standards applicable to the rules of a national securities exchange under Section 6(b) of the Act, and is inconsistent with the Commission's prior interpretations of these standards.

II. The Proposal Imposes an Unnecessary and Inappropriate Burden on Competition by Misappropriating the Official Closing Price Established by the Listing Exchange

Under Section 6(b)(8) of the Act,¹⁷ the rules of a national securities exchange may not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. While BZX claims, and the Division accepted, that the Proposal would enhance competition among exchanges, it does so only as to fees. Crucially, the Proposal is structured so that BZX would be able to compete with lower fees for closing price executions because it would incur none of the costs of generating the closing price. Viewing this activity as enhancing

¹⁵ See, e.g., Order, *supra* note 1, at 3207 n.31 (citing commenters, including institutional investors, expressing concerns regarding the Proposal's impact on price discovery), at 3210 n.75–76 (citing commenters, including exchange-listed companies, expressing concerns regarding the Proposal's impact on an orderly closing).

¹⁶ 15 U.S.C. 78s(b)(2)(C).

¹⁷ 15 U.S.C. 78f(b)(8).

competition is tantamount to viewing a business venture that sells pirated software at a lower price as fairly competing on price with the software company—the pirate can, of course, always sell for less than the producer because it incurs none of the costs of production. The Division suggested, without any detail, other ways in which the Proposal would somehow enhance competition beyond price. But given that the Proposal would merely siphon orders away from the listing market and match them at the closing price established by the listing market, the Proposal presents no new innovation or enhancement to the trading process. Instead, the Proposal minimizes the incentive for true innovation in closing auctions, as actual innovators would incur all the costs while BZX would reap a significant amount of the benefit.

A. *Competition as to Fees*

First and foremost, the Division erred in concluding the Proposal would spur competition as to price, i.e., fees charged by an exchange.¹⁸ If BZX had created a new innovation that permitted it to generate a more accurate closing price at a lower cost, then listing exchanges would be under competitive pressure to reduce their fees to compete with BZX. However, BZX has not found a way to lower the cost of generating the closing price or produced a new method of generating it. Instead, it would simply wait for the listing exchange to conduct its closing auction process, at the listing exchange's cost, and then sell that closing price to BZX members. It is not surprising that BZX expects to offer Cboe Market Close executions at a cost below that of the listing exchange.¹⁹ BZX's cost of providing an execution at the listing exchange's closing

¹⁸ Order, *supra* note 1, at 3222.

¹⁹ BZX Rule Filing, *supra* note 11, at 23321 n.18.

price will always be lower than that of the listing exchange that actually operates the auction to produce that price.²⁰

As described in NYSE Group's comment letters, there are significant regulatory and technology resources and costs dedicated to the processes involved in determining the official closing price of a security, such as providing the systems used by the designated market makers ("DMMs"), developing the systems by which NYSE floor brokers enter and manage their customers' 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.²¹ Since the listing exchange cannot eliminate the costs associated with running a closing auction, it cannot compete on an even playing field with BZX's closing execution price, which does not require BZX to incur these costs.²²

Indeed, part of the reason that BZX is confident that it can, at all times, offer a MOC execution at below the cost charged by the listing exchange, is its ability to arbitrage the

²⁰ BZX itself recognizes that running a closing auction involves costs, as the fees it charges for closing auctions in BZX-listed securities are higher on average than the fees charged by NYSE. See NYSE Letter 1, *supra* note 7, at 9 n.16. Tellingly, BZX would not offer the Cboe Market Close for securities listed on BZX.

²¹ See, e.g., NYSE Letter 2, *supra* note 7, at 2 (describing various functions and costs of operating closing auctions).

²² As discussed in Section III.A below, NYSE Group has concerns that the Proposal would disrupt the price discovery mechanism performed by listing exchanges. Incredibly, 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 1, 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.

