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April 24, 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 has proposed the Extended Life Order (“Proposal”), a new market feature designed solely and exclusively to benefit retail investors, average Americans who invest in equities to save for new homes, for their children’s college educations, and for retirement. Most of the comment letters in opposition to the Proposal were submitted by a small group of competitors that stand to lose business if Nasdaq succeeds in helping retail investors: (1) competing exchanges who would lose the opportunity to execute retail investor orders that are sent to Nasdaq;¹ (2) firms that compete to execute retail orders on their own trading platforms and away from public exchanges;² and (3) Themis Trading,³ which does not directly serve retail investors and, therefore,

¹ See Letter dated March 2, 2017, from John Ramsay, Chief Market Policy Officer, IEX Group, Inc., to Brent J. Fields, Secretary, US Securities and Exchange Commission (“IEX Letter”), available at: <https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1607450-135834.pdf>. See also BATS Letter note 6, *infra*.

² See Citadel Letter, Hudson Letter, IMC Letter, and FIA Letter note 6, *infra*. See also Letter dated March 30, 2017, from Stephen John Berger, Managing Director, Government & Regulatory Policy, Citadel Securities, to Eduardo A. Aleman, Assistant Secretary, Commission (“Citadel Letter II”), available at: <https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1678581-149334.pdf>; and, Letter dated March 30, 2017, from Joanna Mallers, Secretary, FIA Principal Traders Group (“FIA PTG”), to Brent J. Fields, Secretary, Commission (“FIA Letter II”), available at: <https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1677450-149317.pdf>. Nasdaq notes that Citadel and IMC are members of the FIA PTG, therefore those letters should be viewed as duplicative rather than cumulative.

³ See Letter dated March 3, 2017, from Joseph Saluzzi and Sal Arnuk, Partners, Themis Trading LLC, to Brent J. Fields, Secretary, Commission (“Themis Letter II”), available at:

would not be eligible to use the proposed feature. The Proposal is supported by Virtu Financial, the only commenter that addressed its actual experience using an order type very similar in concept to the Extended Life Order.⁴

Background

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 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.⁵ Thus, the Proposal provides incentive to members to provide market-improving behavior on Nasdaq in the form of longer-lived displayed retail orders. In its Proposal, Nasdaq argues that it will increase competition and, consequently, improve participation by allowing investors that may currently be underserved to compete on regulated exchanges based on elements other than the sequence of order arrival.

On February 17, 2017, Nasdaq responded to comments filed during the first comment period.⁶

<https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1609956-135947.pdf>.

See also Themis Letter note 6, *infra*.

⁴ See Letter from Venu Palaparthi, SVP, Compliance, Regulatory & Government Affairs, Virtu Financial, to Brent J. Fields, Secretary, US Securities and Exchange Commission, dated February 9, 2017, available at: <https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1575173-131798.pdf>. This commenter noted that it has experience with the Toronto Stock Exchange’s Long Life Order, which it described as benefiting non-latency sensitive participants including retail investors. This commenter also noted concern about the quarterly compliance review and penalties for non-compliance, which, as discussed in this letter and Nasdaq’s prior response, has been addressed in its amendment to the filing.

⁵ 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.

⁶ See Letter from Joseph Saluzzi and Sal Arnuk, Partners, Themis Trading LLC, to Brent J. Fields, Secretary, Commission, dated December 19, 2016 (“Themis Letter”), available at: <https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1430235-129819.pdf>; Letter from Eric Swanson, EVP, General Counsel and Secretary, BATS Global Markets, Inc., to Brent J. Fields, Secretary, Commission, dated December 22, 2016 (“BATS Letter”), available at: <https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1439665-129974.pdf>; Letter from Adam Nunes, Head of Business Development, Hudson River Trading LLC, to Brent J. Fields, Secretary, Commission, dated December 22, 2016 (“Hudson Letter”), available at:

Those comments raised the following issues: (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. Nasdaq carefully considered the comments, answered each of them in detail, and modified the Proposal in several significant ways in response to legitimate concerns: (1) Nasdaq amended the Proposal to shorten the review period for determining compliance with the eligibility requirements from a quarterly review to a monthly period, which will result in the assessment of member compliance being conducted with greater frequency and consistently non-compliant members potentially phasing out of the program within a much shorter timeframe than originally proposed; (2) Nasdaq also provided greater detail to the Proposal on how the qualification requirements will operate; (3) Nasdaq is developing new surveillances to detect potential misuse of the order attribute.

During the second comment period, three of the original commenters filed repeat comments essentially duplicating earlier arguments, and one new commenter raised issues that are nearly identical to those previously raised and answered.⁷ All of the issues noted by the commenters are similar to, if not the same as, the issues raised by the commenters, and responded to by the Nasdaq. Specifically, the commenters noted concern over the following common items: (1) information leakage; and (2) fairness of the Proposal. Nasdaq provided a comprehensive response⁸ to these issues in its first comment letter, and made significant changes to its Proposal⁹ in response to some of those concerns.

