

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68613; File No. SR-NASDAQ-2012-141)

January 9, 2013

Self-Regulatory Organizations; The NASDAQ Stock Market LLC Notice; of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Penny Pilot Options

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 31, 2012, The NASDAQ Stock Market LLC (“NASDAQ” or “Exchange”) 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 NASDAQ. 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 proposes to modify Chapter XV, Section 2 of the rules governing the NASDAQ Options Market (“NOM”), NASDAQ’s facility for executing and routing standardized equity and index options. Specifically, NOM proposes to amend its pricing to modify the Professional Rebate to Add Liquidity in Penny Pilot Options.<sup>3</sup>

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

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

<sup>3</sup> The Penny Pilot was established in March 2008, expanded in October 2009, and, through a series of orders, extended through December 31, 2012. See Securities Exchange Act Release Nos. 57579 (March 28, 2008), 73 FR 18587 (April 4, 2008)(SR-NASDAQ-2008-026)(notice of filing and immediate effectiveness establishing Penny Pilot); 60874 (October 23, 2009), 74 FR 56682 (November 2, 2009)(SR-NASDAQ-2009-091)(notice of filing and immediate effectiveness expanding and extending Penny Pilot); 60965 (November 9, 2009), 74 FR 59292 (November 17, 2009)(SR-NASDAQ-2009-097)(notice of filing and immediate effectiveness adding seventy-five classes to Penny Pilot); 61455

While the changes proposed herein are effective upon filing, the Exchange has designated that the amendments be operative on January 2, 2013.

The text of the proposed rule change is available on the Exchange's Website at <http://www.nasdaq.cchwallstreet.com>, at the principal office of the Exchange, 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, the Exchange included statements concerning the purpose of and basis for the proposed rule change. The text of these 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 aspects of such statements.

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

1. Purpose

NASDAQ proposes to modify Chapter XV, entitled "Options Pricing," at Section 2(1) governing the rebates and fees assessed for option orders entered into NOM. The Exchange is proposing to amend the Professional Rebate to Add Liquidity in Penny Pilot Options to attract additional order flow to the Exchange.

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(February 1, 2010), 75 FR 6239 (February 8, 2010)(SR-NASDAQ-2010-013)(notice of filing and immediate effectiveness adding seventy-five classes to Penny Pilot); 62029 (May 4, 2010), 75 FR 25895 (May 10, 2010) (SR-NASDAQ-2010-053)(notice of filing and immediate effectiveness adding seventy-five classes to Penny Pilot); 65969 (December 15, 2011), 76 FR 79268 (December 21, 2011) (SR-NASDAQ-2011-169) (notice of filing and immediate effectiveness extension and replacement of Penny Pilot); and 67325 (June 29, 2012), 77 FR 40127 (July 6, 2012) (SR-NASDAQ-2012-075) (notice of filing and immediate effectiveness and extension and replacement of Penny Pilot through December 31, 2012). See also NOM Rules, Chapter VI, Section 5.

The Exchange currently pays a flat Professional Rebate to Add Liquidity in Penny Pilot Options of \$0.29 per contract. The Exchange is now proposing to pay Professionals, a tiered rebate instead. Specifically, the Exchange proposes to eliminate the flat \$0.29 per contract Professional Rebate to Add Liquidity and instead pay Professionals rebates based on total number of Customer and Professional contracts that add liquidity in Penny Pilot Options in a given month as follows:

<b>Monthly Volume</b>	<b>Rebate to Add Liquidity</b>
<b>Tier 1</b> Participant adds Customer and Professional liquidity of up to 34,999 contracts per day in a month	\$0.26
<b>Tier 2</b> Participant adds Customer and Professional liquidity of 35,000 to 74,999 contracts per day in a month	\$0.43
<b>Tier 3</b> Participant adds Customer and Professional liquidity of 75,000 or more contracts per day in a month	\$0.44
<b>Tier 4</b> Participant adds (1) Customer and Professional liquidity of 25,000 or more contracts per day in a month, (2) the Participant has certified for the Investor Support Program set forth in Rule 7014; and (3) the Participant executed at least one order on NASDAQ's equity market	\$0.42
<b>Tier 5</b> Participant has Total Volume of 130,000 or more contracts per day in a month	\$0.46

