

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-71042; File No. SR-FINRA-2013-052)

December 11, 2013

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change Relating to Alternative Display Facility New Entrant

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “SEA”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that, on December 2, 2013, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. 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

FINRA is proposing to add a new entrant to the Alternative Display Facility (“ADF”).

The new ADF entrant, LavaFlow (“FLOW”) has prepared a summary of its policies and procedures regarding access to its quotations in an NMS stock displayed on the ADF, and a summary of its proposed fees for such access, which was filed as Exhibit 3.

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

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

In its filing with the Commission, FINRA 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 these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The ADF is a quotation collection and trade reporting facility that provides ADF Market Participants (i.e., ADF-registered market makers or electronic communications networks (“ECNs”))<sup>3</sup> the ability to post quotations, display orders and report transactions in NMS stocks<sup>4</sup> for submission to the Securities Information Processors for consolidation and dissemination to vendors and other market participants. In addition, the ADF delivers real-time data to FINRA for regulatory purposes, including enforcement of requirements imposed by SEC Regulation NMS.<sup>5</sup>

The ADF was initially approved by the Commission on July 24, 2002, in connection with the SEC's approval of SuperMontage and Nasdaq's registration as a national securities exchange.<sup>6</sup> At that time, the ADF was approved for Nasdaq-listed

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<sup>3</sup> See FINRA Rule 6220(a)(3).

<sup>4</sup> See 17 CFR 242.600.

<sup>5</sup> See 17 CFR 242.600.

<sup>6</sup> See Securities Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49822 (July 31, 2002) (Order Approving File No. SR-NASD-2002-97); see also Notice to Members 02-45 (August 2002).

securities for a nine-month pilot period to provide FINRA members with an alternative to the Nasdaq systems for reporting quotations and transactions in Nasdaq UTP Plan securities.

In 2005, the Commission adopted Regulation NMS, which included the Order Protection Rule.<sup>7</sup> With the adoption of the Order Protection Rule, Regulation NMS established trade-through protection for all NMS stocks.<sup>8</sup> Since the ADF is a display-only facility, a market participant would have to access the actual ADF participant that posted the protected quotation on the ADF in order to comply with the Order Protection Rule.<sup>9</sup> In the NMS Adopting Release, the Commission noted that market participants could potentially access an ADF participant either through direct access or through a private network.<sup>10</sup>

Given that market participants could be required to access multiple ADF participants to comply with the Order Protection Rule, the Commission formulated Rule 610 under SEC Regulation NMS to ensure that market participants would be afforded “fair and efficient access” to such trading centers.<sup>11</sup> Accordingly, Rule 610 requires that a trading center displaying quotations in an NMS stock through an SRO display-only facility (such as the ADF) “provide a level and cost of access to such quotations that is

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<sup>7</sup> The Order Protection Rule provides that a trading center “shall establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs on that trading center of protected quotations in NMS stocks” that do not fall within one of the exceptions set forth in the rule. See 17 CFR 242.611.

<sup>8</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37501 (June 29, 2005) (“NMS Adopting Release”).

<sup>9</sup> NMS Adopting Release, 70 FR at 37541.

<sup>10</sup> NMS Adopting Release, 70 FR at 37543.

<sup>11</sup> NMS Adopting Release, 70 FR at 37549.

substantially equivalent to the level and cost of access to quotations displayed by SRO trading facilities in that stock.”<sup>12</sup> Rule 610 also requires that a trading center displaying quotations in an NMS stock through an SRO display-only facility not impose unfairly discriminatory terms that prevent or inhibit any person from obtaining efficient access to such quotations through a member, subscriber, or customer of the trading center.<sup>13</sup>

In articulating this standard, the Commission noted that the level and cost of access would “encompass both (1) the policies, procedures, and standards that govern access to quotations of the trading center, and (2) the connectivity through which market participants can obtain access and the cost of such connectivity.”<sup>14</sup> The nature and cost of connections for market participants seeking to access the ADF participant’s quotations would need to be substantially equivalent to the nature and cost of connections to SRO trading facilities.<sup>15</sup>

In evaluating whether ADF participants are meeting the access standards under Rule 610, *i.e.*, that the cost of accessing an ADF participant is substantially equivalent to the cost of accessing an SRO trading facility, the Commission stated that the NASD (now FINRA) would act as a gatekeeper in this process. As such, FINRA would be required to submit a proposed rule change pursuant to Section 19(b) of the Act in order to add a new ADF participant.<sup>16</sup> Since the second quarter of 2010, there have been no ADF Market Participants.

