

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-77736; File No. SR-NASDAQ-2016-058)

April 28, 2016

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Nasdaq Rule 7023

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 18, 2016, The NASDAQ Stock Market LLC (“Nasdaq” or the “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

Nasdaq is proposing to amend Nasdaq Rule 7023 (NASDAQ Depth-of-Book Data) to remove free top-of-file (“Top-of-File”) data from Nasdaq OpenView.

The text of the proposed rule change is available at nasdaq.cchwallstreet.com, at Nasdaq’s principal office, and at the Commission’s Public Reference Room.

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

In its filing with the Commission, Nasdaq included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

1. Purpose

The Exchange proposes to amend Nasdaq Rule 7023 (NASDAQ Depth-of-Book Data). Currently, Nasdaq does not charge a fee for use of Nasdaq OpenView Top-of-File data that is created using Nasdaq OpenView. Top-of-File data consists of Nasdaq’s aggregate best bid and offer quotation for each security listed on an exchange other than Nasdaq. Vendors can create Top-of-File data from Nasdaq OpenView and offer it to both professionals and non-professionals either for display or non-display.

The Exchange proposes to keep Top-of-File data as part of Nasdaq OpenView, but to no longer provide for free the use of this data (e.g., a subscriber of Nasdaq OpenView may no longer create a Top-of-File data product and provide it for free to other market participants). All market participants that opt to receive Nasdaq OpenView and create a Top-of-File data product from it will be liable for the Nasdaq OpenView fee rate applicable to Non-Professional Subscribers³ or Professional Subscribers,⁴ as appropriate. The monthly fee is currently \$1 for Non-Professional Subscribers⁵ while the monthly fee for Professional Subscribers is currently \$6

³ See Nasdaq Rule 7023(a)(3)(A). This rule defines a Non-Professional Subscriber as a natural person who is not: (1) registered or qualified in any capacity with the Commission, the Commodity Futures Trading Commission, any state securities agency, any securities exchange or association, or any commodities or futures contract market or association; (2) engaged as an “investment adviser” as that term is defined in Section 201(11) of the Investment Advisers Act of 1940 (whether or not registered or qualified under that Act); or (3) employed by a bank or other organization exempt from registration under federal or state securities laws to perform functions that would require registration or qualification if such functions were performed for an organization not so exempt.

⁴ See Nasdaq Rule 7023(a)(3)(B). This rule defines a Professional Subscriber as any subscriber other than a “Non-Professional Subscriber,” as that term is defined in Nasdaq Rule 7023(a)(3)(A).

⁵ See Nasdaq Rule 7023(b)(3)(A).

each for any display usage, or for non-display usage based upon indirect access.⁶ Market participants cannot be charged for both Top-of-File data and OpenView.

Since no firms currently are utilizing Nasdaq OpenView Top-of-File data, there will be no immediate impact on any subscribers due to the proposed rule change. However, the proposed rule change makes clear going forward that any subscribers creating this data will not be able to use it for free.

To effectuate this proposed rule change, the Exchange will eliminate Nasdaq Rule 7023(b)(3)(C) and renumber Nasdaq Rule 7023(b)(3)(D) as Nasdaq Rule 7023(b)(3)(C).

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,⁷ in general, and furthers the objectives of Sections 6(b)(4) and 6(b)(5) of the Act,⁸ in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using its facilities which the Exchange operates or controls, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Commission and the courts have repeatedly expressed their preference for competition over regulatory intervention in determining prices, products, and services in the securities markets. In Regulation NMS, while adopting a series of steps to improve the current market model, the Commission highlighted the importance of market forces in determining prices and SRO revenues and, also, recognized that current regulation of the market system “has

⁶ See Nasdaq Rule 7023(b)(3)(B).