Professionals would be entitled to the same Rebate to Add Liquidity in Penny Pilot Options that Customers receive today. The Exchange would pay a Tier 1 rebate of \$0.26 per contract to market participants that add Customer and Professional liquidity of up to 34,999 contracts per day in a month. A Tier 2 rebate would pay \$0.43 per contract to market participants that add Customer and Professional liquidity between 35,000 and 74,999 contracts per day in a month. A Tier 3 rebate would pay a \$0.44 per contract rebate to market participants that add Customer and Professional liquidity of 75,000 contracts or more per day in a month. The Tier 4 rebate would pay a \$0.42 rebate to

market participants that add Customer and Professional liquidity of 25,000 or more contracts per day in a month. In addition, to qualify for Tier 4, the Participant must have certified for the Investor Support Program (“ISP”) as set forth in Rule 7014;<sup>4</sup> and executed at least one order on NASDAQ’s equity market.<sup>5</sup> The Tier 5 rebate would pay a \$0.46 per contract Rebate to Add Liquidity to NOM Options Participants that have Total Volume of 130,000 or more contracts per day in a month.<sup>6</sup> Total Volume is defined to include Customer, Professional, Firm, Non-NOM Market Maker and NOM Market Maker volume in Penny Pilot Options and Non-Penny Pilot Options which either adds or removes liquidity.<sup>7</sup>

The Exchange proposes to apply the Rebate to Add Liquidity tiers to Professionals transacting Penny Pilot Options. The Exchange proposes to amend Chapter XV, Section 2 by noting that the tiers would apply to Professionals.

Additionally, the Exchange also proposes to add contracts executed in the “Professional” capacity to the tier requirements. NOM Participants would be able to

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<sup>4</sup> For a detailed description of the ISP, see Securities Exchange Act Release No. 63270 (November 8, 2010), 75 FR 69489 (November 12, 2010) (NASDAQ-2010-141) (notice of filing and immediate effectiveness). See also Securities Exchange Act Release Nos. 63414 (December 2, 2010), 75 FR 76505 (December 8, 2010) (NASDAQ-2010-153) (notice of filing and immediate effectiveness); and 63628 (January 3, 2011), 76 FR 1201 (January 7, 2011) (NASDAQ-2010-154) (notice of filing and immediate effectiveness).

<sup>5</sup> For purposes of Tier 4, the Exchange will allow a NOM Participant to qualify for the rebate if a NASDAQ member under common ownership with the NOM Participant has certified for the Investor Support Program and executed at least one order on NASDAQ's equity market. Common ownership is defined as 75 percent common ownership or control.

<sup>6</sup> For purposes of Tier 5, the Exchange allows NOM Participants under common ownership to aggregate their volume to qualify for the rebate. Common ownership is defined as 75 percent common ownership or control.

<sup>7</sup> See the Exchange’s Rules at Chapter XV, Section 2.

count Customer and Professional contracts toward the number of contracts eligible to qualify for a tier as specified herein. The addition of Professional orders to the number of contracts eligible for each rebate tier will enable NOM Participants to achieve higher rebates.

## 2. Statutory Basis

NASDAQ believes that the proposed rule changes are consistent with the provisions of Section 6 of the Act,<sup>8</sup> in general, and with Section 6(b)(4) of the Act,<sup>9</sup> 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 any facility or system which NASDAQ operates or controls.

The Exchange believes that the proposed tier structure for Professional Rebates to Add Liquidity in Penny Pilot Options is reasonable, equitable and not unfairly discriminatory because by incentivizing NOM Participants to select the Exchange as a venue to post Customer and Professional orders, the Exchange will attract additional Professional order flow to the benefit of all market participants.

The Exchange believes that the proposed monthly volume tier Rebates to Add Liquidity in Penny Pilot Options are equitable and not unfairly discriminatory because members that account for more volume would be able to add greater value to the Exchange's trading environment. Additionally, with the exception of Tier 1, Professionals will have an opportunity to earn higher rebates than they earned in the past. With respect to Tier 1, the Exchange is proposing to pay a \$0.26 per contract Rebate to

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<sup>8</sup> 15 U.S.C. 78f.

<sup>9</sup> 15 U.S.C. 78f(b)(4).

Add Liquidity in Penny Pilot Options as compared to a \$0.29 per contract rebate. The Exchange believes that this proposal is equitable and not unfairly discriminatory because the Professional has an opportunity to earn higher rebates with the tier structure as compared the current \$0.29 per contract Rebate to Add Liquidity in Penny Pilot Options. In addition, the Exchange believes that the proposed monthly tier structure for Professional Rebates to Add Liquidity in Penny Pilot Options is equitable and not unfairly discriminatory because the Exchange would uniformly pay a Rebate to Add Liquidity to Professionals executing Penny Pilot Options based on the monthly tiers proposed herein.