Commission’s rules and, in particular, the different resources that the Commission mandates listing markets invest in their closing auctions as compared to the reduced obligations to which the Cboe Market Close would be subject. 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.²³ Regulation SCI considers systems used by a primary listing exchange to support the exchange’s closing process to be “critical SCI systems”²⁴ and thus subject to heightened standards, including “more rigorous policies and procedures for monitoring”²⁵ and “the most robust controls”²⁶ as compared to an SCI entity’s other SCI systems. For example, for critical SCI systems such as closing auctions, a listing exchange must have “business continuity and disaster recovery plans that include maintaining backup and recovery capabilities sufficiently resilient and geographically diverse and that are reasonably designed to achieve next business day resumption of trading and two-hour resumption ... following a wide-scale disruption.”²⁷ Further, any SCI event (as defined in the rule) that could impact a listing exchange’s closing auction would be considered a “major SCI event,” triggering greater obligations than other SCI events.²⁸

As the Commission anticipated, an exchange system designated as a critical SCI system has additional costs as compared to an exchange system designated as a non-critical SCI

²³ Regulation SCI Adopting Release, *supra* note 6, at 72254.

²⁴ 17 C.F.R. § 242.1000 (definition of “critical SCI system”).

²⁵ Regulation SCI Adopting Release, *supra* note 6, at 72257.

²⁶ *Id.* at 72302.

²⁷ 17 C.F.R. § 242.1001(a)(2)(v).

²⁸ 17 C.F.R. § 242.1000 (definition of “major SCI event”); 17 C.F.R. § 242.1002(c)(3) (obligations in the event of certain SCI events).

system.²⁹ For example, because it is a critical SCI system, a listing exchange must maintain a geographically diverse disaster recovery site to ensure resumption within two hours in the event of an outage involving its closing process—a higher standard than applied to other exchange systems. Yet, BZX would not be the primary listing market for securities traded through the Cboe Market Close and so the Cboe Market Close would not appear to be a critical SCI system. As a result, BZX would not have the same level of additional Commission-mandated costs of ensuring its resiliency. The Proposal would allow BZX to pocket these costs savings and then sell the same closing price at a lower rate. Incredibly, the Division ignored these clear differences in costs and obligations *that the Commission itself imposes* on listing exchanges, viewing competition solely through the lens of the final fee charged by an exchange, without considering that parties cannot fairly compete when one side’s costs are necessarily significantly higher, including due to regulatory differences. The Proposal would allow BZX to reap the benefits, but incur none of the costs, of the investment and efforts of listing exchanges, imposing an undue burden on competition inconsistent with the Act.

Notwithstanding the clearly unfair competition that the Proposal would permit, the Division indicated that it was inclined to permit it on the basis that any drawbacks would be outweighed by the “ultimate benefit” to market participants generally.³⁰ But it is not clear that the investors themselves would actually benefit from the Proposal. As the Commission is aware, it is typical for broker-dealers members to pay the fees charged by national securities exchanges,

²⁹ Regulation SCI Adopting Release, *supra* note 6, at 72411 (“the designation of critical SCI systems may result in additional costs as compared to the proposal,” which did not distinguish between different types of SCI systems).

³⁰ Order, *supra* note 1, at 3222.

rather than directly passing those on to ultimate investors.³¹ Indeed, market analysts already predict that any savings generated by routing MOC orders to the Cboe Market Close are likely “to be shared across dozens of broker-dealers that currently route their client trades to Nasdaq’s and NYSE’s closing crosses” but “**are highly unlikely to be passed along to the end institutional or retail investor.**”³²

B. *Competition as to Execution Quality*

Seeking to justify how the Proposal would enhance competition, aside from the dubious claims regarding fee competition discussed above, the Division concluded—without analysis—that the Proposal will inject competition into the closing process, including competition as to “execution quality.”³³ Although the term “execution quality” is not defined, that term is generally understood to refer to considerations such as how well the price achieved for an order compares to certain other market pricing metrics at the time, the speed of execution, fill rates, as well as any potential impact that the execution itself has on market movements subsequent to execution.³⁴

³¹ See, e.g., Disclosure of Order Handling Information, Securities Exchange Act Release No. 78309 (July 13, 2016), 81 FR 49431 (July 27, 2016) at 49439 (“Order Handling Information Disclosure Proposal”) (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).

