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February 17, 2017

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F. Street NE
Washington, DC. 20549

Re: Securities Exchange Act Release No. 79428 (November 30, 2016), 81 FR 87628 (December 5, 2016) (SR-NASDAQ-2016-161)

Mr. Fields:

Nasdaq is responding to six comment letters[1] generally critical of the above-captioned proposed rule change (”Proposal”). The Proposal would establish a new Extended Life Order Attribute (“ELO”) on Nasdaq that would allow certain displayed orders to have priority on the Nasdaq book over other resting displayed orders at the same price. Orders are eligible for ELO

1 *See* letter dated December 19, 2016, from Joseph Saluzzi and Sal Arnuk, Partners, Themis Trading LLC, to Brent J. Fields, Secretary, US Securities and Exchange Commission (“Themis Letter”), available at: https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1430235-129819.pdf; letter dated December 22, 2016, from Eric Swanson, EVP, General Counsel and Secretary, BATS Global Markets, Inc., to Brent J. Fields, Secretary, Commission (“BATS Letter”), available at: https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1439665-129974.pdf; letter dated December 22, 2016, from Adam Nunes, Head of Business Development, Hudson River Trading LLC, to Brent J. Fields, Secretary, Commission (“Hudson Letter”), available at: https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1440085-129957.pdf ; letter dated December 23, 2016, from Joanna Mallers, Secretary, FIA Principal Traders Group, to Brent J. Fields, Secretary, Commission (“FIA Letter”), available at: https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1440973-129989.pdf ; letter dated December 27, 2016, from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel Securities, to Brent J. Fields, Secretary, Commission (“Citadel Letter”), available at: https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1447364-130084.pdf; and letter dated December 28, 2016, from Andrew Stevens, General Counsel, IMC Financial Markets, to Brent J. Fields, Secretary, Commission (“IMC Letter”), available at: https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1447984-130096.pdf.

if they qualify as Designated Retail Orders and there is commitment from the member that orders designated with ELO will rest on the book, unaltered, for a minimum of one second.[2] Thus, the Proposal provides incentive to members to provide market-improving behavior on Nasdaq in the form of longer-lived displayed retail orders.

As a U.S. national securities exchange, Nasdaq exists to facilitate capital formation through well-regulated markets, on which public companies may list their securities and the public may trade company securities. Starting with initial public offerings – entrusted by Congress exclusively to exchanges – and continuing through secondary trading, Nasdaq, and other exchanges provide deep pools of liquidity and efficient systems to trade securities that market participants trade in any given day. By providing deep and liquid markets, exchanges provide efficient pricing and funding of entrepreneurial activity. The value of an enterprise, how much capital it should receive, and at what cost are best determined by a deep competitive market like the public markets. A company that has a clear price set in the open market will attract more investors and lenders to help fund growth. A public listing also allows the most diverse universe of investor access to equity ownership. In this regard, the Exchange Act prohibits national securities exchanges from discriminating unfairly.[3] This democratization allows employees, individual investors, pension plans, mutual funds, corporations and others to put their capital to work and enjoy the rewards, and risks, of equity ownership. The Proposal is an effort by Nasdaq to promote displayed orders with longer time horizons to enhance the market so that it works for a wider array of market participants, and will benefit publicly traded companies by promoting long-term investment in corporate securities, whether listed on Nasdaq or other exchanges. Nasdaq believes that the Proposal will increase competition and, consequently, improve participation by allowing segments that may currently be underserved to compete on regulated exchanges based on elements other than the sequence of order arrival.

Commenters to the Proposal have raised concerns about both the operational and policy aspects of the Proposal. Generally, comments fell into one of five categories: (1) fairness of the Proposal; (2) the nature and enforcement of ELO eligibility metrics; (3) adequacy of the "retail" definition; (4) information leakage; and (5) the need for the Proposal. We respond to these issues below.

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[2] Nasdaq's Proposal is to apply ELO priority to Designated Retail Orders, which are agency or riskless principal orders that meet the criteria of FINRA Rule 5320.03 and that originate from a natural person, and are submitted by a member that designates it as such. To be eligible as a Designated Retail Order, no change may be made to the terms of the order with respect to price or side of market and the order may not originate from a trading algorithm or any other computerized methodology. Nasdaq may extend ELO to other market participants through future rulemaking.

