



December 20, 2024

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

RE: File Nos. SR-NASDAQ-2024-078; SR-ISE-2024-56; SR-BX-2024-054; SR-Phlx-2024-66; SR-GEMX-2024-42; SR-MRX-2024-45; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt a New Approach to the Options Regulatory Fee (ORF) in 2025

Dear Ms. Countryman:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ respectfully submits this comment letter to the U.S. Securities and Exchange Commission (the “Commission”) in response to a series of related rule filings by Nasdaq’s group of six options exchanges (collectively, the “Proposals”) to amend the method Nasdaq’s exchanges use to calculate the options regulatory fee (“ORF”) those exchanges charge.² SIFMA welcomes changes to the current approaches to ORF, as we consistently stated in past letters on this topic.³

¹ SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry’s one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

² Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt a New Approach to the Options Regulatory Fee (ORF) in 2025, Release No. 34-101892, File No. SR-NASDAQ-2024-078 (Dec. 12, 2024), 89 FR 102994 (Dec. 18, 2024); Release No. 34-101877, File No. SR-ISE-2024-56 (Dec. 11, 2024), 89 FR 102215 (Dec. 17, 2024); Release No. 34-101878, File No. SR-BX-2024-054, 89 FR 102199 (Dec. 17, 2024); Release No. 34-101893, File No. SR-Phlx-2024-66, (Dec. 12, 2024) 89 FR 103003 (Dec. 18, 2024); Release No. 34-101875, File No. SR-GEMX-2024-42, (Dec. 11, 2024) 89 FR 102223 (Dec. 17, 2024); Release No. 34-101891, File No. SR-MRX-2024-45, (Dec. 12, 2024), 89 FR 103017 (Dec. 18, 2024) (together, the “Proposals”).

³ See, e.g., Letters from Ellen Greene, Managing Director, SIFMA, to Vanessa Countryman, Secretary, Securities and Exchange Commission, dated Oct. 29, 2021 (<https://www.sec.gov/comments/sr-box-2021-22/srbox202122-9360126-261671.pdf>); Aug. 31, 2020 (<https://www.sec.gov/comments/sr-cboe-2020-069/srcboe2020069-7715510-222948.pdf>); Aug. 27, 2019 (<https://www.sec.gov/comments/sr-nyseamer-2019-27/srnyseamer201927-6032478->

While we appreciate Nasdaq's attempt to substantially alter the way it calculates ORF charges for its group of exchanges, as further discussed below, Nasdaq's Proposals do not provide enough information for the public to understand and meaningfully comment on the proposed ORF methodology changes included in them.⁴ The Proposals also do not demonstrate that the proposed fees are consistent with the requirements of the Securities Exchange Act of 1934 (the "Exchange Act"). Therefore, the Commission should suspend Nasdaq's rule filing, institute proceedings to determine if the Proposals should be disapproved, and ultimately disapprove them.

Executive Summary

- SIFMA commends Nasdaq for attempting to update its ORF methodology.
- The Commission and options exchanges should reevaluate the separate approaches to ORF to determine whether ORF remains necessary and appropriate given changes to the structure and surveillance of options trading.
- Nasdaq's Proposals do not demonstrate that the proposed changes to its ORF methodology are consistent with the Exchange Act.
- Nasdaq's Proposals would introduce for the first time an ORF charge for executions cleared in the "Firm" range. This new approach would add significant operational complexity that would need to be addressed on an extremely aggressive and unrealistic timeline.
- The Commission should require options exchanges to provide more detailed information regarding options regulatory costs and ORF revenues in connection with ORF filings.

I. SIFMA Supports Reevaluating the Approaches to ORF

SIFMA commends Nasdaq for proposing to make significant changes to its ORF methodology rather than seeking to maintain the status quo. SIFMA supports an industry-wide

191228.pdf); Apr. 10, 2019 (<https://www.sec.gov/comments/sr-emerald-2019-01/sremerald201901-5343269-184039.pdf>); and Sept. 13, 2017 (<https://www.sec.gov/comments/sr-phlx-2017-54/phlx201754-2442743-161060.pdf>).