³² 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) (emphasis Business Insider’s).

³³ Order, *supra* note 1, at 3222.

³⁴ See, e.g., Order Handling Information Disclosure Proposal, *supra* note 31 (proposing amendments to Regulation NMS to require broker-dealer to provide certain execution quality disclosures to customers).

The Division clearly erred in finding that the Proposal would introduce competition as to execution quality for closing orders, as the structure of the proposed Cboe Market Close would offer investors no difference as to execution quality, let alone better execution quality. If functioning as designed, investors sending orders to Cboe Market Close would receive the *exact same* execution price as those sending MOCs to the listing exchange. If anything, execution quality could be worse for investors trading through the Cboe Market Close because an order sent to Cboe Market Close would become irrevocable earlier than if it were sent to the listing exchange, limiting the investor’s ability to react to subsequent market movements.

Rather than competing on execution quality, BZX is likely hoping that it can attract order flow *in spite of* its inferior execution quality. Indeed, the only “value” that BZX points to as being “materially better” than the listing exchange is the lower fee that it could charge.³⁵

C. *Competition Among Execution Services*

In its comment letters, NYSE Group noted concerns that approving the Proposal would allow BZX to unfairly free-ride on the efforts of listing exchanges. In dismissing these concerns, the Division reasoned that the Proposal is merely a “commonplace” example of exchanges competing for order flow by “mimic[king] or build[ing] upon various functionality of their competitors.”³⁶ This reasoning entirely mischaracterizes the Proposal.

NYSE Group agrees that it is appropriate for exchanges to compete for order flow by offering functionality similar to that first introduced by their competitors. Indeed, the competing auctions operated by other exchanges, such as Nasdaq and NYSE Arca, are an example of this appropriate type of competition because they produce independent closing prices through the

³⁵ See BZX Rule Filing, *supra* note 11, at 23322.

³⁶ Order, *supra* note 1, at 3222.

efforts of the exchange actually operating those closing auctions. Investors can determine if they prefer to be guaranteed to trade at the closing price on the listing exchange, or if they prefer the pricing or functionality of a competing closing auction.³⁷ The Proposal, however, is not a competing auction mechanism—it is not an auction and conducts no price discovery. Instead, it entirely relies on the listing exchange’s mechanism, takes its output and sells it as its own.

As a facility to cross unpriced orders by reference to prices established through the closing auction mechanisms of the listing exchanges, the Proposal is similar to services traditionally offered by broker-dealers, not national securities exchanges—a basis the Commission has previously found to disapprove of an exchange’s proposed rule. Specifically, in 2013, the Commission disapproved a Nasdaq proposal to offer certain algorithmic trading services, noting that “NASDAQ’s proposed Benchmark Order is not an exchange order in the traditional sense, in that it would not immediately enter the Exchange’s order book (i.e., NASDAQ Market Center) for potential execution” but instead “is an instruction that would reside outside of the matching engine.”³⁸ The Proposal suffers from the same defect: orders sent to Cboe Market Close would not enter a matching system for continuous trading or a closing auction, but would sit outside of BZX’s book and await the results of the listing exchange’s closing auction.

³⁷ NYSE Group disagrees with BZX’s view that competing auctions are problematic because they offer a price-setting function other than on the listing exchange. 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 would choose to send their orders to the listing exchange.

³⁸ See, e.g., Securities Exchange Act Release No. 68629 at 12 (January 11, 2013), 78 FR 3928, 3931 (January 17, 2013) (SR-NASDAQ-2012-059).