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<sup>12</sup> 17 CFR 242.610(b)(1).

<sup>13</sup> 17 CFR 242.610(b)(2).

<sup>14</sup> NMS Adopting Release, 70 FR at 37549.

<sup>15</sup> NMS Adopting Release, 70 FR at 37549.

<sup>16</sup> NMS Adopting Release, 70 FR at 37549.

Consistent with the requirements of Rule 610 and the NMS Adopting Release, FINRA is submitting this proposed rule change so that FLOW may become an ADF Market Participant. As set forth in its summary, FLOW has proposed policies and procedures that are designed to ensure that the level of access to its quotations is substantially equivalent to the level of access to quotations displayed by SRO trading facilities in that stock, and to ensure that FLOW does not impose unfairly discriminatory terms that prevent or inhibit any person from obtaining efficient access to such quotations.

Specifically, firms wishing to access FLOW liquidity may connect in a variety of ways. Firms that are FLOW subscribers may connect to FLOW via the FLOW Smart Order Router, or through the FLOW Gateway. Non-FLOW subscribers may connect via a third party vendor or connectivity provider, or alternatively through an exchange or a third-party broker-dealer subscriber. FLOW allows a subscriber to determine its level of connectivity, and FLOW does not have any tiers or rules regarding execution of orders based upon Market Participant Identification. No participant is given any priority in the FLOW matching engine. One feature of FLOW is customer anonymity from matching orders through clearing executions, and the FLOW matching engine is blind to the identity of the participant, with the exception of orders using the anti-internalization feature. FLOW also has policies and procedures that require FLOW to respond to orders by non-subscribers as promptly as it responds to orders by subscribers, and have non-subscribers be able to automatically execute against quotations displayed by the system.

As set forth in its summary, FLOW has also established, and regularly maintains, policies and procedures designed to maintain a linkage with at least one SRO trading

facility, or SRO display-only facility. It also has policies and procedures to transmit to such SRO trading facility or SRO display-only facility for display either the best priced order of those orders entered by OTC market makers and exchange market makers for those securities in which they make markets (or act as specialists) or the best priced orders entered by all ECN subscribers. FLOW has policies and procedures to provide, to any broker or dealer, access to such orders that is functionally equivalent to the access that is generally available for quotes displayed by a SRO trading facility or, for orders displayed in an SRO display-only facility, a level and cost of access that is substantially similar to the level and cost of access to quotations displayed by SRO trading facilities in that stock. FLOW also has established and maintains policies and procedures to conduct regular periodic system capacity reviews and tests to ensure future capacity, and to identify potential weaknesses and reduce the risks of system failures and threats to system integrity. FLOW's policies and procedures also require continuous monitoring of its connections with SRO trading facilities or SRO display-only facilities and in the event that FLOW loses connection with any SRO trading facility or SRO display-only facility FLOW will cancel all quotes previously published by the system to that facility and notify its subscribers of such interruption.

FLOW also has policies and procedures, also set forth in its summary, that are designed to ensure that the cost of access to its quotations is substantially equivalent to the cost of access to quotations displayed by SRO trading facilities in that stock, and that FLOW will not charge a fee for accessing its quotations that exceeds the maximum fee

permitted by Rule 610 of Regulation NMS.<sup>17</sup> The cost of accessing the quotation of a trading center may consist of several distinct costs, such as port fees, market data fees, general connectivity fees, and transaction fees, and FLOW proposes to assess costs in these respects that are substantially equivalent to the costs assessed by SRO trading facilities.