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(4) and (5).

been remarkably successful in promoting market competition in its broader forms that are most important to investors and listed companies.”⁹

Likewise, in NetCoalition v. Securities and Exchange Commission¹⁰ (“NetCoalition”) the D.C. Circuit upheld the Commission’s use of a market-based approach in evaluating the fairness of market data fees against a challenge claiming that Congress mandated a cost-based approach.¹¹ As the court emphasized, the Commission “intended in Regulation NMS that ‘market forces, rather than regulatory requirements’ play a role in determining the market data . . . to be made available to investors and at what cost.”¹²

Further, “[n]o one disputes that competition for order flow is ‘fierce.’ . . . As the SEC explained, ‘[i]n the U.S. national market system, buyers and sellers of securities, and the broker-dealers that act as their order-routing agents, have a wide range of choices of where to route orders for execution’; [and] ‘no exchange can afford to take its market share percentages for granted’ because ‘no exchange possesses a monopoly, regulatory or otherwise, in the execution of order flow from broker dealers’”¹³

Vendors can create Top-of-File data from Nasdaq OpenView and offer it to both professionals and non-professionals either for display or non-display. The Exchange believes that the proposed rule change to charge all market participants that opt to receive Nasdaq OpenView and create a Top-of-File data product the Nasdaq OpenView fee rate applicable to Non-Professional Subscribers or Professional Subscribers, as appropriate, is reasonable because

⁹ Securities Exchange Act Release No. 34-51808 (June 9, 2005) (“Regulation NMS Adopting Release”).

¹⁰ NetCoalition v. SEC 615 F.3d 525 (D.C. Cir. 2010).

¹¹ Id. at 534-535.

¹² Id. at 537.

¹³ Id. at 539 (quoting ArcaBook Order, 73 FR at 74782-74783).

the Exchange is entitled to receive a fee from each subscriber that receives such data to help offset costs associated with providing Nasdaq OpenView data to subscribers. Also, the proposed rule change is reasonable because a market participant must use Nasdaq OpenView data in order to create a Top-of-File data product and since Nasdaq OpenView is fee liable, the same should be true of the resulting Top-of-File data product.

The Exchange also believes that the proposed rule change is an equitable allocation of fees and is not unfairly discriminatory because market participants cannot be charged for both Top-of-File data and OpenView and the proposed rule change applies uniformly to all market participants since it treats all similarly situated market participants the same.

The renumbering of Nasdaq Rule 7023(b)(3)(D) as Nasdaq Rule 7023(b)(3)(C) is reasonable because it is a technical and clarifying change that is intended to maintain the coherency and consistency within the Nasdaq rule book.

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

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. Notwithstanding its determination that the Commission may rely upon competition to establish fair and equitably allocated fees for market data, the NetCoalition court found that the Commission had not, in that case, compiled a record that adequately supported its conclusion that the market for the data at issue in the case was competitive. Nasdaq believes that a record may readily be established to demonstrate the competitive nature of the market in question.

There is intense competition between trading platforms that provide transaction execution and routing services and proprietary data products. Transaction execution and proprietary data products are complementary in that market data is both an input and a byproduct of the execution service. In fact, market data and trade execution are a paradigmatic example of joint products

with joint costs. Data products are valuable to many end Subscribers only insofar as they provide information that end Subscribers expect will assist them or their customers in making trading decisions.

The costs of producing market data include not only the costs of the data distribution infrastructure, but also the costs of designing, maintaining, and operating the exchange's transaction execution platform and the cost of regulating the exchange to ensure its fair operation and maintain investor confidence. The total return that a trading platform earns reflects the revenues it receives from both products and the joint costs it incurs.

Moreover, an exchange's customers view the costs of transaction executions and of data as a unified cost of doing business with the exchange. A broker-dealer ("BD") will direct orders to a particular exchange only if the expected revenues from executing trades on the exchange exceed net transaction execution costs and the cost of data that the BD chooses to buy to support its trading decisions (or those of its customers). The choice of data products is, in turn, a product of the value of the products in making profitable trading decisions. If the cost of the product exceeds its expected value, the BD will choose not to buy it. Moreover, as a BD chooses to direct fewer orders to a particular exchange, the value of the product to that BD decreases, for two reasons. First, the product will contain less information, because executions of the BD's orders will not be reflected in it. Second, and perhaps more important, the product will be less valuable to that BD because it does not provide information about the venue to which it is directing its orders. Data from the competing venue to which the BD is directing orders will become correspondingly more valuable.