The Proposal suffers from another defect similar to that which the Commission cited in disapproving the Nasdaq Benchmark Order. In that order, the Commission noted the regulatory disparity between Nasdaq as a national securities exchange and the broker-dealers with which it would compete. There, the Commission found that the Nasdaq proposal would be an inappropriate burden on competition inconsistent with Section 6(b)(8) of the Act because broker-dealers must comply with pre-trade risk controls pursuant to the Market Access Rule, to which Nasdaq, as a national securities exchange, was not subject.³⁹ As noted above,⁴⁰ the Proposal has a regulatory disparity that similarly presents an inappropriate burden on competition: Listing exchanges are subject to heightened requirements with respect to their closing auctions under Regulation SCI, obligations that would not apply to BZX.

III. The Proposal Creates Impediments to, and Fails to Perfect, Mechanisms of a Free and Open Market and National Market System, by Risking Unnecessary Volatility and Disrupting Price Discovery in the Listing Exchange’s Closing Auction

A. Impact of MOC Orders on Price Formation

Section 6(b)(5) of the Act requires that the rules of a national securities exchange “be designed ... to remove impediments to and perfect the mechanism of a free and open market and a national market system.”⁴¹ As the Division acknowledges, the Commission has consistently recognized the importance of the closing auctions conducted by the primary listing exchange, and that the Cboe Market Close could be inconsistent with Section 6(b)(5) were it to negatively

³⁹ *Id.* at 8–9.

⁴⁰ *See supra* text accompanying notes 24–29.

⁴¹ 15 U.S.C. 78f(b)(5).

impact “important price discovery functions, or the reliability and integrity of the closing prices” established by the listing exchange.⁴²

Dismissing the analysis and concerns of NYSE Group and other commenters—including issuers and investors⁴³ (the purported beneficiaries of the Proposal)—the Division erroneously concluded that the Proposal would not disrupt the price-discovery process of the listing exchanges’ closing auctions. The Division reached this view on the basis that the Cboe Market Close would only siphon off MOC orders and, in the Division’s view, MOC orders “are recipients of price formation information and do not directly contribute to setting the official closing price.”⁴⁴

However, NYSE Group and Nasdaq submitted data and analysis indicating the manners in which the Cboe Market Close, if successful, could undermine the price-discovery function of its closing auctions and increase volatility.⁴⁵ Yet, the Division inappropriately discounted these analyses because they indicated the Proposal would have the most significant impact on less-liquid stocks.⁴⁶ NYSE Group acknowledges that the Proposal would have the most serious impact on less-liquid stocks. However, it is precisely because less-liquid stocks tend to be more volatile and difficult to price that it is all the more critical that the price-discovery function of the

⁴² Securities Exchange Act Release No. 81437 at 30 (August 18, 2017), 83 FR 40202 (August 24, 2017) (SR-BatsBZX-2017-34) (instituting proceedings to determine whether to approve or disapprove the Proposal) (“Order Instituting Proceedings”).

⁴³ See *supra* note 15.

⁴⁴ Order, *supra* note 1, at 3212.

⁴⁵ NYSE Letter 1, *supra* note 7, at 4–5; NYSE Letter 3, *supra* note 7, at 4; NYSE Letter 4, *supra* note 7.

⁴⁶ Order, *supra* note 1, at 3213.

listing exchange's closing auction be left undisrupted. The Commission should be particularly concerned, rather than dismissive, of the Proposal's impact on price discovery for illiquid stocks.

The Division further inappropriately discounted NYSE Group's analysis on the basis that the analysis reviewed the potential impact of the Proposal siphoning off all MOC orders from the listing exchange. The Division instead assumes that "the more likely scenario" is that the Proposal would only draw away some MOC orders,⁴⁷ because "market participants likely base decisions regarding where to send closing orders not solely on fees, but rather on many other factors, including the reliability, stability, technology and surveillance associated with such auctions."⁴⁸ While the extent to which market participants would actually use the Cboe Market Close, if approved, is uncertain, NYSE Group believes that the Commission must analyze the Proposal on the assumption that the Cboe Market Close is actually used to the fullest extent it is offered. NYSE Group's analysis therefore appropriately assumes the Proposal is successful—as BZX certainly hopes—and the Commission should consider the risks to listing exchanges' price-formation function should that be the case.