⁴ The Nasdaq filings discussed in this letter replaced prior Nasdaq rule filings for which the Commission initially published notices on November 7, 2024. See Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Lower the Current Options Regulatory Fee (ORF) and Adopt a New Approach to ORF in 2025, Release No. 34-101537, File No. SR-NASDAQ-2024-058 (Nov. 7, 2024), 89 FR 90188 (Nov. 14, 2024); Release No. 34-101547, SR-ISE-2024-49 (Nov. 7, 2024), 89 FR 90157 (Nov. 14, 2024); Release No. 34-101550, SR-BX-2024-040 (Nov. 7, 2024), 89 FR 90165 (Nov. 14, 2024); Release No. 34-101543, SR-Phlx-2024-50 (Nov. 7, 2024), 89 FR 90122 (Nov. 14, 2024); Release No. 34-101546, SR-GEMX-2024-37 (Nov. 7, 2024), 89 FR 90173 (Nov. 14, 2024); Release No. 34-101560, SR-MRX-2024-39 (Nov. 7, 2024), 89 FR 90180 (Nov. 14, 2024). In these initial filings, Nasdaq's model utilized data for the period third quarter 2023 through second quarter 2024. See, e.g., 89 FR 90188 at n. 24. In the new filings, Nasdaq updated the model using data from the period fourth quarter 2023 through third quarter 2024. See, e.g., 89 FR at 102996 n. 25.

reevaluation of the ongoing necessity of the ORF as well as the various methodologies used to calculate exchange ORFs.

Currently, there are three separate ways that options exchanges calculate ORF, which are all based on customer transactions but lead to different outcomes depending on where a transaction is executed.⁵ Additionally, even when exchanges assess and collect ORF fees in the same manner, they typically charge different levels of fees. These inconsistent approaches, which are not clearly explained by options exchanges, cause unnecessary investor confusion and operational complexity in the options market about how the separate ORFs are calculated and how the ORFs are actually applied to fund exchange regulatory programs.⁶

Critically, the current approaches to ORF provide little or no incentive for options exchanges or FINRA to control regulatory costs related to options trading, as each exchange (on day one of operations) merely passes on to customers through the ORF any expense it deems to be regulatory in nature. As discussed below, the disincentives for seeking efficiency in an exchange's current regulatory approach is most evident when an exchange performs some of its own regulation and also enters into a regulatory services agreement ("RSA") with FINRA to perform other regulatory functions.⁷ Among other things, this approach presents a significant risk of regulatory duplication and costs when two separate self-regulatory organizations ("SROs") are regulating activity on one exchange. Additionally, there appears to be no incentives between exchanges using FINRA regulatory services and FINRA to negotiate the RSAs to control costs when the costs are ultimately borne by third-party customers.

In addition, the existence of the Consolidated Audit Trail ("CAT") and its use by FINRA to conduct cross-market options surveillance calls into question the continuing need for the ORF.⁸ As the Commission is aware, broker-dealers are charged CAT fees to pay for the

⁵ Some exchanges assess an ORF on members for each transaction that clears in the customer range (i.e., customer transactions) at the Options Clearing Corporation ("OCC"), regardless of the exchange on which the transaction occurs and regardless of whether the firm clearing the trade is an exchange member. A second group collects ORF on each customer transaction effected by its members, including transactions effected on away exchanges, but excludes trades cleared by non-members, including ones executed on its exchange. A third group of exchanges, including Nasdaq's, assess an ORF on members for transactions in the customer range where the execution takes place on the exchange or the execution takes place at another exchange but is cleared by an exchange member.

⁶ SIFMA's prior comment letters discuss the fundamental problems with having multiple separate approaches to ORF. See *supra* n. 2.

⁷ RSAs are separate from 17d-2 agreements and Nasdaq "notes that its regulatory responsibilities with respect to Participant compliance with options sales practice rules have largely been allocated to FINRA under a 17d-2 agreement. The ORF is not designed to cover the cost of that options sales practice regulation."

