

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-65913; File No. SR-NASDAQ-2011-163)

December 8, 2011

Self-Regulatory Organizations; NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to the Options Regulatory Fee

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 28, 2011, The NASDAQ Stock Market LLC (“NASDAQ” or “Exchange”) 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 proposes to institute a new transaction-based “Options Regulatory Fee” and eliminate registered representative fees for NASDAQ members using the NASDAQ Options Market (“NOM”), NASDAQ’s facility for executing and routing standardized equity and index options.

While fee changes pursuant to this proposal are effective upon filing, the Exchange has designated these changes to be operative on January 3, 2012.

The text of the proposed rule change is set forth below. Proposed new text is underlined and deleted text is in brackets.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

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### **7003. Registration and Processing Fees**

(a) The following fees will be collected and retained by FINRA via the Web CRD registration system for the registration of associated persons of Nasdaq members that are not also FINRA members:

(1) \$85 for each initial Form U4 filed for the registration of a representative or principal;

(2) \$95 for the additional processing of each initial or amended Form U4 or Form U5 that includes the initial reporting, amendment, or certification of one or more disclosure events or proceedings;

(3) \$30 annually for each of the member's registered representatives and principals for system processing;

(4) \$13 for processing and posting to the CRD system each set of fingerprints submitted by the member, plus a pass-through of any other charge imposed by the United States Department of Justice for processing each set of fingerprints;

(5) \$13 for processing and posting to the CRD system each set of fingerprint results and identifying information that has been processed through a self-regulatory organization other than NASD; and

(6) a \$75 session fee for each individual who is required to complete the Regulatory Element of the Continuing Education Requirements pursuant to Nasdaq Rule 1120.

(b) The following fees will be collected via the Web CRD registration system for the registration of associated persons of Nasdaq members:\*

(1) \$55 for each initial Form U4 filed for the registration of a representative or principal.

(2) \$55 for each registration U4 transfer or re-licensing of a representative or principal.

\* NOM Participants that do not transact an equities business on the NASDAQ Stock Market LLC are not subject to the fees in Rule 7003(b).

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### **7059. NASDAQ Options Regulatory Fee**

NOM Participants will be assessed an Options Regulatory Fee of \$0.0015 per contract.\*

\* Effective January 2, 2012, the Options Regulatory Fee will be assessed by NOM to each NOM Participant for all options transactions executed or cleared by NOM Participant that are cleared by The Options Clearing Corporation (OCC) in the customer range regardless of the exchange on

which the transaction occurs. The Options Regulatory Fee is collected indirectly from NOM Participants through their clearing firms by OCC on behalf of NOM. NOM Participants who do not transact an equities business on the NASDAQ Stock Market LLC in a calendar year will receive a refund of the fees specified in Rule 7003(b) upon written notification to the Exchange along with documentation evidencing that no equities business was conducted on the NASDAQ Stock Market for that calendar year. The Exchange will accept refund requests up until sixty (60) days after the end of the calendar year.

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The text of the proposed rule change is available on the Exchange's Website at <http://www.nasdaq.cchwallstreet.com>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

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 aspects of such statements.

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

1. Purpose

NASDAQ is proposing to amend Rule 7003 entitled "Registration and Processing Fees" to eliminate its registered representative fees for NOM Participants and also create a new Rule 7059 entitled "NASDAQ Options Regulatory Fee" to institute a new transaction-based Options Regulatory Fee.

Each Options Participant that registers an options principal and/or representative who is conducting business on NOM is assessed a registered representative fee ("RR Fee") based on the

action associated with the registration. There are annual fees as well as initial, transfer and termination fees. RR Fees as well as other regulatory fees collected by the Exchange were intended to cover only a portion of the cost of the Exchange's regulatory programs. Prior to recent rule changes by other options exchanges such as the Chicago Board Options Exchange, Incorporated ("CBOE"), NASDAQ OMX PHLX, LLC ("Phlx"), the International Securities Exchange, LLC ("ISE"), NYSE Arca, Inc. ("NYSEArca") and NYSE AMEX LLC ("NYSEAmex") and NASDAQ OMX BX, Inc. ("BX"), all options exchanges, regardless of size, charged registered representative fees.