B. *The DERA Analysis*

While discounting NYSE Group's analysis, the Division instead relied on an analysis conducted by the Commission's Division of Economic and Risk Analysis ("DERA") which, by DERA's own admission, "does not allow us to predict how the proposed rule change would affect price discovery in the closing auction process."⁴⁹ Notwithstanding DERA's significant

⁴⁷ *Id.* at 3212.

⁴⁸ *Id.*

⁴⁹ Memorandum to File from DERA, Bats Market Close: Off-Exchange Closing Volume and Price Discovery 2, dated December 1, 2017, *available at* https://www.sec.gov/files/bats_moc_analysis.pdf.

caveat, the Division looked to DERA’s analysis of the impact of existing off-exchange MOC order activity to suggest the impact of the Proposal. This is an extremely flawed approach: current off-exchange activity of broker-dealers is not an accurate predictor of the impact of a national securities exchange offering MOC orders priced with reference to the listing exchange’s close. A significantly greater number of investors may be willing to use a competing MOC execution offered through a national securities exchange than through the services of disparate broker-dealers.

NYSE Group submitted comments, including economic analysis, noting the significant deficiencies in DERA’s analysis.⁵⁰ 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.”⁵¹ In doing so, however, the Division seeks to have it both ways—it can forgive the deficiencies in DERA’s analysis because the analysis was “limited” and “not dispositive,” but at the same time rely on the DERA analysis in concluding that “there is no strong evidence” that facilities that match MOC orders by reference to the listing exchange’s closing price negatively impact price discovery.⁵²

The Division also criticized NYSE Group because it did not provide any data or studies employing alternative approaches to DERA’s methodology in response to the Division’s request in the Order Instituting Proceedings.⁵³ However, while NYSE Group did submit the data and

⁵⁰ See NYSE Letter 4, *supra* note 7.

⁵¹ Order, *supra* note 1, at 3215.

⁵² *Id.* at 3216.

⁵³ *Id.* at 3215.

studies it was able to generate in the time available,⁵⁴ BZX does not appear to have itself submitted any such data or studies.⁵⁵ In looking to NYSE Group to disprove BZX's data-free assertions, the Division reversed the burden of proof. As required by Rule 700(b)(3) of the Commission's Rules of Practice, "[t]he burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder that are applicable to the self-regulatory organization is on the self-regulatory organization that proposed the rule change," while the "mere assertion that the proposed rule change is consistent with those requirements ... is not sufficient."⁵⁶ It is therefore BZX, not NYSE Group, that has the burden of proving that the Proposal is designed to remove impediments to, and perfect, the mechanism of a free and open market and a national market system. Yet BZX did no more than assert that the Proposal would not negatively impact listing exchanges' closing auctions, based solely on stating its surface-level view that price discovery on listing exchanges should not be impacted when only MOCs are removed,⁵⁷ without itself providing any supporting data or studies.

Indeed, the Division did not ultimately conclude that the Proposal would *not* have a negative impact on price discovery, but merely noted that BZX has attempted to "mitigate" those

⁵⁴ See *supra* note 45.

⁵⁵ NYSE Group notes that the only data BZX provided appears to be intended to critique the competing auctions conducted by other exchanges, rather than actually indicate that the Proposal is consistent with the Act. See 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 4 and Appendix A.

⁵⁶ 17 C.F.R. § 201.700(b)(3).