[3] *See* 15 U.S.C. 78f(b)(5).

Fairness

Commenters noted concern about the fairness of allowing only retail orders to be eligible for the new order attribute. One commenter noted that benefiting one type of participant over others may be disruptive to the market.[4] Another commenter stated that the new order attribute would discourage other market participants from displaying liquidity because they would potentially lose their position on the Nasdaq order book after posting.[5] Another commenter stated that it believes the attribute would unfairly burden competition, noting that market participants are compelled by Regulation NMS to either route their orders to the venue with the best price or match that price.[6]

Nasdaq recognizes that participants that invest in capabilities that allow them to drive price formation by repeatedly improving the NBBO on the Exchange bring tremendous value to the market by providing efficient prices, lowering costs for individual investors, and supporting price formation and stability for securities listed on Nasdaq and other U.S. exchanges. Nasdaq believes that retail users of ELO can coexist with existing participation strategies on Nasdaq to the benefit of all Exchange participants. The Proposal may lead to increased retail Order participation and improved execution quality for retail Orders, which would improve overall market quality.

Many actions taken by the exchange will discriminate in some manner. The Exchange Act requires that such actions not discriminate unfairly.[7] Nasdaq believes providing this functionality to retail investors, who generally do not focus on queue placement and instead focus on price and time to execution, will help improve execution quality and retail participation in on-exchange transactions. Further, the proposal will provide firms handling retail order flow with additional options to consider when determining the best way to represent and ultimately execute their non-marketable limit orders. It is Nasdaq's belief that ELO is a useful and beneficial order attribute, but if ultimately Nasdaq is incorrect and market quality does not improve, market participants may choose one or more of the many substitutes in the market where participants may send their orders. Further, while Regulation NMS may dictate that the best displayed price must be accessed before executing at an inferior price, it does not dictate that an order must be displayed on Nasdaq. There are twelve other exchanges, over thirty registered alternative trading systems, and many other non-registered off-exchange trading platforms that a participant may elect to use if the execution quality on Nasdaq suffers due to the ELO Attribute.

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4 *See* FIA Letter.

5 *See* Hudson Letter.

6 *See* Citadel Letter.

7 *See* note 3, *supra*.

Eligibility Metrics

Commenters noted concern with the metrics required of members to be eligible to enter retail orders with ELO priority.[8] Under the Proposal, members must commit to not alter at least 99% of orders entered with ELO priority for the minimum time of one second. Commenters generally requested clarification on how the 99% and one second requirements would operate. Moreover, commenters voiced concern over the quarterly retroactive compliance review, whereby Nasdaq would determine member compliance with ELO requirements upon conclusion of each quarter. With respect to this, commenters voiced concern that market participants may "game" the new order attribute[9] and that compliance with the requirements should be systemically enforced. One commenter noted that a member may receive sub-one second cancellations from its retail customer, resulting in the member becoming ineligible for the program should such cancellations cause them to exceed the 99% requirement.[10] The same commenter noted that the Proposal is at odds with FINRA Rule 5320.

In response to concerns about the quarterly compliance review, Nasdaq is amending the Proposal to shorten the review period for determining compliance with the eligibility requirements from a quarterly review to a monthly period. Thus, member compliance will be conducted with greater frequency, with consistently non-compliant members potentially phasing out of the program within a much shorter timeframe than originally proposed. The Exchange believes that 99% standard is appropriate, as it requires near perfect performance, while also providing some flexibility when a member that is following the spirit and intent of ELO encounters unforeseen technical issues or other issues that result in de minimis non-compliance. Nasdaq is also adding more detail to the Proposal on how the qualification requirements will operate. Nasdaq notes that any attempt to "game" or otherwise abuse the new order attribute would be a violation of Nasdaq's rules and subject the member to possible disciplinary action. Nasdaq is developing new surveillances to detect potential misuse of the order attribute.

