

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-71874; File No. SR-NASDAQ-2014-029)

April 4, 2014

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Managed Data Solution for Non-Display Usage

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 March 21, 2014, The NASDAQ Stock Market LLC (“NASDAQ” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change to modify rules of the NASDAQ Options Market, LLC (“NOM”) 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 add new Section 11 (Managed Data Solutions) to the NOM rule book to establish Managed Data Solution fees for Non-Display Usage.

While the changes proposed herein are effective upon filing, the Exchange has designated that the amendments be operative on April 1, 2014.

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.

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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, 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

The purpose of the proposed rule change is to modify Chapter XV (Options Pricing) by adding proposed new Section 11 in the NOM rule book to establish Managed Data Solution fees. The Exchange is proposing to create a new data distribution model (a Managed Data Solution for Non-Display Usage) to further the distribution of Best of NASDAQ Options and Itch to Trade Options (“BONO and ITTO”), (together “NOM data”).

The proposed Managed Data Solution for Non-Display Usage is similar to data distribution models currently in use and aligns the Exchange with other markets.<sup>3</sup>

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<sup>3</sup> See Securities Exchange Act Release Nos. 70748 (October 23, 2013), 78 FR 64569 (October 29, 2013)(SR-Phlx-2013-105)(notice of filing and immediate effectiveness of proposed rule change to establish non-display Managed Data Solution for Phlx); 70269 (August 27, 2013), 78 FR 54336 (September 3, 2013)(SR-NASDAQ-2013-106)(notice of filing and immediate effectiveness of proposed rule change to establish non-display Managed Data Solution for NASDAQ); and 69182 (March 19, 2013), 78 FR 18378 (March 26, 2013)(SR-Phlx-2013-28)(notice of filing and immediate effectiveness of proposed rule change to establish non-display Managed Data Solution for Phlx equities market PSX). See also Securities Exchange Act Release No. 69041 (March 5, 2013), 78 FR 15791 (March 12, 2013)(SR-BX-2013-018)(notice of filing and immediate

The Managed Data Solution proposal offers a delivery method to firms seeking simplified market data administration. The Managed Data Solution for Non-Display Usage may be offered by Distributors<sup>4</sup> externally distributing data to clients and/or client organizations that are using the NOM data internally for Non-Display Usage. This new pricing and administrative option is in response to industry demand, as well as due to changes in the technology used to distribute market data. As such, rather than substantive changes the proposal reflects current data distribution practices in the industry. Distributors offering Managed Data Solutions for Non-Display Usage continue to be fee liable for the applicable distributor, annual administrative and other applicable fees for the receipt and distribution of NOM data.

This Managed Data Solution for Non-Display Usage is a delivery option that will assess a new, innovative fee schedule to Distributors of NOM data that provide data feed solutions such as an Application Programming Interface (API) or similar automated delivery solutions to Recipients for Non-Display Usage with only limited entitlement controls (e.g., usernames and/or passwords) (“Managed Data Recipients”). However, the Distributor must first agree to reformat, redisplay and/or alter the NOM data prior to retransmission, but not to affect the integrity of the NOM data and not to render it inaccurate, unfair, uninformative, fictitious, misleading, or discriminatory. A Managed Data Solution for Non-Display Usage is any retransmission data product containing NOM data offered by a Distributor where the Distributor manages and monitors, but does

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effectiveness of proposed rule change to establish Managed Data Solution for BX).

<sup>4</sup> “Distributor” shall mean the same as in NOM Chapter XV, Section 4(b). Proposed Chapter XV, Section 11(b).

not control, the information and the Recipient of a Managed Data Solution may use the information for internal Non-Display purposes only and may not distribute the information outside of their organization. However, the Distributor does maintain contracts with the Managed Data Recipients and is liable for any unauthorized use by the Managed Data Recipients under a Managed Data Solution.

Currently, the Exchange does not distinguish between Managed Data Solution Recipients and a recipient of an uncontrolled data product. Some Distributors believe that the Managed Data Solution for Non-Display Usage is a viable alternative to an uncontrolled data product. Some Distributors have even delayed deploying new NOM data offerings, pending the initiation of Managed Data Solutions for Non-Display Usage. Thus, offering a Managed Data Solution fee schedule would not only result in the Exchange offering lower fees for existing Managed Data Recipients utilizing a Managed Data Solution, but will allow new Distributors to deliver Managed Data Solutions to new clients, thereby increasing transparency of the market.