With respect to port fees, FLOW charges port fees to subscribers based upon the number of ports requested. FLOW provides one port per subscriber in each of its data centers (primary and secondary) for free, and reserves the right to charge a port fee for all subsequent connections. Fee-eligible port connections may be charged \$400 per connection, per month. In comparison, exchange port fees on average range from \$100 to \$1,000 per port, per month.<sup>18</sup>

With respect to other connectivity fees, FLOW is already connected in its production environment to most outbound routers via intranets, cross connects and other

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<sup>17</sup> With respect to the requirement that the nature and cost for market participants seeking to access an ADF Trading Center need to be substantially equivalent to the nature and cost of connection to SRO trading facilities, FINRA notes that the Commission stated in the NMS Adopting Release that this requirement does not apply on an absolute basis, but rather applies on a per-transaction basis to reflect the costs relative to the ADF participant's trading volume. See NMS Adopting Release, 70 FR at 37549 n.449. Based on FLOW's representations, FINRA believes that FLOW's proposed level and cost of access to its quotations is substantially equivalent to the level and cost of access to quotations displayed by an SRO trading facility, both in absolute and relative terms.

<sup>18</sup> For example, The Chicago Board Options Exchange, Incorporated Stock Exchange ("CBSX") assesses a fee of \$100 per month per FIX port. See <http://www.cboe.com/publish/cbsxfeeschedule/cbsxfeeschedule.pdf>. BATS Exchange, Inc. ("BATS") assesses a monthly port fee of \$400 for certain ports. See [http://cdn.batstrading.com/resources/regulation/rule\\_book/BZX\\_Fee\\_Schedule.pdf](http://cdn.batstrading.com/resources/regulation/rule_book/BZX_Fee_Schedule.pdf). EDGA Exchange, Inc. assesses a monthly port fee of \$500. See <https://www.directedge.com/Portals/0/01Trading/EDGA%20Fee%20Schedule/2013/EDGA.11.2013.pdf>. CBSX assess a fee of \$1,000 per month for a 10-gigabit network access port. Id.

direct connections. FLOW has represented that the cost to establish connections to FLOW for users of these services and for individual firms not using these services should be substantially the same as the costs to connect to an exchange. Both FLOW subscribers and non-subscribers are responsible for paying for their own external telecommunications costs to connect to FLOW, and FLOW has represented that such fees would be equivalent to the costs to connect to any other trading center, such as an exchange.

With respect to market data fees, FLOW has represented that it does not have any plans to charge its subscribers or non-subscribers for access to FLOW's market data in either of its two forms of distribution (TCP or multicast). In comparison, market data fees vary by exchange, with some exchanges charging fees that range from under \$100 per month to \$750 to \$2,500, and some exchanges charging \$5,000 for external distribution.<sup>19</sup>

Finally, exchanges currently charge a range of other fees, including but not limited to membership fees, trading rights fees, risk gateway fees and other miscellaneous fees. FLOW has represented that it does not assess similar charges.

With respect to the specific fees for accessing protected quotations that it has displayed on the ADF, the FLOW fee structure is currently a maker-taker model where FLOW pays a rebate for added executed liquidity and charges a fee for removed

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<sup>19</sup> For example, The NASDAQ Stock Market LLC ("Nasdaq") assesses a user fee of \$70 per month for professional and corporate subscribers and \$14 for non-professional subscribers to its TotalView and OpenView products for Nasdaq issues. See <http://www.nasdaqtrader.com/Trader.aspx?id=DPUSdata>. NYSE Arca, Inc. charges a monthly access fee of \$750 for its ArcaBook data feed. See <http://www.nyxdata.com/arcabook>. BATS assesses a fee of \$5,000 per month for external distribution of its PITCH feed. See [http://cdn.batstrading.com/resources/regulation/rule\\_book/BZX\\_Fee\\_Schedule.pdf](http://cdn.batstrading.com/resources/regulation/rule_book/BZX_Fee_Schedule.pdf).



