Joan C. Conley
Senior Vice President and Corporate Secretary
805 King Farm Boulevard,
Rockville, MD 20850
[redacted]

May 24, 2016

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

Re: SEC Equity Market Structure Advisory Committee (File No. 265-29)

Dear Mr. Fields:

Nasdaq, Inc. ("Nasdaq") thanks the Equity Market Structure Advisory Committee ("Committee") to the Securities and Exchange Commission ("SEC" or "Commission") for providing Nasdaq the opportunity to comment on recommendations made by the Regulation NMS and the Trading Venues Regulation Subcommittees of the Committee, which were made public on April 19, 2016. We thank the members of the subcommittees for their significant time and effort in formulating initial recommendations for the public to begin to debate and discuss.

As we have previously stated, however, we regret that the Committee and subcommittees do not include a full spectrum of critical market participants. As a result, the recommendations are not the result of a fulsome debate among an appropriately diverse group of market participants in the capital markets. In order for a comprehensive range of facts and opinions to be included in the Commission's deliberative process, the debate will now have to be played out through public comment letters, rather than in the dialogue that was afforded to the participants of the private subcommittee meetings.

<u>Regulation NMS Subcommittee</u>

At the April 26, 2016 Committee meeting, the Regulation NMS Subcommittee ("NMS Subcommittee") recommended an access fee pilot, which would reduce the access fee cap (and as an expected consequence, the rebates provided) in pilot program securities. The proposed pilot would only apply to equity exchanges and, according to the NMS Subcommittee, would provide data to measure the impact of lower access fees and lower rebates on liquidity provisioning and taking.

The proposal seems tailored to suit the concerns of a segment of market participants, while not considering the views of all market participants. For instance, the recommendation admits the inherent weakness in the narrow approach taken, namely a scope that excludes payment for order flow, ATSs, and a "Trade At" rule, while instead focusing only on displayed and non-displayed *exchange* liquidity. Nasdaq believes that this is a missed opportunity. The pilot should not be restrained by a desire to keep the pilot simple; it should be comprehensive to ensure that it provides valid, useful data upon which informed market structure changes may be made to serve the broad public interest.

Nasdaq took a leadership role in determining the impact of access fees on the quality of our markets by conducting its own access fee experiment in 2015. Nasdaq designed a pilot to test whether decreasing access fees and reducing rebates would impact liquidity, price discovery, and spreads on its market. In fact, Nasdaq received strong support from market participants, buy side and sell side alike, for its program. However, Nasdaq's effort was limited by the fact (i) that these issues relate to pricing across exchanges and ATSs and (ii) that we were unable to collaborate with our competitors in designing or implementing the pilot. Therefore, we accept that the Commission may need to take a formal role in designing a *comprehensive* pilot.

Nasdaq also believes that the time and collaboration needed to design, debate, and launch the tick pilot yielded positive results. Therefore, the tick pilot experience should guide the Commission as it weighs the utility and considers the contours of an access fee pilot.

Notwithstanding the fact that Nasdaq's pilot lacked broad exchange/ATS participation, we did glean meaningful lessons from it. Specifically:

1) Liquidity providers are very sensitive to changes in rebates. When Nasdaq lowered its rebates, liquidity providers immediately moved their quotes to other exchanges. As a result, displayed liquidity on Nasdaq diminished, impairing our market quality. We conclude that unless every electronic trading venue - - ATSs and exchanges - - is included in the pilot, we are likely to find that liquidity and market quality on exchanges will be fundamentally harmed, ultimately to the detriment of public investors. Issuers included in the pilot would see a diminishment of transparent quotes, widening of quoted spreads, and an inferior overall trading experience.

2) Rebate-oriented firms are particularly sensitive to changes in rebates. Perhaps not surprisingly, when Nasdaq lowered its rebates, liquidity providers significantly reduced activity on Nasdaq. While rebate-oriented market participants are often viewed negatively by certain market structure pundits, they do post quotes and add liquidity to the markets, thus driving tighter spreads and fast executions for millions of retail orders in the markets every day. If the pilot drives them out of stocks altogether, we could see the negative effect of wider spreads and less liquidity available for issuers and investors.