The Exchange believes that the current RR Fee is no longer equitable given changes among option market participants. The options industry has evolved to a structure with many more Internet-based and discount brokerage firms. These firms have few registered representatives and thus pay very little in RR Fees compared to full service brokerage firms that have many registered representatives. Further, due to the manner in which RR Fees are charged, it is possible for a NOM Participant to restructure its business to avoid paying these fees altogether. A firm can avoid RR Fees by terminating its options participant status and sending its business to NOM through another separate NOM Participant, even an affiliated firm that has many fewer registered representatives. If firms terminated their options participant status to avoid RR Fees, the Exchange would suffer the loss of a source of funding for its regulatory programs. More importantly, the regulatory effort the Exchange expends to review the transactions of each type of firm is not commensurate with the number of registered representatives that each firm employs.

In order to address the inequity of the current regulatory fee structure and to offset more fully the cost of the Exchange's regulatory programs pertaining to NOM, the Exchange proposes

to eliminate the current RR Fee for NOM Participants and adopt an Options Regulatory Fee (“ORF”) of \$0.0015 per contract. All participants will continue to be assessed the RR Fee in Exchange Rule 7003(b),<sup>3</sup> however, NOM Participants that do not transact an equity business on the NASDAQ Stock Market during the applicable year, will receive a refund of the RR fees collected through CRD, specifically the fees specified in Rule 7003(b). The NOM Participant would solely conducted an options business would be refunded the RR Fees at the end of the first quarter of the following year. For example, a NOM Participant that does not transact an equity business on NASDAQ Stock Market during the calendar year would be entitled to a refund of its RR Fees.<sup>4</sup> The Exchange would refund these fees upon written notification to the Exchange and documentation evidencing that no equity business was conducted on the NASDAQ Stock Market for that calendar year. The Exchange will accept refund requests up until sixty (60) days after the end of the calendar year.

The ORF would be assessed by the Exchange to each NOM Participant for all options transactions executed or cleared by the NOM Participant that are cleared by The Options Clearing Corporation (“OCC”) in the customer range, i.e., transactions that clear in the customer account of the NOM Participant’s clearing firm at OCC, regardless of the marketplace of execution. In other words, the Exchange would impose the ORF on all options transactions executed by a NOM Participant, even if the transactions do not take place on NOM.<sup>5</sup> The ORF

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<sup>3</sup> The RR fee would still apply to those NOM Participants that also conduct business on the NASDAQ Stock Market equities trading platform. See Exchange Rule 7003.

<sup>4</sup> This would include the \$55 fee for initial Form U4s filed for the registration of a representative or principal and the \$55 fee for each registration U4 transfer or re-licensing of a representative or principal.

<sup>5</sup> The ORF would apply to all customer orders executed by a NOM Participant on NOM. Exchange rules require each NOM Participant to submit trade information in order to allow the Exchange to properly prioritize and match orders and quotations and report resulting transactions to the OCC. See Exchange Rules Chapter V, Section 7. The

would also be charged for transactions that are not executed by a NOM Participants but are ultimately cleared by a NOM Participant. In the case where a NOM Participant executes a transaction and a NOM Participant clears the transaction, the ORF would be assessed to the NOM Participant who executed the transaction. In the case where a non-NOM Participant executes a transaction and a NOM Participant clears the transaction, the ORF would be assessed to the NOM Participant who clears the transaction. As noted, the ORF would replace RR Fees, which relate to a NOM Participant's options customer business. Further, RR Fees constituted the single-largest fee assessed that is related to NOM customer trading activity (in that NOM generally does not charge customer transaction fees), and the Exchange believes it is appropriate to charge the ORF only to transactions that clear as customer at the OCC. The Exchange believes that its broad regulatory responsibilities with respect to NOM Participants' activities supports applying the ORF to transactions cleared but not executed by a NOM Participant. The Exchange's regulatory responsibilities are the same regardless of whether a NOM Participant executes a transaction or clears a transaction executed on its behalf. The Exchange regularly reviews all such activities, including performing surveillance for position limit violations, manipulation, frontrunning, contrary exercise advice violations and insider trading.<sup>6</sup> These activities span across multiple exchanges.

