

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-70117; File No. SR-NASDAQ-2013-100)

August 5, 2013

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to its Fees for Routing of Orders Priced at \$1 or More Under Rule 7018(a), as Well as Changes to its Excess Order Fee Under Rule 7018(m)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹, and Rule 19b-4² thereunder, notice is hereby given that, on July 25, 2013, The NASDAQ Stock Market LLC (“NASDAQ” or “Exchange”) filed with the Securities and Exchange Commission (“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 is proposing changes to its fees for routing of orders priced at \$1 or more under Rule 7018(a), as well as changes to its Excess Order Fee under Rule 7018(m). The changes pursuant to this proposal are effective upon filing, and the Exchange will implement the proposed rule changes on August 1, 2013.

The text of the proposed rule change is available on the Exchange’s Website at <http://nasdaq.cchwallstreet.com>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 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, 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 Statutory Basis for, the Proposed Rule Change

1. Purpose

Routing Fees

NASDAQ is proposing to adjust certain of the fees it charges for routing orders in securities priced above \$1. Currently, for directed orders³ in securities listed on exchanges other than the New York Stock Exchange ("NYSE") that are sent to NASDAQ OMX BX ("BX"), NASDAQ charges no fee and provides no credit, while charging \$0.0035 per share executed for directed orders sent to other execution venues. Similarly, for directed orders in securities listed on NYSE that are sent to BX, NASDAQ charges no fee and provides no credit. If directed orders in securities listed on NYSE are sent to NYSE, NASDAQ charges (i) \$0.0028 per share executed for a member with an average daily volume through the NASDAQ Market Center in all securities during the month of more than 35 million shares of liquidity provided through one or more of its

³ As provided in Rule 4751, directed orders are directed to an exchange other than NASDAQ, as designated by the entering party, without checking the NASDAQ book. If unexecuted, the order (or unexecuted portion thereof) is returned to the entering party. Directed orders may be designated as intermarket sweep orders by the entering party.

market participant identifiers (“MPIDs”), and (ii) \$0.0029 per share executed for other members.⁴

Effective August 1, 2013, NASDAQ will make its fee for routing directed orders to BX and NYSE \$0.0035 per share executed, equal to its fee for routing directed orders to all other venues. Thus, the change will make the applicable fees more uniform by eliminating an aspect of the pricing schedule that may have provided undue encouragement to those members that use NASDAQ’s routing services to route directed orders to BX or NYSE rather than using routing strategies that access a variety of venues. Moreover, NASDAQ notes that although BX currently pays a credit with respect to orders that access liquidity, NASDAQ currently charges \$0.0035 per share executed for directed orders that are sent to the BATS-Y Exchange and the EDGA Exchange, venues that also pay a credit for orders that access liquidity. Thus, the change will result in a consistent fee for routing directed orders to all such venues. The change is also consistent with NASDAQ’s long-standing practice of charging a high fee for use of directed orders, which represent a special service of the NASDAQ routing broker and which, when designated as intermarket sweep orders, require additional after-the-fact surveillance to determine whether the member’s designation was compliant with the requirements of Regulation NMS.

⁴ It should be noted that Rule 7018(a)(2) currently has text that distinguishes among directed orders that are designated as intermarket sweep orders, directed orders sent to BX, directed orders sent to NASDAQ OMX PSX, and other directed orders, but the applicable fees are as described above: \$0.0029 per share executed for all directed orders sent to NYSE (unless the member qualifies for the volume-based tier described above), no fee or credit if sent to BX, and \$0.0035 per share executed if sent to any venue other than BX or NYSE. The proposed rule change will also simplify the applicable rule text by eliminating classifications of directed order with identical fees.

For orders using NASDAQ's TFTY, SOLV, CART, or SAVE⁵ routing strategies that execute at BX, NASDAQ currently provides a credit of \$0.0004 (equivalent to the credit provided by BX). Effective August 1, 2013, NASDAQ will eliminate this credit, such that there will be no fee or credit when such orders execute at BX. Thus, as is the case with other routed orders, the fee for orders that execute at BX using these routing strategies will reflect a markup that NASDAQ believes will be consistent with the value of the service provided and that will assist NASDAQ in covering its costs of operating a routing service and earning a return.