⁸ Remarks by Jon Kroeper, Head of Quality of Markets, Market Regulation Department, FINRA Podcast, The Cornerstone of FINRA's Market Surveillance Program: A Historical Commitment to Market Transparency (Nov. 30, 2021), transcript available at <https://www.finra.org/media-center/finra-unsigned/commitment-market-transparency> ("CAT includes both equities and options, gives you information about the identity of the parties

development and maintenance of the system. Broker-dealers also separately pay FINRA membership fees, which fund FINRA's market surveillance, investigation, and enforcement functions.⁹ The current state of options exchange cross-market surveillance, which is now primarily conducted on behalf of the exchanges by FINRA pursuant to RSAs using CAT data, should prompt the Commission and the options exchanges to review the continuing need for the ORF going forward.¹⁰ SIFMA observes that neither the CAT filings nor the instant Nasdaq Proposals demonstrate cost control efforts to eliminate or reduce redundant regulatory functions.

II. Summary of the Proposals

Nasdaq currently assesses an ORF of \$0.0016 per contract side for each customer option transaction that is either (1) executed by a participant on NOM or (2) cleared by a NOM Participant at OCC in the Customer range (regardless of whether the transaction was executed by a non-member or the exchange where the transaction occurred).¹¹ Nasdaq currently does not assess an ORF for transactions that are not in the Customer clearing range or transactions executed by members at away exchanges.¹² From November 1, 2024 through December 31, 2024, Nasdaq's Proposals will reduce the amount of ORF the Nasdaq exchanges assess per transaction. For example, the Nasdaq Options Market will reduce the amount of ORF it charges

responsible for the market activity, so it will tell you ultimately who the customer who entered the order was, and you're able to relate that information across different customer accounts, so you know if someone is working through two different brokerage accounts to try and engage in some manipulation or try to do something else. . . . It's a much clearer picture of activity on the marketplace. And then the ability to do cross products surveillance between equities and options on a systematic basis is a game changer for all of this as well, given, as I said before, the relationship between those two products.").

⁹ See Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Adjust FINRA Fees To Provide Sustainable Funding for FINRA's Regulatory Mission, Release No. 34-101696, File No. SR-FINRA-2024-019, 89 FR 93709 (Nov. 27, 2024) (raising its membership fees and stating that "[i]n the absence of a fee increase, eventually FINRA may not be able to hire and retain staff with the appropriate expertise to conduct its regulatory activities (including examinations, market surveillance and investigations, enforcement, regulatory policy and rulemaking, qualification examinations and credentialing, and providing transparency for markets, members and registered persons), or make the necessary investments in the technology needed to support these activities.").

¹⁰ SIFMA also notes that exchanges long-ago transitioned to for-profit companies and some of them are publicly traded. In light of these changes, the Commission should consider whether exchanges should continue to be viewed as industry utilities or whether they should fund their own regulatory obligations, as broker-dealers and other market participants are required to do.

¹¹ Each of the six Nasdaq exchanges follow the same method of charging ORF, but each exchange's ORF rate is different. The current Nasdaq exchange-specific ORF charges are as follows: Phlx \$0.0034 per contract side; GEMX \$0.0012 per contract side; ISE \$0.0013 per contract side; BX \$0.0005 per contract side; and MRX \$0.0004 per contract side.

¹² The terms "assess" and "collect" are used interchangeably in this letter.

from \$0.0016 to \$0.0014 per contract side based on Nasdaq's review of ORF revenue and regulatory costs for this exchange for the remainder of this year.¹³

As of January 1, 2025, Nasdaq is seeking to change its ORF methodology both in terms of the clearing ranges of transactions that are charged and the amounts of the ORF charges. Specifically, Nasdaq will expand the clearing ranges for which it assesses ORF charges from solely Customer transactions to transactions in the Customer and Firm range which would include the Professional Customer, Firm, and Broker-Dealer clearing ranges at OCC (Nasdaq will not apply ORF to transactions that clear in the market-maker range).