With respect to retail customers issuing sub-one second cancellations, Nasdaq believes that retail investor limit orders that are posted on the Exchange will generally not be cancelled in a short period of time such as one second. This is because retail investors tend to have long-term investment goals and increasing their chance of receiving an execution is worth the risk of their order living for one second or longer. As stated previously, Nasdaq will monitor behavior to ensure market participants are not taking steps to circumvent the letter, intent, or spirit of the rule.

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8 *See* BATS Letter, Citadel Letter, FIA Letter, Hudson Letter, Themis Letter.

9 *See* BATS Letter, Themis Letter, FIA Letter.

10 *See* Citadel Letter.

With respect to the issued raised concerning FINRA Rule 5320, Nasdaq does not believe that the concerns raised are applicable to ELO. FINRA Rule 5320, also known as the "Manning" rule, generally prohibits broker-dealers from trading ahead of their customer orders. The commenter described a situation whereby a member has entered a customer Order with ELO to Nasdaq, but is required to cancel that ELO Order in less than one second and internally fill it to comply with its obligations under Manning. As a consequence, the commenter argues, the cancelation of the Order with ELO would negatively impact the member's compliance with the ELO one second requirement.

Nasdaq notes that the Manning obligations of a member using ELO would be no different from the obligations on an OTC market maker that internalizes orders and relies on the "no-knowledge" exception contained in Supplementary Material .02 of FINRA Rule 5320 to separate their proprietary trading from their handling of customer orders. This exception should be equally applicable to a member using ELO.

Retail Definition

Commenters raised concerns about the definition of a "retail order" for purposes of the new order attribute, noting that some market participants may test the boundaries of what permissibly fits under the definition.[11] To this end, one commenter suggested that Nasdaq adjust and make clearer the current definition of Designated Retail Orders to capture "true retail investors."[12] By way of example, one commenter noted that professional traders may pose as retail investors to utilize ELO.[13]

Nasdaq is proposing to use the definition of Designated Retail Order[14] for purposes of defining what a "retail" order is for the order attribute. As defined by Nasdaq Rule 7018, a Designated Retail Order is:

> [a]n agency or riskless principal order that meets the criteria of FINRA Rule 5320.03 and that originates from a natural person and is submitted to Nasdaq by a member that designates it pursuant to [Rule 7018], provided that no change is made to the terms of the order with respect to price or side of market and the order does not originate from a trading algorithm or any other computerized methodology. An order from a "natural person" can include orders on behalf of accounts that are held in a corporate legal form -- such as an Individual Retirement

11 *See* FIA Letter, Citadel Letter.

12 *See* FIA Letter.

13 *See* Citadel Letter.

14 Nasdaq notes that its definition of Designated Retail Order is similar to the definition of "Retail Order" of BATS BZX and BATS EDGX exchanges. *See* BZX Rule 11.25(a)(2) and EDGX Rule 11.21(a)(2).

> Account, Corporation, or a Limited Liability Company -- that has been established for the benefit of an individual or group of related family members, provided that the order is submitted by an individual. Members must submit a signed written attestation, in a form prescribed by Nasdaq, that they have implemented policies and procedures that are reasonably designed to ensure that substantially all orders designated by the member as "Designated Retail Orders" comply with these requirements. Orders may be designated on an order-by-order basis, or by designating all orders on a particular order entry port as Designated Retail Orders.

Nasdaq notes that the definition is clear that the member entering the Designated Retail Order must have policies and procedures designed to ensure that such orders comply with the requirements of the definition, including that the order originate from a natural person. The rule allows for orders to originate from organizations in very limited circumstances. Accordingly, Nasdaq does not believe that there is latitude for a member to legally represent themselves as eligible to enter orders with ELO priority when the orders do not fit within the definition of Designated Retail Order.