Excess Order Fee

In 2012, NASDAQ introduced an Excess Order Fee, imposed on MPIDs that have characteristics indicative of inefficient order entry practices.⁶ As NASDAQ explained at the time, inefficient order entry practices may place excessive burdens on the systems of NASDAQ and its members and may negatively impact the usefulness and life cycle cost of market data.⁷ Market participants that flood the market with orders that are rapidly

⁵ These routing strategies are described in NASDAQ Rule 4758.

⁶ Securities Exchange Act Release Nos. 66951 (May 9, 2012), 77 FR 28647 (May 15, 2012) (SR-NASDAQ-2012-055) (establishing fee); 67292 (June 28, 2012), 77 FR 39773 (July 5, 2012) (SR-NASDAQ-2012-073) (modifying terms and conditions of fee).

⁷ See generally Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010, Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues, at 11 (February 18, 2011) ("The SEC and CFTC should also consider addressing the disproportionate impact that [high frequency trading] has on Exchange message traffic and market surveillance costs.... The Committee recognizes that there are valid reasons for algorithmic strategies to drive high cancellation rates, but we believe that this is an area that deserves further study. At a minimum, we believe that the participants of those strategies should properly absorb the externalized costs of their activity.").

cancelled or that are priced away from the inside market do little to support meaningful price discovery.

In general, the determination of whether to impose the fee on a particular MPID has been made by calculating the ratio between (i) entered orders, weighted by the distance of the order from the national best bid or offer (“NBBO”), and (ii) orders that execute in whole or in part. The fee has been imposed on MPIDs with an “Order Entry Ratio” of more than 100. The Order Entry Ratio is calculated, and the Excess Order Fee imposed, on a monthly basis. NASDAQ is now proposing to modify the fee, such that it will be calculated and assessed on the basis of all of a member’s trading activity on NASDAQ, rather than on an MPID basis. The purpose of this change is to ensure that members do not act in a manner inconsistent with the intent of the fee by spreading inefficient order activity across multiple MPIDs in a manner that allows the MPIDs to avoid a charge that would not be avoided if all of the member’s activity were aggregated. Thus, the change replaces the term “MPID” with the term “member” throughout the text of Rule 7018(m). The rule, as amended, will operate as follows:

For each member, the Order Entry Ratio will be the ratio of (i) the member’s “Weighted Order Total” to (ii) the greater of one (1) or the number of displayed, non-marketable orders⁸ sent to NASDAQ by the member during the month that execute in full or in part.⁹ The Weighted Order Total is the number of displayed, non-marketable orders sent to NASDAQ by the member, as adjusted by a “Weighting Factor.” The applicable

⁸ The fee focuses on displayed orders since they have the most significant impact on investor confusion and the quality of market data.

⁹ Thus, in an extreme case where no orders entered by the member executed, this component of the ratio would be assumed to be 1, so as to avoid the impossibility of dividing by zero.

Weighting Factor is applied to each order based on its price in comparison to the NBBO at the time of order entry:

<u>Order's Price versus NBBO at Entry</u>	<u>Weighting Factor</u>
Less than 0.20% away	0x
0.20% to 0.99% away	1x
1.00% to 1.99% away	2x
2.00% or more away	3x

Thus, in calculating the Weighted Order Total, an order that was more than 2.0% away from the NBBO would be equivalent to three orders that were 0.50% away. Due to the applicable Weighting Factor of 0x, orders entered less than 0.20% away from the NBBO would not be included in the Weighted Order Total, but would be included in the “executed” orders component of the Order Entry Ratio if they execute in full or part. Orders sent by market makers in securities in which they are registered, through the MPID applicable to the registration, are excluded from both components of the ratio.¹⁰ In addition, members with a daily average Weighted Order Total of less than 100,000 during the month will not be subject to the Excess Order Fee. Finally, the fee is based on orders received by NASDAQ during regular market hours (generally, 9:30 a.m. to 4:00