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Exchange represents that it has surveillances in place to verify that NOM Participants comply with the Rule.

<sup>6</sup> The Exchange also participates in The Options Regulatory Surveillance Authority ("ORSA") national market system plan and in doing so shares information and coordinates with other exchanges designed to detect the unlawful use of undisclosed material information in the trading of securities options. ORSA is a national market system comprised of several self-regulatory organizations whose functions and objectives include the joint development, administration, operation and maintenance of systems and facilities utilized in the regulation, surveillance, investigation and detection of the unlawful use of undisclosed material information in the trading of securities options. The Exchange compensates ORSA for the Exchange's portion of the cost to perform insider

The Exchange believes the initial level of the fee is reasonable because it relates to the recovery of the costs of supervising and regulating NOM Participants. The Exchange believes the amount of the ORF is fair and reasonably allocated because it is a closer approximation to the Exchange's actual costs in administering its regulatory program. The ORF would be collected indirectly from NOM Participants through their clearing firms by OCC on behalf of the Exchange. The Exchange expects that NOM Participants will pass-through the ORF to their customers in the same manner that firms pass-through to their customers the fees charged by Self Regulatory Organizations ("SROs") to help the SROs meet their obligations under Section 31 of the Exchange Act.

The ORF is designed to recover a material portion of the costs to the Exchange of the supervision and regulation of NOM Participants, including performing routine surveillances, investigations, as well as policy, rulemaking, interpretive and enforcement activities.<sup>7</sup> The Exchange believes that revenue generated from the ORF, when combined with all of the Exchange's other regulatory fees, will cover a material portion, but not all, of the Exchange's regulatory costs. At present, RR Fees make up the largest part of the Exchange's total options regulatory fee revenue, however, the total amount of NOM specific regulatory fees collected by the Exchange is significantly less than the regulatory costs incurred by NOM on an annual basis. The Exchange notes that its regulatory responsibilities with respect to NOM Participant compliance with options sales practice rules have been allocated to FINRA under a 17d-2 agreement. The ORF is not designed to cover the cost of options sales practice regulation.

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trading surveillance on behalf of the Exchange. The ORF will cover the costs associated with the Exchange's arrangement with ORSA.

<sup>7</sup> As stated above, the RR Fees collected by the Exchange were originally intended to cover only a portion of the cost of the Exchange's regulatory programs.

The Exchange would monitor the amount of revenue collected from the ORF to ensure that it, in combination with its other NOM regulatory fees and fines, does not exceed the Exchange's total regulatory costs. The Exchange expects to monitor NOM regulatory costs and revenues at a minimum on an annual basis. If the Exchange determines NOM regulatory revenues exceed regulatory costs, the Exchange would adjust the ORF by submitting a fee change filing to the Commission. The Exchange would notify NOM Participants of adjustments to the ORF via a Regulatory Information Circular.

The Exchange believes the proposed ORF is equitably allocated because it would be charged to all NOM Participants on all their customer options business. This is because of the amount of resources required by the Exchange to regulate non-customer trading activity, which is significantly less than the amount of resources the Exchange must dedicate to regulate customer trading activity. The ORF seeks to recover the costs of supervising and regulating members, including performing routine surveillances, investigations, examinations, financial monitoring, and policy, rulemaking, interpretive, and enforcement activities. The Exchange believes the proposed ORF is reasonable because it will raise revenue related to the amount of customer options business conducted by NOM Participants, and thus the amount of Exchange regulatory services those NOM Participants will require, instead of how many registered representative a particular NOM Participant employs.<sup>8</sup>

As a fully-electronic exchange without a trading floor, the amount of resources required by the Exchange to regulate non-customer trading activity is significantly less than the amount of resources the Exchange must dedicate to regulate customer trading activity. This is because

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<sup>8</sup> The Exchange expects that implementation of the proposed ORF will result generally in many traditional brokerage firms paying less regulatory fees while Internet and discount brokerage firms will pay more.

regulating customer trading activity is much more labor intensive and requires greater expenditure of human and technical resources than regulating non-customer trading activity, which tends to be more automated and less labor-intensive. As a result, the costs associated with administering the customer component of the Exchange's overall regulatory program are materially higher than the costs associated with administering the non-customer component (e.g., market maker) of its regulatory program.