3) Liquidity takers, on the other hand, did not react to our pilot by driving more order flow to the Nasdaq exchange in the pilot stocks. When asked, they stated that order routing decisions were primarily driven by best-execution parameters, not by exchange fees, and therefore, they did not change their interaction with our market to take advantage of lower fees.

While our pilot was certainly not conclusive, it did highlight some behaviors we might expect from a broader industry pilot. Therefore, before the Commission accepts the recommendation of the subcommittee, we strongly suggest a more thorough investigation into the underlying motivations and trading behaviors of different types of market participants. By conducting careful market research before experimenting on the markets themselves, we can effectively test the impact of lower access fees and yet spare our issuers the potential of diminished public liquidity, wider spreads, and inferior market quality for their shares and their shareholders.

For example, one hypothesis that warrants further consideration is the NMS Subcommittee's assumption that higher market capitalization stocks do not need the same rebate as lower capitalization stocks. Our experience informs us that this simple hypothesis does not account sufficiently for the myriad of factors affecting market participant behavior. Given the link between reduced rebates and reduced liquidity that Nasdaq experienced in its pilot, we believe it is critical for the Commission to examine whether and how this link might impact issuers differently across the full range of market capitalizations.

If, after conducting prudent research and investigation, the Commission ultimately decides to move forward with a pilot program, we believe that the current pilot proposal is missing critical details. The pilot must address questions such as: (i) must trading venues keep fees constant throughout the experiment; (ii) will volume-based price discounts be allowed; (iii) will competitors to exchanges be permitted to replace exchange access fees and rebates with their own access fees and rebates; and (iv) will exchanges be permitted to change pricing for non-execution services? Moreover, the Commission will have to consider the compositional differences between trading venues; merely applying the fee caps among equity exchanges and ATSs uniformly does not mean that all trading venues will be affected or act in the in the same way.

Nasdaq believes that any access fee pilot should include both fees and rebates, and apply to all trading centers. In Nasdaq's opinion, including a cap on both fees and rebates, and applying the pilot broadly, would provide more meaningful data by removing price from market participants' routing decisions. Nasdaq also believes that the proposed two-year length of the pilot is too long, and that including a "relief valve" of aborting the pilot mid-stream may not adequately protect issuers and investors. Nasdaq's observation with its access fee experiment was that the impact on liquidity provision was very rapid. The competitive implications of the proposed pilot and our own experience argues for a shorter, rather than a longer, pilot.

In conclusion, Nasdaq urges the Commission to take a deliberate, measured, and careful approach to any experiments on the market. We learned from our own experiment on a small group of listed company stocks that there could be significant effects from an access fee pilot that could diminish market quality. Therefore, Nasdaq proposes further research and investigation of alternative constructs before moving forward with any access fee pilot. Ultimately, if it is deemed warranted, Nasdaq could support a short, nuanced, access fee pilot that includes all types of automated trading venues and that is consistent with our obligation to maintain fair and orderly markets - - an obligation that extends to the market quality that our listed companies receive. We could never endorse an experiment on our listed companies that could harm the price discovery process for them and their shareholders, or create unfair or disorderly markets to the detriment of public investors.

Trading Venues Regulation Subcommittee

Nasdaq applauds the overall conclusion of the Trading Venues Regulation Subcommittee ("Regulation Subcommittee") that the current regulatory structure for trading venues "works well and generally, is operating fairly and effectively." Nevertheless, and despite its broad mandate to focus on "trading venues," the Regulation Subcommittee's recommendations are focused narrowly on exchanges and National Market System plans ("NMS Plans") that exchanges operate. Given the concerns Nasdaq and other parties have raised about the composition of the Committee, the Commission must carefully consider the merits of the Regulation Subcommittee's recommendations and the competitive milieu that may have influenced them.

Recommendation #1: Evaluate and clarify exchange functions subject to SRO immunity and increase rule-based exchange liability levels.