¹⁰ This is the case because market makers are already subject to rule-based standards designed to promote the efficiency and quality of their order entry practices. See Rule 4613. Although Rule 4613 allows market makers to quote at spreads much wider than 2%, NASDAQ’s assessment of market maker performance has led it to conclude that market makers do not generally engage in the inefficient practices at which the new fee is aimed. NASDAQ will continually assess this data and revisit the applicability of the fee to market makers and/or the requirements of Rule 4613 as needed to promote efficient quotation practices by market makers.

p.m.),¹¹ and will exclude orders received at other times, even if they execute during regular market hours.

The following example illustrates the calculation of the Order Entry Ratio:

- A member enters 35,000,000 displayed, liquidity-providing orders:
 - The member is registered as a market maker with respect to 20,000,000 of the orders. These orders are excluded from the calculation.
 - 10,000,000 orders are entered at the NBBO. The Weighting Factor for these orders is 0x.
 - 5,000,000 orders are entered at a price that is 1.50% away from the NBBO. The Weighting Factor for these orders is 2x.
- Of the 15,000,000 orders included in the calculation, 90,000 are executed.
- The Weighted Order Total is $(10,000,000 \times 0) + (5,000,000 \times 2) = 10,000,000$. The Order Entry Ratio is $10,000,000 / 90,000 = 111$.

If a member has an Order Entry Ratio of more than 100, the amount of the Order Entry Fee will be calculated by determining the member's "Excess Weighted Orders." Excess Weighted Orders are calculated by subtracting (i) the Weighted Order Total that would result in the member having an Order Entry Ratio of 100 from (ii) the member's actual Weighted Order Total. In the example above, the Weighted Order Total that would result in an Order Entry Ratio of 100 is 9,000,000, since $9,000,000 / 90,000 = 100$. Accordingly, the Excess Weighted Orders would be $10,000,000 - 9,000,000 = 1,000,000$.

¹¹ Regular market hours may be different in some circumstances, such as on the day after Thanksgiving, when regular market hours on all exchanges traditionally end at 1:00 p.m.

The Excess Order Fee charged to the member will then be determined by multiplying the “Applicable Rate” by the number of Excess Weighted Orders. The Applicable Rate is determined based on the member’s Order Entry Ratio:

<u>Order Entry Ratio</u>	<u>Applicable Rate</u>
101 – 1,000	\$0.005
More than 1,000	\$0.01

In the example above, the Applicable Rate would be \$0.005, based on the member’s Order Entry Ratio of 111. Accordingly, the monthly Excess Order Fee would be $1,000,000 \times \$0.005 = \$5,000$.

NASDAQ continues to expect that the impact of the fee, as modified, will be narrow because the change will encourage potentially affected market participants to modify their order entry practices in order to avoid the fee, thereby improving the market for all participants. Accordingly, NASDAQ does not expect to earn significant revenues from the modified fee.

2. Statutory Basis

NASDAQ believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,¹² in general, and with Sections 6(b)(4) and 6(b)(5) of the Act,¹³ 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, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

¹² 15 U.S.C. 78f.

¹³ 15 U.S.C. 78f(b)(4) and (5).

NASDAQ believes that the adoption of a uniform fee of \$0.0035 per share executed for directed orders is reasonable because NASDAQ already charges this fee for directed orders sent to most venues, charging lower fees only with respect to BX and NYSE. The fee level is consistent with NASDAQ's long-standing practice of charging a high fee for use of directed orders, which represent a special service of the NASDAQ routing broker and which, when designated as intermarket sweep orders, require additional after-the-fact surveillance to determine whether the member's designation was compliant with the requirements of Regulation NMS. The change is consistent with an equitable allocation of fees because it is assessed solely upon members that opt to use NASDAQ's directed order functionality. The change is not unfairly discriminatory because it will result in NASDAQ charging the same fee for all directed orders in securities priced above \$1, regardless of the activity level of the member, the listing venue of the security, or the venue to which the order is directed.