Thus, an increase in the fees charged for either transactions or data has the potential to impair revenues from both products. "No one disputes that competition for order flow is

‘fierce’.”¹⁴ However, the existence of fierce competition for order flow implies a high degree of price sensitivity on the part of BDs with order flow, since they may readily reduce costs by directing orders toward the lowest-cost trading venues. A BD that shifted its order flow from one platform to another in response to order execution price differentials would both reduce the value of that platform’s market data and reduce its own need to consume data from the disfavored platform. Similarly, if a platform increases its market data fees, the change will affect the overall cost of doing business with the platform, and affected BDs will assess whether they can lower their trading costs by directing orders elsewhere and thereby lessening the need for the more expensive data.

Analyzing the cost of market data distribution in isolation from the cost of all of the inputs supporting the creation of market data will inevitably underestimate the cost of the data. Thus, because it is impossible to create data without a fast, technologically robust, and well-regulated execution system, system costs and regulatory costs affect the price of market data. It would be equally misleading, however, to attribute all of the exchange’s costs to the market data portion of an exchange’s joint product. Rather, all of the exchange’s costs are incurred for the unified purposes of attracting order flow, executing and/or routing orders, and generating and selling data about market activity. The total return that an exchange earns reflects the revenues it receives from the joint products and the total costs of the joint products.

Competition among trading platforms can be expected to constrain the aggregate return each platform earns from the sale of its joint products, but different platforms may choose from a range of possible, and equally reasonable, pricing strategies as the means of recovering total costs. Nasdaq pays rebates to attract orders, charges relatively low prices for market information

¹⁴ Id.

and charges relatively high prices for accessing posted liquidity. Other platforms may choose a strategy of paying lower liquidity rebates to attract orders, setting relatively low prices for accessing posted liquidity, and setting relatively high prices for market information. Still others may provide most data free of charge and rely exclusively on transaction fees to recover their costs. Finally, some platforms may incentivize use by providing opportunities for equity ownership, which may allow them to charge lower direct fees for executions and data.

In this environment, there is no economic basis for regulating maximum prices for one of the joint products in an industry in which suppliers face competitive constraints with regard to the joint offering. Such regulation is unnecessary because an “excessive” price for one of the joint products will ultimately have to be reflected in lower prices for other products sold by the firm, or otherwise the firm will experience a loss in the volume of its sales that will be adverse to its overall profitability. In other words, an increase in the price of data will ultimately have to be accompanied by a decrease in the cost of executions, or the volume of both data and executions will fall.

The level of competition and contestability in the market is evident in the numerous alternative venues that compete for order flow, including eleven SRO markets, as well as internalizing BDs and various forms of alternative trading systems (“ATSS”), including dark pools and electronic communication networks (“ECNs”). Each SRO market competes to produce transaction reports via trade executions, and two FINRA-regulated TRFs compete to attract internalized transaction reports. It is common for BDs to further and exploit this competition by sending their order flow and transaction reports to multiple markets, rather than providing them all to a single market. Competitive markets for order flow, executions, and transaction reports provide pricing discipline for the inputs of proprietary data products.

The large number of SROs, TRFs, BDs, and ATSs that currently produce proprietary data or are currently capable of producing it provides further pricing discipline for proprietary data products. Each SRO, TRF, ATS, and BD is currently permitted to produce proprietary data products, and many currently do or have announced plans to do so, including NASDAQ, NYSE, NYSE MKT, NYSE Arca, and BATS/Direct Edge.

Any ATS or BD can combine with any other ATS, BD, or multiple ATSs or BDs to produce joint proprietary data products. Additionally, order routers and market data vendors can facilitate single or multiple BDs' production of proprietary data products. The potential sources of proprietary products are virtually limitless. Notably, the potential sources of data include the BDs that submit trade reports to TRFs and that have the ability to consolidate and distribute their data without the involvement of FINRA or an exchange-operated TRF.