Information Leakage

Commenters raised concerns that the Proposal may result in information leakage to the detriment of orders with ELO priority.[15] Specifically, commenters note that, because the identifier will be disseminated solely through Nasdaq's proprietary data feed, ELO orders will be easily identified by high frequency traders, since such traders are the most common subscribers to the data feed.[16] A similar argument was made by another commenter, who stated that because Nasdaq is disclosing through its data feeds which orders are using ELO, retail investors may be disadvantaged in that market participants will know that the order must remain unmodified for at least one second.[17]

Nasdaq agrees that information leakage is a concern for some market participants and that it may be an issue if ELO were applied in its current form to non-retail market participants' orders. Nasdaq does not believe, however, that information leakage is a concern with respect to the Proposal because ELO is available only to retail orders. Information leakage is often associated with market participants that are building or unwinding significant trading positions that may have market impact or a trading strategy that is proprietary and therefore confidential. For example, a large buyer might break one large buy order into several smaller orders to allow the market to absorb the demand in small amounts. Retail investor orders

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15 *See* FIA Letter, Citadel Letter, Themis Letter.

16 *See* Themis Letter.

17 *See* Citadel Letter and FIA Letter. FIA also noted that, by deduction, market participants would be able to identify the presence of other quotes as either coming from institutional or professional market makers.

generally are not part of a broader multi-order trading strategy. Retail investor interest is most often represented with one order at a single price and, as such, information leakage is not a concern. It is also worth noting that there are thousands of subscribers to its TotalView ITCH data feed. The subscribers to TotalView ITCH cover a broad array of market participants such as proprietary trading firms, agency broker dealers representing retail and institutional clients, vendors, institutional firms, and retail firms themselves. Because the data is available to so many market participants, Nasdaq believes the transparency that will be provided to the industry will be a valuable way for the efficacy of the program to be evaluated. Last, Nasdaq notes that identification of retail orders in data feeds occurs today.[18]

Need for the Proposal

One commenter directly questioned whether the Proposal was necessary, noting that retail orders currently do not experience problems receiving executions and thus do not need, or deserve, the priority granted by the new order attribute.[19] As noted above, the Proposal is designed to provide incentive to members to bring greater retail order participation to Nasdaq. Nasdaq believes that users of ELO can coexist with existing participation strategies on Nasdaq to the benefit of all Nasdaq participants and in support a balanced ecosystem. Additionally, providing a mechanism by which retail orders may have an increased chance of execution on Nasdaq will promote competition among Nasdaq, its exchange peers and, other off-exchange trading venues.

Last, commenters have raised concerns about Nasdaq's possible future expansion of the order attribute. As noted in the Proposal, any expansion of the program to other market participants would be filed with the SEC in a separate filing, subject to notice and comment. Thus, issues raised by commenters concerning the application of ELO to other participants is not at issue for purposes of approving the Proposal.

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Nasdaq has carefully considered the comments made on the Proposal. As discussed above, in certain cases Nasdaq has responded to the commenters' concerns by amending the Proposal, and in other cases Nasdaq has explained the benefits it believes ELO will bring to retail investors and the market overall. The Proposal is designed to improve retail participation on Nasdaq, to promote competition, and to improve market quality for all market participants. Nasdaq notes that it recently received a comment letter supportive of the Proposal, describing

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18 *See*, *e.g.*, BZX Rule 11.25(e) and EDGX Rule 11.21(e). *See also* US Equities/Options Multicast Depth of Book (PITCH) Specification at p. 22 ("ParticipantID"), available at http://cdn.batstrading.com/resources/membership/BATS_US_EQUITIES_OPTIONS_MULTICAST_PITCH_SPECIFICATION.pdf.

19 *See* Citadel Letter.

the benefits the commenter has observed with a similar order type available on the Toronto Stock Exchange.[20] For the reasons stated above and in the Proposal itself, as amended, the proposed Extended Life Order Attribute is consistent with the Exchange Act. Accordingly, Nasdaq asks that the Commission approve the Proposal without delay.

Sincerely,

T. Sean Bennett

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20 *See* letter dated February 9, 2017, from Venu Palaparthi, SVP, Compliance, Regulatory & Government Affairs, Virtu Financial, to Brent J. Fields, Secretary, US Securities and Exchange Commission, available at: https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1575173-131798.pdf. This commenter also noted concern about the quarterly compliance review and penalties for non-compliance, which, as noted above, Nasdaq has addressed.