liquidity. FLOW charges a standard rate of \$0.0030 to remove liquidity.<sup>20</sup> Pricing is subject to change with advance notice provided to subscribers. For non-subscribers, notice of a price change is published to the FLOW website in advance of such price change. FLOW charges subscribers and non-subscribers the same fees for utilizing its system, and monitors the average fee charged to non-subscribers and compares it to the average fee paid by subscribers in order to ensure the prices are the same.<sup>21</sup>

All members in good standing of a self-regulatory organization (“SRO”) are eligible to become FLOW subscribers, and will be subject to credit limits set by FLOW. In setting a subscriber’s credit limits, FLOW considers the subscriber’s financial condition and its regulatory history.

FINRA believes that the policies, procedures and standards governing access to protected quotations displayed on the ADF by FLOW are reasonably designed to provide market participants with fair and efficient access, and are not unfairly discriminatory such that they would prevent a market participant from obtaining efficient access to such quotations. For example, all members in good standing of an SRO are eligible to become FLOW subscribers, and both subscribers and non-subscribers may access FLOW liquidity. Additionally, both subscribers and non-subscribers have multiple options when accessing FLOW liquidity: subscribers may use either the FLOW Smart Order Router or

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<sup>20</sup> FLOW also pays a current base rebate is \$0.0024 per share for added executed visible liquidity and \$0.0010 per share of added executed non-visible liquidity. There are increased rebate incentives for FLOW subscribers that maintain higher volumes on a daily basis.

<sup>21</sup> FINRA notes that these are the current fees assessed, and rebates paid, by FLOW, and that FLOW’s fees may be subject to change. In that event that FLOW makes a material change to the policies and procedures governing access to FLOW, including a change to its fees, it will submit to FINRA, and FINRA will post on its web site, an amended description of its policies, procedures and fees governing access.

the FLOW Gateway, and non-subscribers may connect to FLOW through a third-party vendor, an exchange, or through a third-party broker-dealer that is a subscriber. FLOW allows a subscriber to determine its level of connectivity, and FLOW does not have any tiers or rules regarding execution of orders based upon Market Participant Identification. No participant is given any priority in the FLOW matching engine, and the FLOW matching engine is blind to the identity of the participant, with the exception of orders using the anti-internalization feature. FLOW also has policies and procedures that require FLOW to respond to orders by non-subscribers as promptly as it responds to orders by subscribers, and allow for non-subscribers to be able to automatically execute against quotations displayed by the system.

FINRA also believes that the proposed level and cost of access is, in relative terms, substantially equivalent to the level and cost of access provided by SRO trading facilities. FLOW charges a standard rate of \$0.0030 to remove liquidity; in comparison, BATS assesses a \$0.0030 charge per share for orders in securities priced \$1 or above that remove liquidity.<sup>22</sup> Also by way of comparison, Nasdaq assesses a fee for removing liquidity for orders in securities that are priced at or above \$1 that ranges from \$0.0029 to \$0.0030.<sup>23</sup> FLOW provides one port per subscriber in each of its data centers (primary

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<sup>22</sup> See BATS BZX Exchange Fee Schedule, available at [http://cdn.batstrading.com/resources/regulation/rule\\_book/BZX\\_Fee\\_Schedule.pdf](http://cdn.batstrading.com/resources/regulation/rule_book/BZX_Fee_Schedule.pdf).

<sup>23</sup> See Nasdaq fee schedule, available at <http://www.nasdaqtrader.com/Trader.aspx?id=PriceListTrading2>.