The Proposals state that "[t]he combined amount of Local ORF and Away ORF collected may not exceed 88% of Options Regulatory Cost."¹⁴ To achieve this goal, Nasdaq created a "new regression model" (the "Model") that it states "would tie expenses attributable to regulation to a respective source."¹⁵ The chart in the Proposals that depicts the Model shows a line that demonstrates the "marginal" (or variable) cost of regulation, and an intercept showing the fixed cost of regulation. Nasdaq states that its Model shows that the variable cost of regulation is "significantly attributable to Customer activity" and that the fixed costs of regulation should be evenly attributed across exchanges.¹⁶

However, in addition to generating the Model, Nasdaq's Proposals also state that it "established a 'normalization'" per options exchange.¹⁷ According to Nasdaq, this additional step was necessary because of "idiosyncratic exchange expense-volume relationships," which are primarily driven by "negotiated regulatory contracts that were negotiated at different points in time, yielding some differences in per contract regulatory costs by exchange."¹⁸ Nasdaq's Proposals further state that this "normalization" is "the average of a given exchange's historical (prior 4 quarters) ratio of regulatory expense to revenue when using the regressed values . . . that yields an effective rate by exchange."¹⁹ Following normalization, the resulting value was "multiplied to a 'targeted collection rate' of approximately 88% to arrive at ORF rates for

¹³ Without taking a position on whether this aspect of Nasdaq's Proposals complies with the Exchange Act, SIFMA supports a reduction in the Nasdaq exchanges' ORF through the remainder of this year.

¹⁴ 89 FR at 90190. Although not explicit in the Proposals, SIFMA understands that the remaining 12% is the amount of Options Regulatory Costs Nasdaq is assigning to transactions by market makers, a group of market participants that will not be charged an ORF under Nasdaq's model. Like the other elements of Nasdaq's Options Regulatory Costs, it is not possible for the public to determine how Nasdaq calculated that market makers account for 12% of these costs.

¹⁵ Id.

¹⁶ Id.

¹⁷ 89 FR at 90191.

¹⁸ Id.

¹⁹ Id.

Customer, Firm and Broker-Dealer Transactions.”²⁰ Nasdaq states that generally, “the model does not appear to increase marginal returns.”²¹

As a result of its Model plus the additional “normalization” described above, Nasdaq states that for the Nasdaq Options Market, it was able to attribute the amounts of the (1) Customer Local (\$0.0203 per contract), (2) Firm and Broker-Dealer Local (\$0.00024 per contract), and (3) Firm and Broker-Dealer Away (\$0.00024 per contract) ORFs it should charge to generate 88% of Options Regulatory Costs.²²

Nasdaq notes that although the updated methodology will take effect on January 1, 2025, it will sunset the changes on July 1, 2025 “at which point the Exchange would revert back to the ORF methodology and rate . . . that was in effect prior to this rule change.”²³ Nasdaq will reconsider whether to proceed with the updated ORF structure sometime prior to the sunset date.

III. Nasdaq has not Demonstrated that the Proposals are Consistent with the Exchange Act

As stated above, SIFMA appreciates the work Nasdaq has performed to create the Proposals to amend its ORF methodology. In general, Nasdaq’s Proposals attempt to more closely tailor its exchange group ORF charges to the particular trading activity that Nasdaq has identified as generating regulatory costs for those exchanges. Theoretically, this approach makes more sense than the current approach, but there are several aspects to Nasdaq’s Proposals that are lacking the transparency necessary for the Commission or the public to conduct a meaningful review of the rationale and analysis Nasdaq cites as support for amending its ORF methodology or the amounts of ORF charges Nasdaq selected.²⁴

²⁰ Id.

²¹ Id.