The Exchange believes that paying Professionals a tiered Rebate to Add Liquidity in Penny Pilot Options as proposed herein is equitable and not unfairly discriminatory as compared to other market participants. For example, Customers are entitled to the same rebates. NOM Market Makers are entitled to a \$0.30 per contract Rebate to Add Liquidity in Penny Pilot Options, and that rebate is higher than Professionals that achieve a Tier 1 rebate because NOM Market Makers add value through continuous quoting<sup>10</sup> and the commitment of capital. With respect to Tiers 2, 3 and 4, pursuant to this proposal, a Professional earns a higher rebate as compared to a NOM Market Maker. In addition, a Professional would earn a higher rebate with any tier as compared to a Firm

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<sup>10</sup> Pursuant to Chapter VII (Market Participants), Section 5 (Obligations of Market Makers), in registering as a market maker, an Options Participant commits himself to various obligations. Transactions of a Market Maker in its market making capacity must constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and Market Makers should not make bids or offers or enter into transactions that are inconsistent with such course of dealings. Further, all Market Makers are designated as specialists on NOM for all purposes under the Act or rules thereunder. See Chapter VII, Section 5.

and Non-NOM Market Maker. Today, Professionals are paid a higher Rebate to Add Liquidity in Penny Pilot Options as compared to Firms and Non-NOM Market Makers however the differential would become larger. The Exchange believes that paying Professionals higher Tier 2, 3 and 4 rebates as compared to NOM Market Makers and paying Professionals higher rebates as compared to Firms and Non-NOM Market Makers is equitable and not unfairly discriminatory because the Exchange does not believe that the amount of the rebate offered by the Exchange has a material impact on a NOM Participant's ability to execute orders in Penny Pilot Options. The Exchange has been assessing the impact of rebates since it first began to offer them and has also observed the impact of fees and rebates on other options exchanges in terms of quoting and liquidity. The Exchange believes that the Fees for Adding Liquidity in Penny Pilot Options, as compared to rebates, impact a market participant's decision-making more prominently with respect to posting order flow on different venues and price. In modifying its rebates, the Exchange hopes to simply remain competitive with other venues so that it remains a choice for market participants when posting orders and the result may be additional Professional order flow for the Exchange. In addition, a NOM Participant may not be able to gauge the exact rebate tier it would qualify for until the end of the month because Professional volume would be commingled with Customer volume in calculating tier volume. Other participants have a known rebate rate at which they would execute the entire month. A Professional could only otherwise presume the Tier 1 rebate would be achieved in a month when determining price.

The Exchange initially established Professional pricing in order to "...bring additional revenue to the Exchange."<sup>11</sup> The Exchange noted in the Professional Filing that it believes "...that the increased revenue from the proposal would assist the Exchange to recoup fixed costs."<sup>12</sup> Further, the Exchange noted in that filing that it believes that establishing separate pricing for a Professional, which ranges between that of a Customer and market maker, accomplishes this objective.<sup>13</sup> Herein, the Exchange is not proposing to amend fees, which fees continue to meet the objectives noted in the Professional Filing. Rather, the Exchange desires to amend the rebates it pays because it believes that NOM Participants would view NOM as a favorable venue to transact Professional volume. The Exchange does not believe that providing Professionals with the opportunity to obtain higher rebates would create a competitive environment where Professionals would be necessarily advantaged on NOM as compared to other NOM Market Makers, Firms or Non-NOM Market Makers. First, a Professional would be assessed the same fees as these other market participants, as is the case today. Second, a

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<sup>11</sup> See Securities Exchange Act Release No. 64494 (May 13, 2011), 76 FR 29014 (May 19, 2011) (SR-NASDAQ-2011-066) ("Professional Filing"). In this filing, the Exchange addressed the perceived favorable pricing of Professionals who were assessed fees and paid rebates like a Customer prior to the filing. The Exchange noted in that filing that a Professional, unlike a retail Customer, has access to sophisticated trading systems that contain functionality not available to retail Customers.

<sup>12</sup> See Securities Exchange Act Release No. 64494 (May 13, 2011), 76 FR 29014 (May 19, 2011) (SR-NASDAQ-2011-066).

<sup>13</sup> See Securities Exchange Act Release No. 64494 (May 13, 2011), 76 FR 29014 (May 19, 2011) (SR-NASDAQ-2011-066) The Exchange also in the Professional Filing that it believes the role of the retail Customer in the marketplace is distinct from that of the Professional and the Exchange's fee proposal at that time accounted for this distinction by pricing each market participant according to their roles and obligations.



Professional only has the opportunity to achieve the higher rebate by sending in more than 35,000 contracts, otherwise the Professional only achieves a Tier 1 rebate with at least one trade and the differential in that scenario as between market participants remain the same.<sup>14</sup> The Exchange recognizes that the rebate tiers provide an incentive to Professionals, but it is not a guaranteed rebate.