The Exchange proposes to establish a monthly Managed Data Solution Administration fee and a monthly Subscriber<sup>5</sup> fee for Distributors and Subscribers that adopt the Managed Data Solution for Non-Display Usage.<sup>6</sup> The proposed fees for

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<sup>5</sup> “Subscriber” shall mean a device or computer terminal or an automated service which is entitled to receive Information. Proposed Chapter XV Section 11(c).

<sup>6</sup> Without a Managed Data Solution as proposed herein, the current fee for internal distribution that is not a Managed Data Solution but rather an uncontrolled NOM data product with a distributor fee of \$1,500 per month would apply (along with a \$5 or \$10 professional subscriber fee). Per the proposal for the Managed Data Solution, on the other hand, the Managed Data Recipient fee for Non-Display internal use of NOM Orders managed data would be \$125 per Subscriber for each of ITTO and BONO, thereby providing a reduced cost option where the data is for Non-Display internal use only.

Managed Data Solutions products for Non-Display Usage -- ITTO would be \$500/mo per Distributor and \$125/mo per Subscriber; and for Non-Display Usage -- BONO would be \$500/mo per Distributor and \$125/mo per Subscriber.<sup>7</sup> The Exchange proposes to establish a Managed Data Solution for Non-Display Usage only, as is done on other markets. The Exchange believes that the proposal is in line with current market practice.<sup>8</sup>

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>9</sup> in general, and with Section 6(b)(4) of the Act,<sup>10</sup> in particular, in that it provides an equitable allocation of reasonable fees among Subscribers and Recipients of NOM data. In adopting Regulation NMS, the Commission granted self-regulatory organizations (“SROs”) and broker-dealers (“BDs”) increased authority and flexibility to offer new and unique market data to the public. It was believed that this authority would expand the amount of data available to consumers, and also spur innovation and competition for the provision of market data.

The Commission concluded that Regulation NMS—by lessening the regulation of the market in proprietary data—would itself further the Act’s goals of facilitating efficiency and competition:

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<sup>7</sup> The proposed monthly fee would be in addition to the monthly Market Data Distributor fee of \$2,000 (for external usage) currently set forth in the Options Schedule in NOM Chapter XV for recipients of BONO and ITTO options data feeds.

<sup>8</sup> The Exchange believes that most firms, as an example, currently use BONO and ITTO options data feeds in non-display format.

<sup>9</sup> 15 U.S.C. 78f.

<sup>10</sup> 15 U.S.C. 78f(b)(4).

[E]fficiency is promoted when broker-dealers who do not need the data beyond the prices, sizes, market center identifications of the NBBO and consolidated last sale information are not required to receive (and pay for) such data. The Commission also believes that efficiency is promoted when broker-dealers may choose to receive (and pay for) additional market data based on their own internal analysis of the need for such data.<sup>11</sup>

By removing “unnecessary regulatory restrictions” on the ability of exchanges to sell their own data, Regulation NMS advanced the goals of the Act and the principles reflected in its legislative history. If the free market should determine whether proprietary data is sold to BDs at all, it follows that the price at which such data is sold should be set by the market as well.

The decision of the United States Court of Appeals for the District of Columbia Circuit in NetCoalition v. SEC, 615 F.3d 525 (D.C. Cir. 2010) (“NetCoalition I”), upheld the Commission’s reliance upon competitive markets to set reasonable and equitably allocated fees for market data. “In fact, the legislative history indicates that the Congress intended that the market system ‘evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed’ and that the SEC wield its regulatory power ‘in those situations where competition may not be sufficient,’ such as in the creation of a ‘consolidated transactional reporting system.’ NetCoalition I, at 535 (quoting H.R. Rep. No. 94–229, at 92 (1975), as reprinted in 1975 U.S.C.C.A.N. 321,

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<sup>11</sup> Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

