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December 8, 2017

Via Electronic Mail (rule-comments@sec.gov)

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

Re: File No. SR-BatsBZX-2017-34; 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

Dear Mr. Fields:

The Securities Industry and Financial Markets Association ("SIFMA")[1] submits this letter to the Securities and Exchange Commission ("Commission") to provide further comments on the above-referenced proposed rule change filed by Bats BZX Exchange, Inc. (now known as Cboe BZX Exchange, Inc.) (the "Exchange") to introduce Bats Market Close, a closing match process for non-BZX Listed Securities. SIFMA continues to support the proposal.[2] The purpose of this letter is to request that, as a condition of any Commission approval of the proposal:

(1) The Exchange and the Commission clarify in writing that Bats Market Close would not be entitled to any application of regulatory immunity; and
(2) The Exchange amend its limitations on liability to specifically provide that Bats Market Close would not be subject to the monetary limits currently set out in the Exchange's Rule 11.16.

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[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] *See* Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA to Brent J. Fields, Secretary, Securities and Exchange Commission dated June 13, 2017; s*ee also* Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA to Brent J. Fields, Secretary, Securities and Exchange Commission dated August 18, 2017.

SIFMA has noted previously that national securities exchanges serve two specific roles under the Securities Exchange Act of 1934 ("Exchange Act"). First, exchanges serve as market participants through the exchange function. In this regard, the Exchange is a for-profit commercial entity and part of a publicly-traded corporation. Second, exchanges act as market regulators through the self-regulatory organization ("SRO") function. As registered entities, exchanges are regulated by the Commission with respect to their functions as market participants, including securities trading, dissemination of transaction information, and listing of securities. As SROs, exchanges have the ability to regulate the conduct of their member firms, subject to Commission oversight.

Over the years, exchanges have benefitted from two legal protections against financial liability, namely the judicial doctrine of regulatory immunity and the Commission-approved limitations on liability in exchange rules. As we describe below, neither of these legal protections should apply to the Bats Market Close proposal.

Regulatory Immunity

As the Commission is aware, there is a body of case law that provides SROs with immunity from lawsuits in limited situations involving the specific discharge of their responsibilities as SROs.[3] However, the courts have extended this immunity to SROs only because they "stand in the shoes" of the Commission[4] to perform a variety of regulatory functions that would otherwise be performed by the Commission.[5] As one court has noted, an SRO is entitled to immunity "when it engages in conduct consistent with the quasi-governmental powers delegated to it pursuant to the Exchange Act and the regulations and rules thereunder."[6] In addition, courts considering these cases have stated that the extension of regulatory immunity is to be evaluated on a case-by-case basis, depending upon the nature of the governmental function being performed.[7] One court in particular has stated that SROs "do not enjoy complete immunity from suits; it is only when they are acting under the aegis of the Exchange Act's delegated authority that they so qualify. When conducting private business, they remain subject to liability."[8] In 2012, SIFMA argued for the correct application of regulatory immunity when Nasdaq claimed that regulatory immunity applied to losses caused by its systems issues during the Facebook IPO.[9]

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3 *See, e.g.*, DL Capital Group, LLC v. Nasdaq Stock Mkt., Inc., 409 F.3d 93, 96 (2d Cir. 2005); *see also*D'Alessio v. NYSE, Inc., 258 F.3d 93, 105 (2d Cir. 2001); Sparta Surgical Corp. v. National Ass'n of Securities Dealers, Inc., 159 F.3d 1209 (9th Cir. 1998); Barbara v. NYSE, 99 F.3d 49, 50 (2d Cir. 1996).

4 *See* D'Alessio.

5 *See* DL Capital Group¸409 F.3d at 97

6 *Id.*

7 *See, e.g.*, D'Alessio, 258 F.3d at 104-105

8 Sparta, supra note 3

9 *See* Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission dated August 22, 2012.