FINRA also notes that FLOW offers rebates that are substantially comparable to rebates offered by SRO trading facilities. FLOW's current base rebate is \$0.0024 per share for added executed displayed liquidity and \$0.0010 per share of added executed non-displayed liquidity. By way of comparison, BATS Exchange, Inc. pays a standard rebate of \$0.0020 rebate per share for orders in securities priced \$1 or above that add displayed liquidity, and a rebate of \$0.0017 for orders in

and secondary) for free, and reserves the right to charge a port fee for all subsequent connections, which would be assessed \$400 per connection, per month. This is comparable to port fees assessed by certain exchanges. Both FLOW subscribers and non-subscribers are responsible for paying for their own external telecommunications costs to connect to FLOW, and FLOW believes that these fees are equivalent to the costs to connect to any other trading center, such as an exchange.

FLOW also believes that the cost to establish connections to FLOW for users of most outbound routers via intranets, cross connects and other direct connections, and for individual firms not using these services, should be substantially the same as the costs to connect to an exchange. FLOW does not charge its subscribers or non-subscribers for access to FLOW's market data, in comparison to market data fees assessed by exchanges, which range from under \$100 per month to costs for external distribution, for which some exchanges assess \$5,000. FLOW does not assess other charges that may be assessed by exchanges, including membership fees, trading rights fees, risk gateway fees and other miscellaneous fees.

The proposal shall be effective upon Commission approval.

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securities priced \$1 or above that, with certain exceptions, add non-displayed liquidity. See BATS BZX Exchange Fee Schedule, available at [http://cdn.batstrading.com/resources/regulation/rule\\_book/BZX\\_Fee\\_Schedule.pdf](http://cdn.batstrading.com/resources/regulation/rule_book/BZX_Fee_Schedule.pdf). FLOW offers increased rebate incentives for subscribers that maintain higher volumes on a daily basis. Similarly, BATS offers a tiered rebate structure for displayed liquidity for orders in securities priced \$1 or above for members that meet certain volume thresholds.

FINRA also notes that Nasdaq offers rebates to firms that add displayed liquidity for orders in securities priced at or above \$1 that range, with certain exceptions, from \$0.0015 to \$0.00305, depending in part on whether the firm meets certain volume thresholds. Nasdaq offers rebates to firms that add non-displayed liquidity for orders in securities priced at or above \$1 that range, with certain exceptions, from \$0.0005 to \$0.0017. See Nasdaq fee schedule, available at <http://www.nasdaqtrader.com/Trader.aspx?id=PriceListTrading2>.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>24</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, and Section 15A(b)(9) of the Act,<sup>25</sup> which requires that FINRA rules not impose any burden on competition that is not necessary or appropriate.

FINRA believes this proposal is consistent with the Act because it is being submitted pursuant to Rule 610 and the requirements set forth in the NMS Adopting Release, which require FINRA to submit a proposed rule change upon the addition of a new ADF participant. This rule change is also consistent with the Act in that it sets forth the fees, policies and procedures governing access to protected quotations FLOW may display on the ADF, which were identified by the Commission as central concerns surrounding the adoption of Rule 610.

As set forth above, FINRA believes that the policies, procedures and standards governing access to protected quotations displayed on the ADF by FLOW are reasonably designed to provide market participants with fair and efficient access, and are not unfairly discriminatory such that they would prevent a market participant from obtaining efficient access to such quotations. FINRA also believes, as set forth above, that the proposed level and cost of access is, in relative terms, substantially equivalent to the level and cost of access provided by SRO trading facilities.

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<sup>24</sup> 15 U.S.C. 78o-3(b)(6).

<sup>25</sup> 15 U.S.C. 78o-3(b)(9).

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

FINRA 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. FINRA notes that the purpose of this filing is to provide for the opportunity for public notice and comment on the addition of a new ADF entrant as required by SEC Rule 610 and the NMS Adopting Release, along with that new entrant's proposed fees and policies and procedures for accessing protected quotations that it may display on the ADF. As such, FINRA believes that this filing may in fact promote competition by providing information about the level of access provided, and fees assessed, by a new ADF entrant.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### 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](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2013-052 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2013-052. 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 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 the filing also will be available for inspection and copying at the principal office of FINRA. 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-FINRA-2013-052 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.<sup>26</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>26</sup> 17 CFR 200.30-3(a)(12).