The Exchange believes it is reasonable and appropriate for the Exchange to charge the ORF for options transactions regardless of the exchange on which the transactions occur. The Exchange has a statutory obligation to enforce compliance by NOM Participants and their associated persons with the Exchange Act and the Rules of the Exchange and to surveil for other manipulative conduct by market participants (including non-NOM Participants) trading on the Exchange. The Exchange cannot effectively surveil for such conduct without looking at and evaluating activity across all options markets. Many of the Exchange's market surveillance programs require the Exchange to look at and evaluate activity across all options markets, such as surveillance for position limit violations, manipulation, frontrunning and contrary exercise advice violations/expiring exercise declarations.<sup>9</sup> Also, the Exchange and the other options exchanges are required to populate a consolidated options audit trail ("COATS") system in order to surveil NOM Participant activities across markets.<sup>10</sup>

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<sup>9</sup> The Exchange and other options SROs are parties to a 17d-2 agreement allocating among the SROs regulatory responsibilities relating to compliance by the common members with rules for expiring exercise declarations, position limits, OCC trade adjustments, and Large Option Position Report reviews. See Securities Exchange Act Release No. 63430 (December 3, 2010), 75 FR 76758 (December 9, 2010).

<sup>10</sup> COATS effectively enhances intermarket options surveillance by enabling the options exchanges to reconstruct the market promptly to effectively surveil certain rules.

-In addition to its own surveillance programs, the Exchange works with other SROs and exchanges on intermarket surveillance related issues. Through its participation in the Intermarket Surveillance Group (“ISG”),<sup>11</sup> the Exchange shares information and coordinates inquiries and investigations with other exchanges designed to address potential intermarket manipulation and trading abuses. The Exchange’s participation in ISG helps it to satisfy the Exchange Act requirement that it have coordinated surveillance with markets on which security futures are traded and markets on which any security underlying security futures are traded to detect manipulation and insider trading.<sup>12</sup>

The Exchange believes that charging the ORF across markets will avoid having NOM Participants direct their trades to other markets in order to avoid the fee and to thereby avoid paying for their fair share of regulation. If the ORF did not apply to activity across markets then NOM Participants would send their orders to the least cost, least regulated exchange. Other exchanges could impose a similar fee on their member’s activity, including the activity of those members on NOM. In addition to the ORF that is currently in place at other exchanges,<sup>13</sup> the Exchange notes that there is established precedent for an SRO charging a fee across markets, namely, FINRA’s Trading Activity Fee.<sup>14</sup> While the Exchange does not have all the same

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<sup>11</sup> ISG is an industry organization formed in 1983 to coordinate intermarket surveillance among the SROs by cooperatively sharing regulatory information pursuant to a written agreement between the parties. The goal of the ISG’s information sharing is to coordinate regulatory efforts to address potential intermarket trading abuses and manipulations.

<sup>12</sup> See Exchange Act Section 6(h)(3)(I).

<sup>13</sup> See other options exchanges such as the Chicago Board Options Exchange, Incorporated (“CBOE”), NASDAQ OMX PHLX, LLC (“Phlx”), the International Securities Exchange, LLC (“ISE”), NYSE Arca, Inc. (“NYSEArca”) and NYSE AMEX LLC (“NYSEAmex”) and NASDAQ OMX BX, Inc. (“BX”), all options exchanges, regardless of size, charged registered representative fees.

<sup>14</sup> See Securities Exchange Act Release No. 47946 (May 30, 2003), 68 FR 3402 (June 6, 2003).

regulatory responsibilities as FINRA, the Exchange believes that, like the other exchanges that assess an ORF, its broad regulatory responsibilities with respect to NOM Participants' activities, irrespective of where their transactions take place, supports a regulatory fee applicable to transactions on other markets. Unlike FINRA's Trading Activity Fee, the ORF would apply only to a NOM Participant's customer options transactions.

While fee changes pursuant to this proposal are effective upon filing, the Exchange has designated these changes to be operative on January 3, 2012.

## 2. Statutory Basis

NASDAQ believes that the proposed rule changes are consistent with the provisions of Section 6 of the Act,<sup>15</sup> in general, and with Section 6(b)(4) of the Act,<sup>16</sup> in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system which NASDAQ operates or controls.