323). The court agreed with the Commission’s conclusion that “Congress intended that ‘competitive forces should dictate the services and practices that constitute the U.S. national market system for trading equity securities.’”<sup>12</sup>

The court in NetCoalition I, while upholding the Commission’s conclusion that competitive forces may be relied upon to establish the fairness of prices, nevertheless concluded that the record in that case did not adequately support the Commission’s conclusions as to the competitive nature of the market for NYSE Arca’s data product at issue in that case. As explained below in the Exchange’s Statement on Burden on Competition, however, the Exchange believes that there is substantial evidence of competition in the marketplace for data that was not in the record in the NetCoalition I case, and that the Commission is entitled to rely upon such evidence in concluding that the fees established in this filing are the product of competition, and therefore in accordance with the relevant statutory standards.<sup>13</sup> Moreover, the Exchange further notes that the product at issue in this filing – NOM Managed Data Solutions for Non-Display Usage fees – is quite different from the NYSE Arca depth-of-book data product at issue in NetCoalition I. Accordingly, any findings of the court with respect to that product may not be relevant to the product at issue in this filing.

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

The Exchange does not believe that the proposed rule change will result in any

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<sup>12</sup> NetCoalition I, at 535.

<sup>13</sup> It should also be noted that Section 916 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”) has amended paragraph (A) of Section 19(b)(3) of the Act, 15 U.S.C. 78s(b)(3), to make it clear that all exchange fees, including fees for market data, may be filed by exchanges on an immediately effective basis.

burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. The Exchange's ability to price its Managed Data Solution products for Non-Display Usage is constrained by (1) competition between exchanges and other trading platforms that compete with each other in a variety of dimensions; (2) the existence of inexpensive real-time consolidated data and market-specific data and free delayed consolidated data; and (3) the inherent contestability of the market for this data.

The market for proprietary data products is currently competitive and inherently contestable because there is fierce competition for the inputs necessary to the creation of proprietary data and strict pricing discipline for the proprietary products themselves. Numerous exchanges compete with each other for listings, trades, and market data itself, providing virtually limitless opportunities for entrepreneurs who wish to produce and distribute their own market data. This proprietary data is produced by each individual exchange, as well as other entities, in a vigorously competitive market.

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. The decision whether and on which platform to post an order will depend on the attributes of the platform where the order can be posted, including the execution fees, data quality and price and distribution of its data products. Without trade executions, exchange data products cannot exist. Moreover, data products are valuable to many end users only insofar as they provide information that end users 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, the operation of the exchange is characterized by high fixed costs and low marginal costs. This cost structure is common in content and content distribution industries such as software, where developing new software typically requires a large initial investment (and continuing large investments to upgrade the software), but once the software is developed, the incremental cost of providing that software to an additional user is typically small, or even zero (e.g., if the software can be downloaded over the internet after being purchased).<sup>14</sup> In the Exchange's case, it is costly to build and maintain a trading platform, but the incremental cost of trading each additional share on an existing platform, or distributing an additional instance of data, is very low. Market information and executions are each produced jointly (in the sense that the activities of trading and placing orders are the source of the information that is distributed) and are each subject to significant scale economies. In such cases, marginal cost pricing is not feasible because if all sales were priced at the margin, the Exchange would be unable to defray its platform costs of providing the joint products.

An exchange's BD customers view the costs of transaction executions and of data as a unified cost of doing business with the exchange. A BD will direct orders to a particular exchange only if the expected revenues from executing trades on the exchange

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<sup>14</sup> See William J. Baumol and Daniel G. Swanson, "The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power," Antitrust Law Journal, Vol. 70, No. 3 (2003).

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 trading activity 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.

Similarly, in the case of products such as this that are distributed through market data vendors, the vendors provide price discipline for proprietary data products because they control the primary means of access to end users. Vendors impose price restraints based upon their business models. For example, vendors such as Bloomberg and Reuters that assess a surcharge on data they sell may refuse to offer proprietary products that end users will not purchase in sufficient numbers. Internet portals, such as Google, impose a discipline by providing only data that will enable them to attract "eyeballs" that contribute to their advertising revenue. Retail BDs, such as Schwab and Fidelity, offer their customers proprietary data only if it promotes trading and generates sufficient commission revenue. Although the business models may differ, these vendors' pricing discipline is the same: They can simply refuse to purchase any proprietary data product that fails to provide sufficient value. The Exchange and other producers of proprietary

data products must understand and respond to these varying business models and pricing disciplines in order to market proprietary data products successfully. Moreover, the Exchange believes that products such as this can enhance order flow to the Exchange, thereby encouraging wider participation in the market by investors with access to the internet or television. Conversely, the value of such products to distributors and investors decreases if order flow falls, because the products contain less content.