NASDAQ believes that the change to fees for TFTY, SOLV, CART, and SAVE orders that execute at BX is reasonable because even though market participants will receive no credit with respect to such orders, they will also pay no fee.¹⁴ NASDAQ believes that the change is consistent with an equitable allocation of fees because it is allocated solely to members that use NASDAQ's routing services and opt to use the specified routing strategies. The change is not unfairly discriminatory because it will make the economics applicable to executions on BX of orders using the specified routing strategies less disparate from the fee applicable to such executions using other routing

¹⁴ By contrast, the fee for routed orders that execute at BX using the STGY, SCAN, SKNY, or SKIP routing strategies is \$0.0030 per share executed.

strategies. Moreover, the change is not discriminatory in that it applies equally to all members using the specified routing strategies.

With respect to the Excess Order Fee, NASDAQ stated in its original filing to institute the fee that it is reasonable because it is designed to achieve improvements in the quality of displayed liquidity and market data that will benefit all market participants. In addition, although the level of the fee may theoretically be very high, the fee is reasonable because market participants may readily avoid the fee by making improvements in their order entry practices that reduce the number of orders they enter, bring the prices of their orders closer to the NBBO, and/or increase the percentage of their orders that execute. Similarly, the change proposed herein is reasonable because it will provide further incentive to members to improve order entry practices by insuring that they cannot evade the fee by spreading activity across multiple MPIDs.

For similar reasons, the fee is consistent with an equitable allocation of fees, because although the fee may apply to only a small number of market participants, the fee would be applied to them in order to encourage better order entry practices that will benefit all market participants. The change is also equitable because it will further encourage better order entry practices across a wider group of market participants. Finally, NASDAQ believes that the fee is not unfairly discriminatory. Although the fee may apply to only a small number of market participants, it will be imposed because of the negative externalities that such market participants impose on others through inefficient order entry practices. Accordingly, NASDAQ believes that it is fair to impose the fee on these market participants in order to incentivize them to modify their behavior and thereby benefit the market. The change is likewise not unfairly discriminatory

because it will negatively affect members only if they have been evading the incentives to improve order entry practices provided by the fee.

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

NASDAQ 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.¹⁵ NASDAQ notes that it operates in a highly competitive market in which market participants can readily favor competing venues if they deem fee levels at a particular venue to be excessive, or rebate opportunities available at other venues to be more favorable. In such an environment, NASDAQ must continually adjust its fees to remain competitive with other exchanges and with alternative trading systems that have been exempted from compliance with the statutory standards applicable to exchanges, while also seeking to earn a reasonable profit from its trading and routing services. Because competitors are free to modify their own fees in response, and because market participants may readily adjust their order routing practices, NASDAQ believes that the degree to which fee changes in this market may impose any burden on competition is extremely limited. In this instance, the changes to routing fees do not impose a burden on competition because NASDAQ's routing services are optional and are the subject of competition from other exchanges and broker-dealers that offer routing services, as well as the ability of members to develop their own routing capabilities. Accordingly, if the changes are unattractive to market participants, it is likely that NASDAQ will lose market share as a result of them.

¹⁵ 15 U.S.C. 78f(b)(8).

With respect to the change to the Excess Order Fee, NASDAQ believes that the change, like the original fee, will constrain market participants from pursuing certain inefficient and potentially abusive trading strategies. To the extent that this change may be construed as a burden on competition, NASDAQ believes that it is appropriate in order to allow NASDAQ to better achieve this purpose.

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) of the Act¹⁶ and paragraph (f) of Rule 19b-4 thereunder.¹⁷ 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

¹⁶ 15 U.S.C. 78s(b)(3)(A).

¹⁷ 17 CFR 240.19b-4(f).

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2013-100 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-NASDAQ-2013-100. 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 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-2013-100 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.¹⁸

Kevin M. O'Neill
Deputy Secretary

¹⁸ 17 CFR 200.30-3(a)(12).