⁵⁷ See, e.g., BZX Letter 1, *supra* note 55, at 3; 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 2").

negative effects.⁵⁸ Again reversing the burden and misapplying the law, the Division approved the Proposal on the basis that “there is no strong evidence” that “off-exchange MOC activity negatively impacts the price discovery process” on the listing exchange.⁵⁹ Section 6(b)(5) of the Act requires that exchange rules, including the Proposal, be designed “to remove impediments to and perfect the mechanism of a free and open market and a national market system.”⁶⁰ Instead of requiring that BZX show that this standard is met, the Division was willing to approve the Proposal so long as it did not have strong evidence to the contrary. In approving the Proposal on this basis, the Division appears to have failed to find or determine that the statutory standards *are met*.

C. The Proposal Increases Market Complexity and Operational Risk

Rather than removing impediments to and perfecting the mechanism of a free and open market and a national market system, the Proposal would increase market complexity and operational risk. In an effort to mitigate the Proposal’s negative impact on market participants seeking to analyze the size of matched MOCs on the listing exchange when such orders have been siphoned away by BZX, the Proposal would require BZX to disseminate its paired-off volume at 3:35 p.m., Eastern Time.⁶¹ However, many commenters raised concerns about the addition of another market data feed that would have to be ingested and analyzed by market

⁵⁸ Order, *supra* note 1, at 3217.

⁵⁹ *Id.* at 3216.

⁶⁰ 15 U.S.C. 78f(b)(5).

⁶¹ See BZX Letter 2, *supra* note 57, at 2.

participants seeking to trade in the listing exchange’s closing auction—and the risk that these feeds will multiply as other exchanges adopt a similar mechanism.⁶²

The Division inappropriately dismissed these concerns on the basis that market participants already monitor several market data feeds.⁶³ NYSE Group acknowledges that many market professionals already monitor and analyze market data for purposes of trading during the fragmented continuous trading session. But the stakes are higher in trading during the final minutes leading into the close, and, as one commenter noted, the complications caused by the Proposal would “put even more stress” on the closing auction process.⁶⁴ Further, the Division assumed, without analysis, that the type of market participant that actively trades during the continuous session with access to sophisticated market data aggregation and analytics is the same type of market participant that enters orders into the closing auction.⁶⁵ However, market participants entering on-close orders may be less active during the continuous session and choose to enter on-close orders to take advantage of the consolidated liquidity on the listing exchange at the close. The Proposal would greatly increase the complexity of this process by requiring that these market participants obtain access to, and build systems to analyze, several data feeds, benefiting sophisticated market participants to the detriment of the public.

The Division additionally sought to minimize concern regarding the need to aggregate market data feeds by suggesting that approving the Proposal would only cause “one exchange to

⁶² See Order, *supra* note 1, at 3217.

⁶³ *Id.*

⁶⁴ Letter to Brent J. Fields, Secretary, SEC, from Ari M. Rubenstein, Co-Founder and CEO, GTS Securities LLC, dated June 22, 2017, at 6.

⁶⁵ Order, *supra* note 1, 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”).

disseminate information on one data feed.”⁶⁶ However, it is highly likely, and consistent with precedent that the Division itself noted, that once a functionality is approved for one exchange, many others are likely to mimic it.⁶⁷ In fact, Investors Exchange LLC has already stated that it is considering filing a “similar proposal in the near future.”⁶⁸ 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.

IV. The Proposal Is Not Designed to Prevent Fraudulent and Manipulative Acts and Practices, and Creates New Opportunities for Manipulation of the Closing Price

Section 6(b)(5) of the Act further requires that the rules of a national securities exchange “be designed to prevent fraudulent and manipulative acts and practices.”⁶⁹ Commenters, including NYSE Group, noted the risk that the Proposal would increase the opportunities for and risk of manipulation of the critical closing price, through cross-market activity or as a result of information asymmetries introduced by the Proposal.⁷⁰ For example, a market participant intending to purchase 10,000 shares at the closing price could enter an order to purchase 100,000 shares into the Cboe Market Close. If all 100,000 shares are paired off at 3:35 p.m., that market participant could then enter an order to sell 90,000 shares into the primary listing exchange’s closing auction at 3:45 p.m. The result would be a net purchase of 10,000 shares as intended, but

⁶⁶ *Id.* at n.186.