²² The relevant amounts for the remaining five Nasdaq exchanges are as follows. ISE: (1) Customer Local (\$0.0116 per contract), (2) Firm and Broker-Dealer Local (\$0.00014 per contract), and (3) Firm and Broker-Dealer Away (\$0.00014 per contract). BX: (1) Customer Local (\$0.0203 per contract), (2) Firm and Broker-Dealer Local (\$0.00024 per contract), and (3) Firm and Broker-Dealer Away (\$0.00024 per contract). Phlx: (1) Customer Local (\$0.0190 per contract), (2) Firm and Broker-Dealer Local (\$0.00022 per contract), and (3) Firm and Broker-Dealer Away (\$0.00022 per contract). GEMX: (1) Customer Local (\$0.0170 per contract), (2) Firm and Broker-Dealer Local (\$0.00020 per contract), and (3) Firm and Broker-Dealer Away (\$0.00020 per contract). MRX: (1) Customer Local (\$0.0149 per contract), (2) Firm and Broker-Dealer Local (\$0.00018 per contract), and (3) Firm and Broker-Dealer Away (\$0.00018 per contract).

²³ 89 FR at 90191.

²⁴ Although Nasdaq stated that it provided the Commission with further details about its projected regulatory revenue and expenses, those details are not included in the public filing. See, e.g., 89 FR at 102995 n. 15.

Nasdaq as an SRO has the burden under the Commission's Rules of Practice "to demonstrate that a proposed rule change is consistent with the [Exchange Act] and the rules and regulations issued thereunder."²⁵ Section 6 of the Exchange Act requires that the fees of a national securities exchange be (i) reasonable, (ii) equitably allocated, (iii) not unfairly discriminatory, and (iv) not an undue burden on competition.²⁶

As the Commission noted in an OIP suspending a Municipal Securities Rulemaking Board fee filing in January 2024:²⁷

The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding, and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Act and the applicable rules and regulations. Moreover, "unquestioning reliance" on an SRO's representations in a proposed rule change would not be sufficient to justify Commission approval of a proposed rule change. [footnotes omitted]

To assist in complying with these obligations, the Commission staff in 2019 issued guidance to the SROs on information that they could include in fee filings to help demonstrate that filings met the Exchange Act fee requirements.²⁸

Based on the lack of information included in the Proposals, Nasdaq has not met its burden under the Exchange Act, the Commission's Rules of Practice, or the staff guidance regarding fee filings. SIFMA and other interested parties are left to take Nasdaq at its word that its amended ORF methodology is appropriate to collect ORF revenue that matches the amount of Options Regulatory Costs its options exchanges incur, as well as whether Nasdaq is appropriately determining whether certain costs are regulatory in nature.²⁹ Instead of detailing its costs and cost sources, Nasdaq generally states that its Options Regulatory Costs consist of "the supervisory and regulation of member Customer options business including performing routine surveillances, investigations, examinations, financial monitoring, and policy, rulemaking,

²⁵ See Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

²⁶ 15 U.S.C. § 78s(b)(4), (5), and (8).

²⁷ See Release No. 34-99444 (January 29, 2024), 89 FR 7424 (February 2, 2024).

²⁸ See Commission "Staff Guidance on SRO Rule Filings Relating to Fees" (May 21, 2019), *available at* <https://www.sec.gov/tm/staff-guidance-sro-rule-filings-fees>.

²⁹ Unlike other exchanges, Nasdaq's Options Pricing Schedule does not require that the exchange's ORF revenue only be used to fund the options regulatory costs of the exchange. See Cboe Options Rule 2.2.

interpretive, and enforcement activities.”³⁰ The Proposals do not provide further detail or costs regarding these functions to allow commenters to understand and meaningfully comment on them. Without this information, it is not possible for the public to evaluate the levels Nasdaq selected for the Customer ORF and Firm Local and Away ORFs and whether Nasdaq has demonstrated that the fees are reasonable, equitably allocated, not unfairly discriminatory, and not unduly burdensome on competition.³¹