Information Leakage

Commenters raised concerns that the Proposal may result in information leakage to the detriment of orders with ELO priority.¹⁰ This argument fails conceptually on multiple levels.

<https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1440085-129957.pdf>; Letter from Joanna Mallers, Secretary, FIA PTG, to Brent J. Fields, Secretary, Commission, dated December 23, 2016 (“FIA Letter”), available at: <https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1440973-129989.pdf>; Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel Securities, to Brent J. Fields, Secretary, Commission, dated December 27, 2016 (“Citadel Letter”), available at: <https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1447364-130084.pdf>; and Letter from Andrew Stevens, General Counsel, IMC Financial Markets, to Brent J. Fields, Secretary, Commission, dated December 28, 2016 (“IMC Letter”), available at: <https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1447984-130096.pdf>.

⁷ See IEX Letter.

⁸ See Letter from T. Sean Bennett, Associate Vice President and Principal Associate General Counsel, Nasdaq, to Brent J. Fields, Secretary, Commission, dated February 17, 2017.

⁹ See Amendment No. 1 to SR-NASDAQ-2016-161, available at <https://www.sec.gov/comments/sr-nasdaq-2016-161/nasdaq2016161-1589828-132168.pdf>.

¹⁰ See Citadel Letter II, IEX Letter, and Themis Letter II.

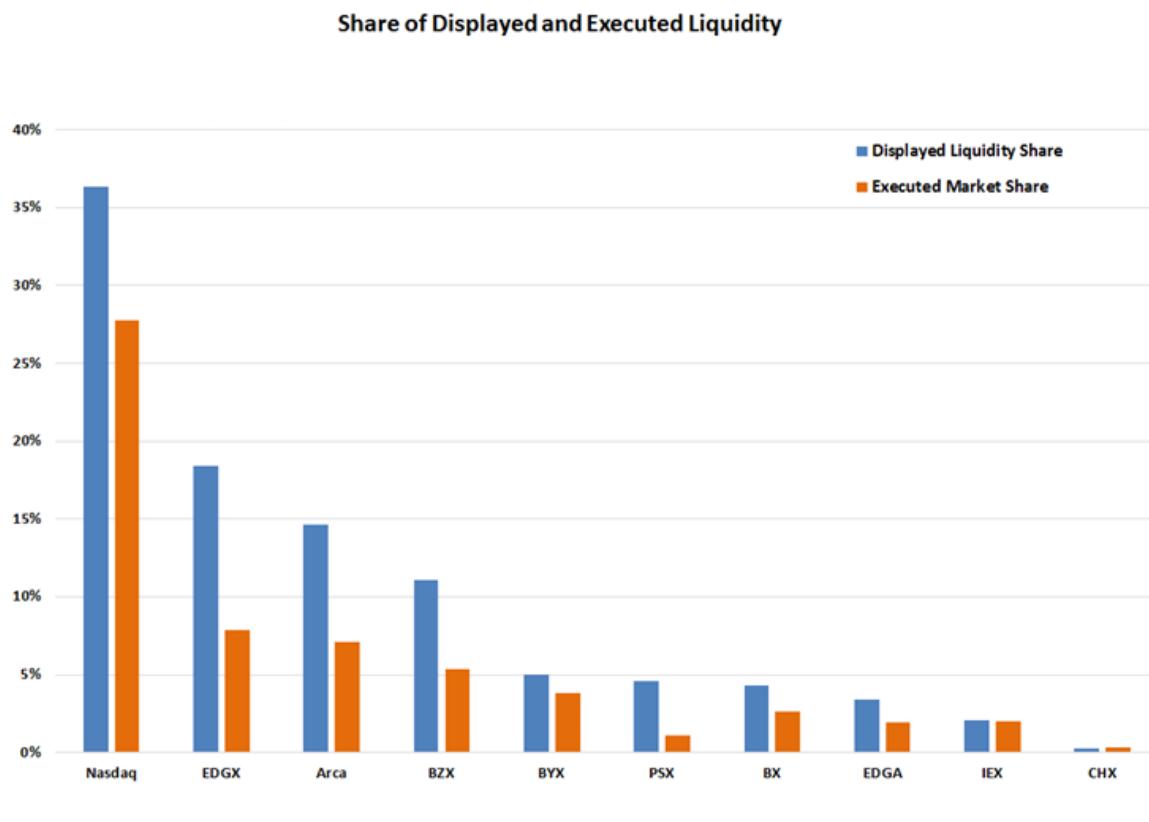
First, the ELO order creates transparency, not information leakage. Nasdaq operates a public market charged with transparently displaying trading interest and contributing to price discovery. Transparency differs from information leakage because it is purposeful, equally visible to all, and fully disclosed in public rule proposals. Information leakage, on the other hand, is generally understood to be inadvertent, selective, and secretive. Second, there is little risk that ELO orders will be harmed because ELO is a voluntary feature and its use can quickly be discontinued if submitting ELO orders yields sub-optimal execution quality. Third, not only can members quickly discontinue using ELO if it performs badly, they would be obligated to do so. Members routing retail orders to Nasdaq, or to any venue, must comply with the Duty of Best Execution which requires to conduct a regular and rigorous review to ensure compliance; in this case a regular and rigorous review of the performance of ELO.