In particular, the Exchange believes the ORF is objectively allocated to NOM Participants because it would be charged to all NOM Participants on all their transactions that clear as customer at the OCC. RR Fees constituted the single-largest fee assessed that is related to NOM customer trading activity (in that NOM generally does not charge customer transaction fees), and the Exchange believes it is appropriate to charge the ORF only to transactions that clear as customer at the OCC. In addition, the Exchange is assessing higher fees to those Participants that require more Exchange regulatory services based on the amount of customer options business they conduct. As a fully-electronic exchange without a trading floor, the amount of resources required by the Exchange to regulate non-customer trading activity is significantly less than the amount of resources the Exchange must dedicate to regulate customer

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<sup>15</sup> 15 U.S.C. 78f.

<sup>16</sup> 15 U.S.C. 78f(b)(4).

trading activity. This is because regulating customer trading activity is much more labor intensive and requires greater expenditure of human and technical resources than regulating non-customer trading activity, which tends to be more automated and less labor-intensive.

Moreover, the Exchange believes the ORF ensures fairness by assessing higher fees to those NOM Participants that require more Exchange regulatory services based on the amount of customer options business they conduct. The ORF seeks to recover the costs of supervising and regulating Participants including performing routine surveillances, investigations, examinations, financial monitoring, and policy, rulemaking, interpretive, and enforcement activities. The Exchange's regulatory responsibilities are the same regardless of whether a NOM Participant executes a transaction or clears a transaction executed on its behalf. The Exchange believes that this proposal is reasonable, equitable and not unfairly [sic] for the foregoing reasons and also because this proposal would remove the inequity of the current regulatory fee structure<sup>17</sup> and offset more fully the cost of the Exchange's regulatory programs.

The Commission has addressed the funding of an SRO's regulatory operations in the Concept Release Concerning Self-Regulation<sup>18</sup> and the release on the Fair Administration and Governance of Self-Regulatory Organizations.<sup>19</sup> In the Concept Release, the Commission states

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<sup>17</sup> As discussed herein, the options industry has evolved to a structure with many more Internet-based and discount brokerage firms. These firms have few registered representatives and thus pay very little in RR Fees compared to full service brokerage firms that have many registered representatives. Further, due to the manner in which RR Fees are charged, it is possible for a NOM Participant to restructure its business to avoid paying these fees altogether. A firm can avoid RR Fees by terminating its options participant status and sending its business to NOM through another separate NOM Participant, even an affiliated firm that has many fewer registered representatives.

<sup>18</sup> See Securities Exchange Act Release No. 50700 (November 18, 2004), 69 FR 71256 (December 8, 2004) ("Concept Release").

<sup>19</sup> See Securities Exchange Act Release No. 50700 (November 18, 2004), 69 FR 71256 (December 8, 2004) ("Concept Release"). [sic]

that: “Given the inherent tension between an SRO’s role as a business and a regulator, there undoubtedly is a temptation for an SRO to fund the business side of its operations at the expense of regulation.”<sup>20</sup> In order to address this potential conflict, the Commission proposed in the Governance Release rules that would require an SRO to direct monies collected from regulatory fees, fines, or penalties exclusively to fund the regulatory operations and other programs of the SRO related to its regulatory responsibilities.<sup>21</sup> The Exchange has designed the ORF to generate revenues that would recover a material portion of NOM’s regulatory costs, which is consistent with the Commission’s view that regulatory fees be used for regulatory purposes and not to support the Exchange’s business side.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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

No written comments were either solicited or received.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>22</sup> and paragraph (f)(2) of Rule 19b-4<sup>23</sup> thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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<sup>20</sup> Concept Release at 71268.

<sup>21</sup> Governance Release at 71142.

<sup>22</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>23</sup> 17 CFR 240.19b-4(f)(2).

#### 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](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2011-163 on the subject line.

##### Paper comments:

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

All submissions should refer to File Number SR-NASDAQ-2011-163. 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 such 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 publicly available. All submissions should refer to File Number SR-NASDAQ-2011-163 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.<sup>24</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>24</sup> 17 CFR 200.30-3(a)(12).