Nasdaq has not demonstrated that its proposed ORF fees are reasonable. In an attempt to more accurately tie activity on its exchanges to the costs of regulating the activity, Nasdaq created a regression model. Ultimately, Nasdaq’s explanation of the Model’s output is that Options Regulatory Costs grow proportionally with volume, and in particular Customer volume. But one would expect there to be a point (or several points) at which a single corporate entity that operates and ultimately is responsible for regulating six separate exchanges, each of which performs essentially the same trading functions, would not necessarily experience ever-increasing regulatory costs based on higher trading volume. That is, at some level(s) of volume, Nasdaq should experience economies of scale in the performance of its regulatory functions across six separate options exchanges. Nasdaq does not explain why this is not the case. As options market volumes continue to grow, it would appear Nasdaq could cite to its proprietary Model to justify continuously increasing its ORF revenues across its six options exchanges.³²

Nasdaq also states that its Options Regulatory Costs include both direct (65%) and indirect (35%) expenses.³³ But Nasdaq also does not explain how each of these categories, and the costs associated with each one, are truly regulatory in nature. Nor does Nasdaq provide the amounts of any of these purported regulatory costs. For example, Nasdaq includes “policy, rulemaking, interpretive” as a regulatory category to which it attributes Options Regulatory Costs. It is not clear, however, if all or only a portion of Nasdaq’s activities in this category are truly regulatory costs to supervise and regulate members’ Customer options business.³⁴ In

³⁰ 89 FR at 90189. Nasdaq notes that Options Regulatory Costs are offset by fines collected in connections with disciplinary matters.

³¹ We also observe that the Proposals are overly complex and do not address certain basic transparency deficiencies. Rather, the Proposals will add to the confusion surrounding ORF fees as well as the expense of implementation to other participants (e.g., bank-trading desks and market makers that utilize Joint Back Office facilities for non-bona fide market making activity both clear trades in the Firm range that the Proposals are seeking to include).

³² See OCC November 2024 Monthly Volume Data (indicating a 35% year-over-year increase in equity options contracts and 21% increase in total options volume), available at <https://www.theocc.com/newsroom/views/2024/12-03-occ-november-2024-monthly-volume-data>.

³³ 89 FR at 90189.

³⁴ Many of the filings Nasdaq’s separate options exchanges submit to the Commission are substantially similar immediately effective fee filings, generally to impose a new fee or change an existing fee. Nasdaq does not explain whether each one of these fee filings is for the purpose of supervising or regulating members’ Customer options business, or whether certain fee filings are excluded from Options Regulatory Costs. See, e.g., Notice of Filing and

addition, Nasdaq's exchanges have recently filed separate rule changes to charge members fees for the CAT. It would be duplicative to charge members through CAT fees and through the ORF for the costs of rule filings associated with CAT fees.³⁵ This is but one example of the complicated questions raised by Nasdaq's Proposals as well as the existence of the ORF and CAT fees at the same time. SIFMA also observes that with respect to CAT, its implementation was intended, in part, to reduce complexity and regulatory duplication in terms of costs and burdens imposed on both regulators and regulated entities. However, with the recent imposition of CAT fees on broker-dealers, regulatory complexity and duplication and the associated costs and burdens on broker-dealers have only increased without any rationalization of what regulatory services broker-dealers are being asked to pay for and the actual costs of those services.

Furthermore, regarding the Nasdaq exchanges' RSAs with FINRA, Nasdaq acknowledges that each agreement was negotiated separately, which appears to have resulted in different rates for each of the agreements.³⁶ But Nasdaq does not provide any detail about why these rates might be different or why it is unable to negotiate lower rates with FINRA given its use of FINRA for regulatory services for its six options exchanges. On this latter point, there is no discussion of economies of scale that potentially would be available from negotiating similar (or a single) RSA agreements for FINRA to conduct regulatory services across Nasdaq's six options exchanges. As discussed above, there appears to be little or no incentive for Nasdaq (or any other options exchange owner) and FINRA to take any steps to efficiently manage an options exchange's regulatory expenses, including reviewing the expenses it devotes to RSAs with FINRA or FINRA's performance with respect to the RSAs, because those expenses are passed through to customers.