The Commission provided its own view on the application of regulatory immunity in a recent amicus brief to the U.S. Court of Appeals for the Second Circuit. In that brief, the Commission clearly stated that regulatory immunity is "properly afforded to the exchanges when they are engaged in their traditional self-regulatory functions—in other words, when the exchanges are acting as regulators of their members." The Commission also stated that regulatory immunity "does not properly extend to functions performed by an exchange itself in the operation of its own market, or to the sale of products and services arising out of those functions…" In summary, the Commission stated that "when an exchange is operating its own market and engaging in its own conduct pursuant to Commission regulation, it is acting as a regulated entity—not a regulator of others. Although the latter warrants immunity, the former does not."[10]

Bats Market Close would be part of the operation of the Exchange's market and would not involve the Exchange acting as a regulator of others. In fact, the Bats Market Close function would be essentially identical to functions currently provided by broker-dealers as competitive execution services. There should be no colorable argument by the Exchange that the Bats Market Close function should be protected by regulatory immunity. Instead, the Bats Market Close function would be an exchange function regulated by the Commission, not an SRO function in which the Exchange is regulating members. Accordingly, as a condition to any Commission approval of the proposal, the Exchange should acknowledge, and the Commission should affirm, that the Exchange would not be entitled to apply regulatory immunity for any losses arising from the Bats Market Close function.

Limitations on Liability

Exchanges benefit from Commission-approved, rules-based limitations on liability. For example, the Exchange's Rule 11.16 limits liability to $100,000 for any claim by a single member on a single trading day, $250,000 for claims by all members on a single trading day, and $500,000 for claims by all members during a single calendar month. In addition, these limits are legally protected and strictly enforced through the Commission's approval of the exchanges' rulebooks and through the statutory requirement that exchanges comply with their own rules.[11] If an exchange wants to provide compensation beyond the scope of its limitation of liability, the

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[10] The Commission raised similar concerns in disapproving a commercial proposal by Nasdaq to offer algorithmic trading services in 2013. In that case, the Commission based its disapproval in part on the fact that "Nasdaq [did] not respond to concerns raised by SIFMA with any substantive analysis of whether regulatory immunity, or exchange rules limiting liability, in the context of Nasdaq's proposal to offer a service traditionally provided by broker-dealers, would impose an undue burden on competition under the [Exchange] Act." Securities Exchange Act Release No. 68629 (January 11, 2013), 78 FR 3928 (January 17, 2013). *See also* Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission dated October 5, 2012.

[11] *See* Exchange Act § 19(g)(1).

Commission has to specifically approve the compensation and the terms of the payment.[12] Even more problematic than absolute immunity, the limits on liability apply without regard to the regulatory or commercial nature of the activity involved.

Should a broker-dealer wish to limit its potential liability, it must negotiate the limitation with a customer. A customer can reject any requested limitation, or take its business elsewhere if an agreement cannot be reached. In addition, a broker-dealer's contractual limitation on liability is always subject to being overturned in litigation. In contrast, by adopting limitations in their rulebooks, exchanges are able to unilaterally impose their limits on anyone doing business on the exchange. This creates a fundamental and untenable regulatory disparity: Regulation NMS requires broker-dealers to route orders to the exchange displaying the best available quotation. A broker-dealer is therefore legally obligated to do business with an exchange, even if the broker-dealer would not willingly accept the exchange's limitation on liability.

The Exchange's limits under Rule 11.16 limits bear no relation to the actual amount of financial loss that could result from an exchange malfunction. This disparity is particularly acute in connection with a service such as Bats Market Close, which broker-dealers also perform with no limitation on liability. As a condition of operating this service, the Exchange should be required to carve out Bats Market Close from its limitations on liability under the Exchange's Rule 11.16.

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SIFMA greatly appreciates the Commission's consideration of the issues raised above and would be pleased to discuss these comments in greater detail with the Commission and the Staff. If you have any questions, please contact me (at [redacted] or [redacted]).

Sincerely,

Theodore R. Lazo
Managing Director and
Associate General Counsel

cc: The Honorable Jay Clayton, Chairman
The Honorable Michael S. Piwowar, Commissioner

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[12] *See* Exchange Act Release No. 69216 (Mar. 22, 2013) (order approving NASDAQ "accommodation" payments relating to Facebook IPO in excess of its liability limitation).

The Honorable Kara M. Stein, Commissioner

Brett Redfearn, Director, Division of Trading and Markets
Gary Goldsholle, Deputy Director, Division of Trading and Markets
David S. Shillman, Associate Director, Division of Trading and Markets