With respect to specific comments, one commenter stated that identifying ELO orders, which must exist unaltered on the Nasdaq book for at least one second, on Nasdaq's data feed may impact routing strategies in ways that would adversely affect execution quality for ELO orders. As an example, the commenter explained that a market participant that is looking to take liquidity from multiple trading centers may route to an ELO order last because it knows that such order will not be cancelled for at least one second. Nasdaq does not believe that this would be an issue with ELO because most members utilize transaction cost analytic tools to evaluate and measure the related impact of an execution by weighting opportunity cost and market impact. As such, we expect that as a result of ELO Nasdaq execution quality metrics will improve over time and that members will adjust routing behavior to ensure a higher degree of interaction with the Nasdaq book. This would lead to firms moving Nasdaq higher on the routing tables, not lower.

Commenters noted concern that, because ELO orders are identified, market participants may identify the presence of other quotes as either coming from participants that are not retail, to those participants' detriment.¹¹ Nasdaq does not believe that this is an issue for two reasons. First, excluding ELO orders will not allow a market participant to say with any assurance that all other orders are of a particular participant type because not all retail orders will be designated as ELO. Moreover, the Nasdaq Stock Market is a diverse ecosystem of market participants, which do not lend themselves to such simple categorizations. Nasdaq notes that a primary purpose of ELO is to bring new retail participation to Nasdaq, which currently may not participate for all the reasons stated in the Proposal. If ELO succeeds in drawing more retail participation back to Nasdaq, there will be larger pool of retail orders, which will not provide any additional clues to the non-ELO book. Thus, identifying orders that are not ELO orders would not provide much benefit. Second, retail market participants tend to invest in certain heavily-traded securities, which do not lend themselves to easy identification

¹¹ See IEX Letter and Themis Letter II.

of the nature of the market participant behind the order. For example, during March 2017, Bank of America (BAC) had on average approximately 22,700 shares at the inside best bid and offer on the Nasdaq book. With displayed liquidity of this size, it is unlikely that the addition of retail-sized orders will result in new information about the already deep book on Nasdaq. More broadly, the chart below, which shows Nasdaq's share of displayed liquidity in comparison to other exchange, Nasdaq's displayed quantity at the NBBO is vast. Thus, identification of ELO orders is unlikely to result in any actionable information leakage concerning non-ELO participants. Accordingly, Nasdaq does not believe that identification of ELO orders will negatively impact those orders, or participants entering non-ELO orders.



* Average of all Nasdaq Listed stocks - February 2017

Fairness

A commenter noted concern that professional traders that are natural persons may abuse ELO priority.¹² This argument also fails at a conceptual level. As a registered national securities exchange, Nasdaq is required by Section 6 of the Exchange Act to adopt rules that are properly designed to maintain compliance and that it actively enforces those rules to achieve

¹² See Citadel Letter II.

compliance. Before proposing the ELO feature, Nasdaq carefully considered these regulatory obligations and the appropriate means for achieving compliance. It would not, as the commenters imply, simply leave the outcome to chance. Nasdaq's history and experience operating and surveillance equities markets amply demonstrates its ability and commitment in this area, separate and apart from Nasdaq's success supplying its state-of-the-art SMARTS surveillance technology to regulators, exchanges and broker-dealers across the globe.

Moreover, Nasdaq is proposing to use the definition of Designated Retail Order¹³ for purposes of defining what a "retail" order is for ELO. The commenter described a scenario whereby a day trader or other professional trader¹⁴ may use ELO to gain priority over other resting orders, while still retaining the ability to cancel orders within one second, presumably when trading at that price would no longer benefit the trader. Nasdaq does not believe that this is an issue because, as acknowledged by the commenter, the determination to enter an order as ELO is that of the participant's broker-dealer, not that of the participant. Thus, if a day trader or other professional a trader makes consistent sub-second cancelation of its orders, presumably the broker-dealer would determine that orders entered by this customer are not best suited for ELO.