Nasdaq's Proposals also do not meet its burden to show the proposed fees are equitably allocated and not unfairly discriminatory. Under the Proposals, Nasdaq is setting its Local ORF fee for Customer transactions at \$0.0205 per contract. This is approximately 175 times greater than the ORF fees it is proposing for both Local and Away executions in the Firm clearing range. To support the difference, the Proposals assert that "regulating Customer trading activity is 'much more labor-intensive' and therefore, more costly." Furthermore, Nasdaq states that "obtaining Customer information may be more time intensive. . . . [and] [t]he Exchange may have to take additional steps to understand the facts surrounding particular trades involving a Customer which may require requesting such information from a broker-dealer."³⁷ However, Nasdaq does not explain the circumstances or frequency with which it would request information

Immediate Effectiveness of Proposed Rule Change to Establish Fees for Its Expanded Co-Location Services, Release No. 34-101788, File No. SR-ISE-2024-53 (Dec. 2, 2024), 89 FR 97089 (dec. 6, 2024).

³⁵ See FINRA Notice supra n. 7 at n. 28 (not that FINRA's fee filing "does not include fees associated with [CAT] or [SLATE], both of which are subject to separate proposed rule changes with the Commission.").

³⁶ 89 FR at 90191 ("The primary driver of this need for "normalization" are negotiated regulatory contracts that were negotiated at different points in time, yielding some differences in per contract regulatory costs by exchange.").

³⁷ Id. at 90193.

from broker-dealers about particular trades versus when FINRA would conduct that surveillance on Nasdaq's behalf pursuant to the parties' RSA. It also is not evident why Local Customer transactions require regulatory work at a rate that is 175 times higher than the regulatory work performed for Local and Away Firm transactions since all of the information for both customer and firm range transactions are now in CAT and easily accessible by SROs. Without more detailed information, it is difficult for the Commission or commenters to assess Nasdaq's assertions regarding the costs of regulating Customer trading activity or whether its approach to ORF is unfairly discriminatory.

IV. Operational Complexity

In addition to the reasons discussed throughout this letter, the Commission should suspend the Nasdaq Proposals because it will introduce significant operational complexity by requiring firms to build or update systems to track the new ORF charges on both Local and Away executions in the "Firm" range. These updates are not possible by the proposed January 2, 2025 implementation date.

As discussed, exchanges assess separate ORF rates on all options executions in the "Customer" range. Broker-dealers generally track these charges by designing their systems to apply a single "blended" ORF rate to any execution in the "Customer" range, regardless of the exchange on which it occurs.³⁸ This internal tracking allows firms to pass-on some or all of the ORF charges to customers. Firms do not currently have systems to track ORF charges on executions in the Firm range because ORF is not assessed on those executions.

Nasdaq's Proposals will for the first time assess ORF charges for executions cleared in the "Firm" range at OCC. In addition, the Proposals will implement separate "Customer" and "Firm" charges for Local and Away executions.³⁹ This novel approach to assessing ORF on "Firm" executions, as well as whether the executions are Local or Away, will require broker-dealers to update their systems to accurately track the amount of ORF they are being charged on each execution. Based on Nasdaq's Proposals, firms will be required to program their systems to track not only whether an execution was cleared in the "Customer" or "Firm" range, but also whether the execution was "Local" or "Away." Then the system must apply the relevant ORF rate, of which there would be up to 24 separate rates for the Nasdaq exchanges alone (Customer Local, Customer Away, Firm Local, and Firm Away on each of the six Nasdaq exchanges). While it may be possible for firms to eventually "blend" the Firm-specific ORF charges internally as is common today with Customer-specific ORF charges, the system builds required

³⁸ As further discussed below, firms are not provided with an itemized invoice by the exchanges or OCC detailing ORF fees on a transaction-by-transaction basis.

³⁹ SIFMA notes that under the current Proposals, all of the Nasdaq exchanges would have an Away ORF charge for Customer transactions of \$0.00. However, if Nasdaq changes that amount in the future, the complexity introduced by the Proposals would be even greater.

to design, test, and implement these significant changes by January 2, 2025 are simply not possible.