The fact that proprietary data from ATSs, BDs, and vendors can by-pass SROs is significant in two respects. First, non-SROs can compete directly with SROs for the production and sale of proprietary data products, as BATS and NYSE Arca did before registering as exchanges by publishing proprietary book data on the internet. Second, because a single order or transaction report can appear in a core data product, an SRO proprietary product, and/or a non-SRO proprietary product, the data available in proprietary products is exponentially greater than the actual number of orders and transaction reports that exist in the marketplace.

In addition to the competition and price discipline described above, the market for proprietary data products is also highly contestable because market entry is rapid, inexpensive, and profitable. The history of electronic trading is replete with examples of entrants that swiftly grew into some of the largest electronic trading platforms and proprietary data producers: Archipelago, Bloomberg Tradebook, Island, RediBook, Attain, TracECN, BATS Trading and

BATS/Direct Edge. A proliferation of dark pools and other ATSs operate profitably with fragmentary shares of consolidated market volume.

Regulation NMS, by deregulating the market for proprietary data, has increased the contestability of that market. While BDs have previously published their proprietary data individually, Regulation NMS encourages market data vendors and BDs to produce proprietary products cooperatively in a manner never before possible. Multiple market data vendors already have the capability to aggregate data and disseminate it on a profitable scale, including Bloomberg and Thomson Reuters. In Europe, Cinnober aggregates and disseminates data from over 40 brokers and multilateral trading facilities.¹⁵

In the case of TRFs, the rapid entry of several exchanges into this space in 2006-2007 following the development and Commission approval of the TRF structure demonstrates the contestability of this aspect of the market.¹⁶ Given the demand for trade reporting services that is itself a by-product of the fierce competition for transaction executions – characterized notably by a proliferation of ATSs and BDs offering internalization – any supra-competitive increase in the fees associated with trade reporting or TRF data would shift trade report volumes from one of the existing TRFs to the other¹⁷ and create incentives for other TRF operators to enter the space. Alternatively, because BDs reporting to TRFs are themselves free to consolidate the market data that they report, the market for over-the-counter data itself, separate and apart from the markets for execution and trade reporting services – is fully contestable.

¹⁵ See <http://www.cinnober.com/boat-trade-reporting>.

¹⁶ The low cost exit of two TRFs from the market is also evidence of a contestable market, because new entrants are reluctant to enter a market where exit may involve substantial shut-down costs.

¹⁷ It should be noted that the FINRA/NYSE TRF has, in recent weeks, received reports for almost 10% of all over-the-counter volume in NMS stocks.

Moreover, consolidated data provides two additional measures of pricing discipline for proprietary data products that are a subset of the consolidated data stream. First, the consolidated data is widely available in real-time at \$1 per month for non-professional users. Second, consolidated data is also available at no cost with a 15- or 20- minute delay. Because consolidated data contains marketwide information, it effectively places a cap on the fees assessed for proprietary data (such as last sale data) that is simply a subset of the consolidated data. The mere availability of low-cost or free consolidated data provides a powerful form of pricing discipline for proprietary data products that contain data elements that are a subset of the consolidated data, by highlighting the optional nature of proprietary products.

In this instance, the proposed rule change to charge all market participants that create a Top-of-File product using Nasdaq OpenView data the fee rate applicable to Non-Professional Subscribers or Professional Subscribers, as appropriate, by eliminating current rule text in Nasdaq Rule 7023(b)(3)(C), does not impose a burden on competition because no firms currently are utilizing this data so there will be no immediate impact on any subscribers.

In sum, if the rule change proposed herein is unattractive to market participants, it is likely that the Exchange will lose market share as a result. Accordingly, the Exchange does not believe that the proposed change will impair the ability of members or competing order execution venues to maintain their competitive standing in the financial markets.

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

Written comments were neither solicited nor received.

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

The foregoing change has become effective pursuant to Section 19(b)(3)(A)(ii) of the

Act.¹⁸ At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2016-058 on the subject line.

Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2016-058. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those

¹⁸ 15 U.S.C. 78s(b)(3)(A)(ii).

that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASDAQ-2016-058, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁹

Robert W. Errett
Deputy Secretary

¹⁹ 17 CFR 200.30-3(a)(12).