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. For example, some platform may choose to pay rebates to attract orders, charge relatively low prices for market information (or provide information free of charge) and charge 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 thirteen SRO markets, as well as internalizing BDs and various forms of alternative trading systems (“ATs”), including dark pools and electronic communication networks (“ECNs”). Each SRO market competes to produce transaction reports via trade executions, and two FINRA-regulated Trade Reporting Facilities (“TRFs”) compete to attract internalized transaction reports. It is common for BDs to further 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 Stock Market LLC, New York Stock Exchange, The NYSE MKT LLC, NYSE Arca, Inc., BATS Exchange, Inc., and 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 BD production of proprietary data products. The potential sources of proprietary products are virtually limitless.

Market data vendors provide another form of price discipline for proprietary data products because they control the primary means of access to end Subscribers. Vendors impose price restraints based upon their business models. For example, vendors such as Bloomberg and Thomson Reuters that assess a surcharge on data they sell may refuse to offer proprietary products that end Subscribers will not purchase in sufficient numbers. Internet portals, such as Google, impose a discipline by providing only data that will enable them to attract “eyeballs” that contribute to their advertising revenue. Retail broker-dealers, such as Schwab and Fidelity, offer their customers proprietary data only if it promotes trading and generates sufficient commission revenue. Although the business models may differ, these vendors’ pricing discipline is the same: they can simply refuse to purchase any proprietary data product that fails to provide sufficient value. The Exchange and other producers of proprietary data products must understand and respond to these varying business models and pricing disciplines in order to market proprietary

data products successfully.

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 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.

Competition among platforms has driven the Exchange continually to improve its platform data offerings and to cater to customers' data needs. For example, the Exchange has developed and maintained multiple delivery mechanisms (e.g., IP, multi-cast) that enable customers to receive data in the form and manner they prefer and at the lowest cost to them. The Exchange has created products like Depth Data and Top of Market Data, because offering data in multiple formatting allows the Exchange to better fit customer needs. The Exchange offers data via multiple extranet providers, thereby helping to reduce network and total cost for its data products. The Exchange has developed an online administrative system to provide customers transparency into their

data feed requests and streamline data usage reporting.

Despite these enhancements and a dramatic increase in message traffic, the Exchange's fees for market data have remained flat. In fact, as a percent of total Subscriber costs, Exchange data fees have fallen relative to other data usage costs -- including bandwidth, programming, and infrastructure -- that have risen. The same holds true for execution services; despite numerous enhancements to the Exchange's trading platform, absolute and relative trading costs have declined. Platform competition has intensified as new entrants have emerged, constraining prices for both executions and for data.

The vigor of competition for proprietary information is significant and the Exchange believes that this proposal itself clearly evidences such competition. The Exchange is offering a new pricing model in order to keep pace with changes in the industry and evolving customer needs. It is entirely optional and is geared towards attracting new customers, as well as retaining existing customers.

The Exchange has witnessed competitors creating new products and innovative pricing in this space over the course of the past year. The Exchange continues to see firms challenge its pricing on the basis of the Exchange's explicit fees being higher than the zero-priced fees from other competitors such as BATS. In all cases, firms make decisions on how much and what types of data to consume on the basis of the total cost of interacting with the Exchange or other exchanges. Of course, the explicit data fees are but one factor in a total platform analysis. Some competitors have lower transactions fees and higher data fees, and others are vice versa. The market for this proprietary information is highly competitive and continually evolves as products develop and

change.

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>15</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-2014-029 on the subject line.

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



Paper comments:

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

All submissions should refer to File Number SR-NASDAQ-2014-029. 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-2014-029 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>16</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>16</sup> 17 CFR 200.30-3(a)(12).