In its first recommendation, the Regulation Subcommittee begins by stating that it "has not reached consensus on any formal recommendations" regarding self-regulatory organization or "SRO" immunity, "including as it may apply to specific exchange functions." The absence of recommendations here is understandable, since SRO immunity is a judicial doctrine, the contours of which have been determined by Article III Federal courts. Moreover, the scope of the doctrine is not in doubt, since it applies to functions that a court determines to be regulatory in nature. There is simply no reason to believe that courts are not competent to make this determination, and the Regulation Subcommittee wisely eschews the temptation to second-guess them.

The Regulation Subcommittee does suggest a review of limitations of liability contained in certain SRO rules, however. These limitations exist because exchanges handle billions of dollars of securities transactions each trading day. Without such limitations, exchanges could be called upon to stand as the guarantor of the successful completion of every transaction and intended transaction. By limiting liability, these rules spread the risk that transactions will not be successfully completed across many market participants rather than concentrating them at exchanges. Broker-dealers, including non-exchange trading venues, impose similar liability limitations on their customers through the contracts that they require them to sign, but the Regulation Subcommittee has not recommended an examination of these contracts.

The Regulation Subcommittee also suggests that exchanges might be required to "set aside funds" to perform this proposed insurance function. The Regulation Subcommittee does not, however, analyze the costs to the market that would be associated with this proposal. The current rules help to keep trading costs extremely low, because risk is spread throughout the market. Setting aside funds in an insurance pool of any meaningful size, by contrast, would require increased charges to market participants, and might also require the Commission to establish a regulatory structure for this novel exchange insurance function. Nasdaq also notes that insurance inevitably introduces an element of moral hazard, as market participants may alter the care they exercise when interacting with exchange systems due to the knowledge that an insurance fund is available. Nasdaq believes that before the Commission moves down this risky path, it must give careful consideration to the downstream consequences (or implications) associated with altering the current risk allocations.

> *Recommendation #2: Changes should be implemented to the NMS Plan governance structure and the role of NMS Plan Advisory Committees (AC) should be expanded, formalized and made uniform.*

The Regulation Subcommittee recommendations appear to respond to the needs of a segment of the market rather than to the overall needs of all market participants. The NMS Plans are a statutory tool the Commission uses to develop a National Market System and to protect investors when uniformity and consistency are essential. The Commission has used this tool with great success and with increasing frequency in recent years. There are now over a dozen functioning NMS Plans performing critical tasks in listing, data, trading and regulation, including the new Limit Up Limit Down and Tick Size Pilot NMS Plans. The Regulation Subcommittee presents no evidence that the NMS Plans are failing generally, or that NMS Plan governance is failing specifically. In other words, it appears that the Regulation Subcommittee presents a solution in search of a problem.

Expanding non-SROs rights to NMS Plans is unnecessary because the investing public is already well-represented in the creation and operation of every NMS Plan. Each NMS Plan is subject to full notice-and-comment review, including by broker-dealers, asset managers, and individual investors. In approving any NMS Plan or amendment, the Commission must respond to comments filed and explain why the NMS Plan or amendment is consistent with the purposes of the Securities Exchange Act ("Exchange Act"). Any party aggrieved by such Commission approval can seek judicial review. Moreover, the Commission has authority to amend any NMS Plan at any time, as it did in conjunction with its adoption of Regulation NMS and its approval of the Tick Size Pilot NMS Plan.

Non-SROs already have a strong voice in the operation of NMS Plans through the significant participation of advisory committees, many of which have been voluntarily adopted by the SROs. The SROs have exercised care and judgment to solicit industry input that supports the specific duties of each plan and its role in the national market system:

- The Consolidated Audit Trail Operating Committee created the Development Advisory Group (DAG) comprised of the SROs, as well as 24 representative firms (broker-dealers, market makers, vendor firms, and a clearing firm) and three industry trade associations (FIF, SIFMA and STA). Industry trade associations represent numerous securities firms, banks, asset managers, traders, vendors, exchanges, ATSs, and broker-dealers.

- The Tick Size Pilot Operating Committee created a Data Collection Advisory Committee to include input from a vendor, market maker, prime broker, and industry association representative. The SROs adjusted the Tick Size Pilot NMS Plan based on this advisory input.