In addition, it will be impossible for any broker-dealer that is subject to an end-of-year code freeze to do so by January 2, 2025. Even if it were feasible for such a broker-dealer to determine how to appropriately track the new ORF charges in its systems by the current deadline, it would be unable to do so based on its code freeze policies. Given these realities, if the Proposals were to go into effect as proposed on January 2, 2025, broker-dealers could be forced into the impossible task of manually calculating the amount of ORF assessed on each transaction.

Therefore, in addition to the above reasons, the Commission should suspend the Nasdaq Proposals so that broker-dealers subject to the new ORF approach will have sufficient time to update their systems to accurately track the new ORF charges.

V. Other Concerns

As we have stated previously, SIFMA continues to urge the Commission to require that exchanges provide more public detail in ORF filings regarding their regulatory costs as such costs do not seem to be an area of competitive concern among the exchanges.⁴⁰ As discussed, this lack of transparency could be one factor contributing to a lack of incentive among the options exchanges to control overall regulatory costs. Nasdaq's Proposals are consistent with other exchanges' filings regarding ORF methodologies, which historically have provided very little public details regarding how the exchange determines the expenses that fall under the exchange's options regulatory functions, the costs of those functions, or the rationale for selecting the level of ORF rates to fund appropriate regulation. Regardless of private SEC audits of ORF revenue and expenses, the Commission should require that ORF filings provide enhanced information, such as actual breakouts by category and dollar amount of each options regulatory function, its cost, and the amount of ORF revenue collected and assigned to each function. Such breakouts should be designed to provide enough detail to allow market participants to have a reasonable picture of the regulatory functions that the exchanges use ORF revenue to fund as well as the costs of those functions. The Commission could consider its 2004 proposed amendments to Form 1 as a reference point in connection with determining the level of detail to require in future ORF filings. SIFMA continues to strongly believe that greater transparency is especially important as the options exchanges have long-since moved to for-profit models and many of them are part of larger holding company structures in which the parent holding company is listed and publicly traded.

SIFMA also has observed that the ORF enables existing exchange groups and new entrants to launch a new options exchange without funding regulatory expenses of the new

⁴⁰ See supra n. 3.

exchange once it launches in production. In other words, currently, a newly formed options exchange can start collecting ORF revenue on customer options transactions without having executed a single trade based on the current model utilized by several exchanges. These newly formed exchanges often have very little market share but can collect ORF on all away transactions at an ORF rate similar to that of an exchange with substantial market share. It is also possible that an exchange may be able to launch other commercial endeavors if they can somehow point to some of the costs associated with those endeavors as being regulatory in nature, i.e., exchange transaction fee filings which are commercial in nature. The current lack of public transparency regarding exchanges' determination of the level of ORF rates and exchanges' use of the ORF revenue makes these scenarios possible or at least plausible to believe without real details.

Finally, SIFMA requests that the SEC help facilitate work between the options exchanges and OCC to ensure that execution details for each transaction that is assessed ORF is available to the OCC clearing firm assessed that ORF. Similar to other transaction and regulatory fees, trade details from each exchange on the transactions that were assessed an ORF by the exchange should be disseminated to each clearing firm so they can conduct a reconciliation of that data with their own trading data to make sure they are assessing customers the proper amount of ORF per execution. Currently, this level of transparency does not exist, and firms do not receive an itemized invoice detailing how exchanges determined the monthly charge amount. Exchanges continue to leverage an antiquated capability and instruct the OCC to debit the member's account monthly. Providing this additional detail is necessary to align with basic financial audit controls and would be a useful incremental improvement to current ORF practices.

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SIFMA appreciates the opportunity to submit this letter to the Commission regarding the Proposals. For the reasons set forth above, we urge the Commission to ultimately disapprove the filing after suspending it and issuing an order instituting proceedings, as Nasdaq has not met its burden of demonstrating that the proposed fees are consistent with the Exchange Act fee requirements. If you have any questions or need any additional information, please contact Ellen Greene at (212) 313-1287.

Sincerely,



Ellen Greene
Managing Director
Equities & Options Market Structure