⁶⁷ *Id.* at 3222 (“[I]t is commonplace for exchanges to attempt to mimic or build upon various functionality of their competitors.”).

⁶⁸ Letter to Brent J. Fields, Secretary, SEC, from John Ramsay, Chief Market Policy Officer, IEX, dated June 23, 2017, at 1.

⁶⁹ 15 U.S.C. 78f(b)(5).

⁷⁰ *See Order, supra* note 1, at 3218.

the large size of the sell order entered in the listing exchange's auction could push the closing price down so that the 10,000 shares would be executed at an artificially lower price.⁷¹

As noted in NYSE Group's comment letters,⁷² detecting this sort of manipulation presents unique challenges due to the time difference between the Cboe Market Close and the primary market close.⁷³ It may be difficult to tell, for example, whether the decision to enter a trade into the Cboe Market Close at 3:35 p.m. and then to place an opposite-way trade on the listing exchange at 3:45 p.m. was the result of attempted manipulation or a bona fide change of an investment decision due to intervening events.

Instead of requiring that BZX address these risks of manipulation, the Division accepted BZX's commitment to "enhance" its surveillance mechanisms and work with other self-regulatory organizations to detect and prevent inappropriate trading activity⁷⁴ and noted that self-regulatory organizations already have obligations to surveil for manipulative activity.⁷⁵ But the fact that these obligations already exist is not enough to satisfy—and effectively reads out of the Act—the requirement that exchange rules be designed to prevent fraudulent activity. If that were the case, any proposed exchange rule, no matter the risk of manipulation it creates, would be consistent with the Act. The Commission has, in fact, taken *precisely the opposite position* in the past. For example, NYSE recently proposed to eliminate certain restrictions on the trading

⁷¹ See NYSE Letter 4, *supra* note 7, Assessment of DERA Study at 19; NYSE Letter 1, *supra* note 7, at 6–7 (detailing other potential manipulation scenarios that could result from the Proposal).

⁷² NYSE Letter 1, *supra* note 7, at 6.

⁷³ *Id.* at 7.

⁷⁴ Order, *supra* note 1, at 3220.

⁷⁵ *Id.*

activities of DMMs that were originally designed to address the risk of manipulative activity by DMMs, but that had become unnecessary and outdated in light of changes to the market structure and NYSE's other safeguards to detect manipulative activity.⁷⁶ The Commission disapproved the proposal on the basis that the existence of other anti-manipulation rules and existing surveillance systems are not an adequate substitute for a bright-line rule that would avoid the risk of the manipulative activity occurring in the first place.⁷⁷ Yet, in approving the Proposal, the Division embraces the exact analysis it rejected just last year.

CONCLUSION

For the foregoing reasons, NYSE Group respectfully requests that the Commission grant review of the Order in light of the important policy decisions it embodies and the significant erroneous conclusions of material fact and law it reflects. Further, NYSE Group requests that the Commission ultimately disapprove the Proposal as required under Section 19(b)(2)(C)(ii) of the Act,⁷⁸ as the Proposal is inconsistent with 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 thereunder.⁷⁹

⁷⁶ Securities Exchange Act Release No. 79284 (November 10, 2016), 81 FR 81222 (November 17, 2016) (SR-NYSE-2016-71).

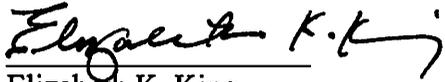
⁷⁷ Securities Exchange Act Release No. 81150 (July 14, 2017), 82 FR 33534 (July 20, 2017) (SR-NYSE-2016-71) at 33537.

⁷⁸ 15 U.S.C. § 78s(b)(2)(C)(ii).

⁷⁹ 15 U.S.C. 78f(b)(8); 15 U.S.C. 78f(b)(5).

DATED: February 2, 2018

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Elizabeth K. King". The signature is written in a cursive style with a horizontal line underneath the name.

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