

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-88320; File No. SR-NASDAQ-2020-011)

March 4, 2020

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Amend Rules 4702(b)(14) and (b)(15) to Shorten the Holding Period Requirements for Midpoint Extended Life Orders and Midpoint Extended Life Orders Plus Continuous Book

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 February 26, 2020, 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 and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend Rules 4702(b)(14) and (b)(15) of the Exchange’s Rulebook to shorten the holding period requirements for Midpoint Extended Life Orders and Midpoint Extended Life Orders Plus Continuous Book.

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.

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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 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. 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 Exchange proposes to amend Rules 4702(b)(14) and (15) of the Exchange’s Rulebook to shorten the holding period requirements for its Midpoint Extended Life Order (“M-ELO”) and Midpoint Extended Life Order Plus Continuous Book (“M-ELO+CB”) Order Types.

In 2018, the Exchange introduced the M-ELO, which is a Non-Displayed Order priced at the Midpoint between the National Best Bid and Offer (“NBBO”) and which is eligible for execution only against other eligible M-ELOs and only after a minimum of one-half second passes from the time that the System accepts the order (the “Holding Period”).<sup>3</sup> In 2019, the Exchange introduced the M-ELO+CB, which closely resembles the M-ELO, except that a M-ELO+CB may execute at the midpoint of the NBBO, not only against other eligible M-ELOs (and M-ELO+CBs), but also against Non-Displayed Orders with Midpoint Pegging and Midpoint Peg Post-Only Orders (“Midpoint Orders”) that rest on the Continuous Book for at

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<sup>3</sup> See Securities Exchange Act Release No. 34-82825 (March 7, 2018), 83 FR 10937 (March 13, 2018) (SR-NASDAQ-2017-074) (“M-ELO Approval Order”).

least one-half second and have Midpoint Trade Now enabled.<sup>4</sup> For both M-ELOs and M-ELO+CBs, the Holding Period is the same length of time.

When the Exchange designed M-ELO, it set the length of the Holding Period at one-half second because it determined that this time period would be sufficient to ensure that likeminded investors would interact only with each other, and with minimal market impacts. Additionally, the Exchange chose one-half second because it was then, and it remains today, a time period that is significantly longer than the delay mechanisms that other exchanges employ for similar purposes, such as the IEX 350 microsecond speed bump. The Exchange believed that the longer length of the M-ELO Holding Period and its simplicity in design would provide greater protection for participants than they could achieve through competing delay mechanisms.

Although the Holding Period requirement is a key design element of both the M-ELO and the M-ELO+CB, the length of that Holding Period is not sacrosanct. After adopting the M-ELO, the Exchange studied the actual use and performance of M-ELOs, as well as customer feedback, and make refinements, as necessary, to improve its operation and effectiveness. Indeed, such study and feedback is what prompted the Exchange last year to introduce the M-ELO+CB Order Type as well as to enhance M-ELO by permitting odd-lot order sizes.<sup>5</sup>

Now, after observing M-ELO and M-ELO+CB trading over the past two years, and after gathering feedback from market participants, in particular those that trade with a longer time horizon and who are concerned with market impact, the Exchange has determined that the length of the Holding Period can and should be re-calibrated. Although the Exchange designed M-ELO

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<sup>4</sup> See Securities Exchange Act Release No. 34-86938 (September 11, 2019), 84 FR 48978 (September 17, 2019) (SR-NASDAQ-2019-048) (“M-ELO+CB Approval Order”).