As we noted in our original response to comments, 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. A professional trader's orders may qualify for ELO entry by its broker-dealer, however, may not, in practice, be suitable for ELO as determined by the broker-dealer. 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.

Commenters also noted a more general concern about the fairness of retail orders with the ELO attribute gaining priority in the Nasdaq book over other resting orders.¹⁵ As Nasdaq described in its initial comment letter response, Nasdaq recognizes that participants that invest in capabilities that allow them to drive price formation by repeatedly improving the NBBO on Nasdaq 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 providing ELO priority to retail investors, who generally do not focus on queue placement and instead focus on price and time to execution,

¹³ See Nasdaq Rule 7018.

¹⁴ Nasdaq believes the commenter is referring to a person that trades for their own account as their business.

¹⁵ See Citadel Letter II and FIA Letter II.

will help improve execution quality and retail participation in on-exchange transactions, which would support a diverse ecosystem of participants on Nasdaq.

Other Issues

One commenter argues that the Proposal is inconsistent with FINRA Rule 5320.¹⁶ Nasdaq disagrees. As noted in Nasdaq's first response, FINRA Rule 5320 generally prohibits broker-dealers from trading ahead of their customer orders. 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. The commenter notes that some broker-dealers often choose not to use the "no-knowledge" exception while still providing Manning protection to customer orders in order to provide higher fill rates or price improvement to their customer orders. Under that scenario, the broker-dealer may have to cancel the customer order in less than one second to comply with FINRA Rule 5320. Nasdaq notes that the scenario provided by the commenter is representative of a voluntary strategy used by the broker-dealer to improve the execution of its customer orders. Thus, ELO may not be consistent with such a broker-dealer's current business model and such a broker-dealer is not compelled to use ELO.

Last, Nasdaq is compelled to correct a statement made by one commenter that stated "Consumers of [Nasdaq's] proprietary feeds already have information that can be used to identify which orders are submitted by electronic trading firms...."¹⁷ Nasdaq's proprietary data feed TotalView ITCH supports voluntary market maker identification or "attribution," which is used to allow identification of market maker quotes and orders to meet their quoting obligations.¹⁸ The specification is not limited to any type of market participant, and is wholly voluntary. Consequently, Nasdaq does not believe that the comment is accurate in stating that the current data feed offerings identify electronic trading firms.

* * *

Nasdaq has carefully considered the comments made on the Proposal. In this regard, Nasdaq responded to the comments received by amending the Proposal to shorten the review period for determining compliance with the eligibility requirements from a quarterly review to a monthly period. As discussed above, Nasdaq has explained that the Proposal is fair as it will benefit retail investors and the market overall. The Proposal is designed to improve retail

¹⁶ See Citadel Letter II.

¹⁷ See IEX Letter.

¹⁸ See http://www.nasdaqtrader.com/content/technicalsupport/specifications/dataproducts/NQTVITC_HSpecification.pdf.

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participation on Nasdaq, to promote competition, and to improve market quality for all market participants. Indeed, one commenter writing in support of the Proposal agrees, noting that it has experience with the Toronto Stock Exchange's Long Life Order, which it noted "benefited non-latency sensitive participants including retail investors...without impacting the markets as a whole in a negative way."¹⁹ As another commenter to the Proposal has stated before, and with which we agree, the equity markets should stand for freedom of choice.²⁰ Like novel markets and existing markets seeking novel approaches to improve market quality, Nasdaq believes that so long as such innovation is consistent with the Exchange Act it should be allowed to be implemented. This is not just Nasdaq's belief, but also that of a respected academic who has stated, "Exchanges should have the flexibility to experiment with different features to fulfill their statutory mandate.... Congress has called for competition among exchanges in 11A of the '34 Act, and part of competition is innovation in exchange functionality in order to provide a better trading environment. In order to promote such innovative competition, the Commission should treat exchange proposals as innocent until proven guilty and resist the temptation to micromanage exchange operations."²¹ For the reasons stated above, in Nasdaq's initial comment letter response, and in the Proposal itself, as amended, the proposed Extended Life Order Attribute is both innovative and consistent with the Exchange Act. Accordingly, Nasdaq asks that the Commission approve the Proposal without delay.

Sincerely,



T. Sean Bennett

¹⁹ See Virtu Letter.

²⁰ See Letter from Sophia Lee, General Counsel, IEX Group, Inc., to Brent J. Fields, dated November 13, 2015 at 19, available at <https://www.sec.gov/comments/10-222/10222-20.pdf>.

²¹ See Letter from James J. Angel, Ph.D, CFA, Associate Professor of Finance, Georgetown University, McDonough School of Business, to Commission, dated October 16, 2016 at 2 (commenting on SR-CHX-2016-16), available at <https://www.sec.gov/comments/sr-chx-2016-16/chx201616-11.pdf>.