- The Limit-Up/Limit-Down Operating Committee created an Advisory Committee that mirrors representation of other Advisory Committees.

The Regulation Subcommittee should note the voluntary efforts the SROs have already made to strengthen the role of the Advisory Committee for the CTA and UTP Plans. The Advisory Committee currently consists of nine industry representatives, including four representatives who have been appointed voluntarily by exchanges. The advisors represent retail brokers, vendors, institutional investors, alternative trading systems and prime brokers. These representatives, five of which are SIFMA members, are a mix of market structure and market data experts. To expand the role of these Advisors, the SROs have voluntarily:

- Reduced the number of issues discussed or decided in executive session outside the presence of advisors;[1]

- Increased the amount of committee paperwork that advisors can share with the industry by limiting the use of the "confidential" designation;

- Recorded advisory input in committee meeting minutes;

- Prepared meeting summaries for release to the industry;

- Solicited and answered Advisory Committee questions;

- Invited the Advisory Committee to participate in the SIP selection process; and

- Included the Advisory Committee in informal SIP subcommittees.

Further expanding non-SRO governance rights poses potential risks to the critical market functions the NMS Plans perform - - risks that significantly outweigh the potential rewards. The biggest risk is that of disruption and litigiousness that members of the industry bring to Commission proceedings. For almost ten years, SIFMA and industry members (including several represented on the Committee and testifying as witnesses) have been suing the SEC regarding market data proposals submitted by the NMS Plans and the exchanges. Having lost

[1] Investors and the industry are further protected by the attendance of Commission staff at all meetings of the UTP and CTA Operating Committees, including attendance at all executive sessions. For instance,the staff worked with the Operating Committees to limit the scope and number of items discussed in the executive session.

two cases in the Federal Court of Appeals for the DC Circuit, SIFMA has filed over 130 separate petitions with the Commission, two of which have already been tried by a Commission Administrative Law Judge. Given this history, we must conclude that implementing the Regulation Subcommittee's recommendation will only lead to additional litigation and disruption.

Expanding the rights of non-SROs also risks undermining sound regulation. SROs are uniquely positioned to operate NMS Plans because each SRO, unlike broker-dealers, carries the statutory obligation to enforce compliance with the Exchange Act, the rules promulgated under the Exchange Act, and the SRO's own rules. In contrast to SROs that continually surveil and enforce SRO and SEC rules, broker-dealers have no such regulatory obligations. In fact, other than ensuring their own compliance with the securities laws and rules of SROs, broker-dealers must be expected to act in their own commercial interests. SROs could be placed in the untenable position whereby broker-dealers (or other non-SRO committee members) could fail to support or veto changes that the SROs believe are necessary to discharge their statutory obligations.

Nasdaq opposes the proposed change to the allocation of voting rights among exchanges. Under the Exchange Act, each self-regulatory organization receives a unique approval from the SEC. The Commission has consistently held that each SRO must have its own systems, rules, operations, and members. Based on this principle of separation, the Commission has also prevented exchange operating companies from offering "cross-SRO" products that bundle products from multiple exchanges. Bundling voting for purposes of NMS Plans contradicts this historic treatment by the Commission.

Finally, Nasdaq opposes changes to the super-majority voting requirements. Nasdaq (and NYSE) represents thousands of issuers; no Committee member does that. Supermajority votes are limited to a small set of scenarios, and when appropriate they enable Nasdaq to protect the interests of listed companies and their investors.

> *Recommendation #3: If a rule change will require technology changes by the industry that will be prescribed through the publication of Technical Specification, the SEC and the SROs should link the implementation date of those rule changes to the publication of Technical Specifications or FAQs where appropriate.*

To evaluate this recommendation, Nasdaq and other affected parties must better understand what is being recommended and what problem is being addressed. Currently, Nasdaq voluntarily publishes detailed technical specifications that accurately and fully describe its trading systems. Additionally, Nasdaq provides significant lead time for members to code to and test changes in its technical specifications. Nasdaq has viewed these practices as pro-competitive in that they enable the industry to adopt new functionality faster and more reliably.