Additionally, the Exchange believes the proposed tiered Rebates to Add Liquidity in Penny Pilot Options are reasonable, equitable and not unfairly discriminatory because the rebates are similar to a tiered rebate offered by NYSE Arca, Inc. (“NYSE Arca”). NYSE Arca pays a per contract rate on all posted liquidity in Customer Penny Pilot Issues by aggregating total contracts from customer posted orders in Penny Pilot Issues in a given month.<sup>15</sup> Of note, NYSE Arca does not have a professional category similar to NOM and therefore, orders that would otherwise be classified as Professionals orders on NOM<sup>16</sup> are being counted towards customer volume at NYSE Arca.

The Exchange proposes to count both Customer and Professional orders in the number of contracts eligible for the Rebate to Add Liquidity in Penny Pilot Options.

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<sup>14</sup> If a Professional earned a Tier 1 rebate, the Professional would continue to receive a lower rebate as compared to a NOM Market Maker and a higher rebate as compared to a Firm and a Non-NOM Market Maker, as is the case today. The rebate differential, however, for a Professional as compared to a Firm and a Non-NOM Market Maker would be lower than it is today.

<sup>15</sup> See NYSE Arca’s Fee Schedule.

<sup>16</sup> See Securities Exchange Act Release No. 63028 (October 1, 2010), 75 FR 62443 (October 8, 2010) (SR-NASDAQ-2012-099). In this rule filing, the Exchange noted that NOM Participants will be required appropriately to mark all Professional orders. To comply with this requirement, Participants will be required to review their Public Customers' activity on at least a quarterly basis to determine whether orders that are not for the account of a broker-dealer should be represented as Professional orders.

NOM Participants would benefit from the addition of Professional orders to the number of contracts eligible for the rebate and as a result may qualify for a higher tier. The Exchange believes the addition of Professional orders to the types of orders eligible for a rebate tier is reasonable because it will incentivize NOM Participants to send additional Professional orders to the Exchange as well as Customer orders. The Exchange believes that adding Professional orders to the types of orders eligible for a rebate tier is equitable and not unfairly discriminatory because all NOM Participants will benefit from the additional liquidity the amendment may attract to the Exchange as a result of the increased incentive to send Professional as well as Customer orders. Also, all NOM Participants are eligible for the rebate and are able to earn a rebate by simply transacting one Customer or Professional order in a Penny Pilot Option.<sup>17</sup>

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

NASDAQ does not believe that the proposed rule changes will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

While the Exchange's proposal would result in a Professional receiving a higher rebate as compared to a NOM Market Maker if a Professional qualified for a Tier 2, 3 or 4 rebate and the differential in the rebate would increase as between a Professional and a Firm and a Non-NOM Market Maker, the Exchange does not believe the proposed rebate tiers would result in any burden on competition as between market participants on NOM. The Exchange does not believe that the amount of the rebate offered by the Exchange has

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<sup>17</sup> A NOM Participant qualifies for a Tier 1 rebate of \$0.26 per contract by adding Customer and Professional liquidity of up to 34,999 contracts per day in a month.

a material impact on a NOM Participant's ability to execute orders in Penny Pilot Options.

The Exchange has been assessing the impact of rebates since it first began to offer them and has also observed the impact of fees and rebates on other options exchanges in terms of quoting and liquidity. The Exchange believes that the Fees for Adding Liquidity, as compared to rebates, impact a market participant's decision-making more prominently with respect to posting order flow on different venues and price. The Exchange does not believe that allowing a Professional to obtain a higher rebate than other market participants, if a certain number of contracts were to be executed on the Exchange, results in a burden on competition among market participants on NOM for the reasons noted herein.

The Exchange believes that offering Professionals the proposed tiered rebates creates competition among options exchanges because the Exchange believes that the rebates may cause market participants to select NOM as a venue to send Professional order flow. The fees that the Exchange assesses are not being amended with this proposal, rather the Exchange is offering to pay increased rebates in exchange for additional Professional order flow being executed at the Exchange, which additional order flow should benefit other market participants.

The Exchange operates in a highly competitive market comprised of eleven U.S. options exchanges in which sophisticated and knowledgeable market participants can readily send order flow to competing exchanges if they deem fee levels at a particular exchange to be excessive. The Exchange believes that the proposed rebate structure and tiers are competitive with rebates and tiers in place on other exchanges. The Exchange

believes that this competitive marketplace impacts the rebates present on the Exchange today and substantially influences the proposals set forth above.

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

No written comments were either solicited or received.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act.<sup>18</sup> 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. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or 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-NASDAQ-2012-141 on the subject line.

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<sup>18</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

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-NASDAQ-2012-141. 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, D.C. 20549-1090, 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-2012-141, 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>19</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>19</sup> 17 CFR 200.30-3(a)(12).