Nasdaq opposes any recommendation that would require disclosure of proprietary information, or the publication of information that would unnecessarily create a competitive disadvantage. The recommendations do not describe the specificity required in the published specifications or how such publication and approval would impact Nasdaq's change management process. For example, if the notice and comment process results in a change to the functionality and underlying specifications, would that require re-publication of the proposed rule change? If the technology implementation process reveals the need to change technical specifications, would that require re-proposal and re-approval? If post-production use of technology reveals an enhancement consistent with the approved functionality, would that require re-proposal and re-approval?

Nasdaq also questions whether the Regulation Subcommittee recommendation is consistent with Exchange Act Rule 19b-4 and Form 19b-4, which limit the contents required of propose SRO rule changes, as well as Section 19(b) of the Exchange Act, which contemplates a more final and definitive process than the current Regulation Subcommittee recommendation implies. The Regulation Subcommittee, Committee, and the Commission clearly have significant details to consider before moving to a final recommendation or a proposed Commission rule making.

Given the lack of operational transparency of ATSs and other execution venues, the answer to these questions could pose serious competitive risks. Again, Nasdaq notes that the Regulation Subcommittee purports to evaluate all trading venues, but its recommendations are singularly focused on exchanges. Accordingly, Nasdaq will await further clarification before responding fully to this recommendation.

> *Recommendation #4: SEC should work to formalize by rule the centralization of common regulatory functions across SROs into a single regulator.*

Nasdaq believes the record of exchanges and other self-regulatory organizations protecting the best interests of investors is illustrated by the size and depth of the U.S. markets and their resiliency through events like the financial crises of 2008. Exchanges use their regulatory powers in proposing and enforcing rules that establish initial and continued listing rules for public companies and ensure transparent trading rules. Perhaps reflecting the limitations of the Regulation Subcommittee membership, the subcommittee appears to ignore these critical regulatory functions performed by exchange SROs. No central authority could perform these functions without creating a homogenized market structure that would violate the central tenet of the Exchange Act that the Commission foster innovation and promote competition among markets.[2]

Yet, the world the Regulation Subcommittee advocates - - responsibility for market-specific activity and listing monitoring resting with exchanges while centralizing cross-market

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[2] The Regulation Subcommittee's concern that "some SRO activities might be perceived as favoring exchanges over competing venues" is not grounded in any analysis and ignores the fact that all exchange rules are subject to Commission review and the notice and comment process. To the extent this comment refers to surveillance and enforcement activity related to non-exchange trading venues, the concern seems misplaced given that such oversight is already performed by FINRA, which bears responsibility for over-the-counter trading.

regulation - - already exists. Where it makes sense, Nasdaq and other exchanges have consolidated cross-market surveillance for insider trading and many other cross-market threats with FINRA. However, FINRA, subject by regulation to Nasdaq oversight, has to earn our confidence to continue performing these services, and we have the authority to take action if FINRA fails to meet our expectations and regulatory obligations. Requiring centralization under a single authority would create a monopoly without competition or oversight except for that of the Commission itself. We believe that this centralization risks moving regulation in the wrong direction precisely when new technology like the Consolidated Audit Trail should be opening new frontiers for regulation that competition and multiple SROs could leverage.

Of course, Nasdaq's real-time surveillance and listing regulatory obligations are fulfilled by Nasdaq personnel and are not outsourced. For instance, a substantial percentage of Nasdaq's technological infrastructure and its SMARTS surveillance system are devoted to regulatory operations. These regulatory systems processed over 300,000 alerts and resulted in 689 referrals to FINRA and the Commission in 2015. Last year Nasdaq's regulatory staff reviewed more than 49,000 issuer SEC filings for continued compliance with Nasdaq's listing standards and reviewed over 50,000 press releases to determine the materiality of disclosed information. Nasdaq believes regulation is core to our reputation.

Therefore, Nasdaq believes the Commission should reject recommendations that at best try to freeze the existing model thereby stifling innovation, and at worst seem designed to undermine the decades-old SRO model that has served markets and investors well.

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If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact me.

Respectfully,

J. C. Conley

Joan C. Conley