<sup>5</sup> See Securities Exchange Act Release No. 34-86416 (July 19, 2019), 84 FR 35918 (July 25, 2019) (SR-NASDAQ-2019-044).

and M-ELO+CB for use by market participants that are less concerned with achieving rapid executions of their Orders than are other participants, that is not to say that M-ELO and M-ELO+CB users are indifferent about the length of time in which their M-ELOs and M-ELO+CBs must wait before they are eligible for execution. Indeed, participants have informed the Exchange that in certain circumstances, such as when they seek to trade symbols that on average have a lower time-to-execution than a half-second, they are reticent to enter M-ELOs or M-ELO+CBs because even though they want the protections that M-ELO and M-ELO+CB provide, the associated Holding Periods for these Order Types are too long and present countervailing risks. That is, the Holding Periods are longer than necessary and, during the residual portion of the Holding Periods, participants risk losing out on favorable execution opportunities that would otherwise be available to them had they placed a non-MELO order. The Exchange also notes that many institutional routing strategies recalibrate using a “heatmap” where they will route an order based on where trade activity is occurring, at times; this recalibration occurs prior to the completion of the M-ELO and M-ELO+CB Holding Periods. For such participants, the opportunity cost of missed execution opportunities may outweigh the protective benefits that M-ELOs and M-ELO+CBs provide.

Based upon this feedback, the Exchange studied the potential effects of reducing the length of the Holding Periods for both M-ELOs and M-ELO+CBs (as well as for Midpoint Orders that would execute against M-ELO+CBs). Ultimately, the Exchange determined that it could reduce the Holding Periods to 10 milliseconds without compromising the protective power that M-ELO and M-ELO+CB are intended to provide to participants and investors. Indeed, the Exchange examined each of its historical M-ELO executions to determine at what Midpoints of the NBBO the M-ELOs would have executed if their Holding Periods had been shorter than one-

half second (500 milliseconds). After examining the historical effects of shorter Holding Periods of between 10 milliseconds and 400 milliseconds, the Exchange determined that a reduction of the M-ELO Holding Period to as short as 10 milliseconds would have caused an average impact on markouts of only 0.10 basis points (across all symbols). In other words, compared to the execution price of an average M-ELO with a one-half second Holding Period, the Exchange found that a M-ELO with a 10 millisecond Holding Period would have had an average post-execution impact that was only a tenth of a basis point per share – a difference in protective effect that is immaterial.<sup>6</sup> Thus, the Exchange determined that shortening the Holding Periods to 10 milliseconds for M-ELOs and M-ELO+CBs would increase the efficacy of the mechanism while not undermining the power of those Order Types to fulfill their underlying purpose of minimizing market impacts. The Exchange notes that, even at a length of 10 milliseconds, the Holding Periods still will be as or more effective than the delay mechanisms that competing exchanges employ, such that the M-ELO and M-ELO+CB would remain among the highest-performing order types available to market participants. At the same time, the Exchange determined that a reduction in the Holding Periods to 10 milliseconds would dramatically add to the circumstances in which M-ELOs and M-ELO+CBs would be useful to participants. Accordingly, the Exchange proposes to amend Rules 4702(b)(14) and (15) to decrease to 10 milliseconds the length of the Holding Periods for M-ELOs and M-ELO+CB, along with the length of the corresponding resting period for Midpoint Orders on the Continuous Book that are eligible to interact with M-ELO+CBs.

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<sup>6</sup> See Nasdaq, “The Midpoint Extended Life Order (M-ELO); M-ELO Holding Period,” available at <https://www.nasdaq.com/articles/the-midpoint-extended-life-order-m-elo%3A-m-elo-holding-period-2020-02-13> (analyzing effects of shortened Holding Periods on M-ELO performance).

The Exchange intends to make the proposed change effective for M-ELOs and M-ELO+CBs in the Second Quarter of 2020. The Exchange will publish a Trader Alert at least 14 days in advance of making the proposed change effective.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>7</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>8</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest, by allowing for more widespread use of M-ELOs and M-ELO+CBs.

When the Commission approved the M-ELO and the M-ELO+CB, it determined that these Order Types are consistent with the Act because they “could create additional and more efficient trading opportunities on the Exchange for investors with longer investment time horizons, including institutional investors, and could provide these investors with an ability to limit the information leakage and the market impact that could result from their orders.”<sup>9</sup> Nothing about the Exchange’s proposal should cause the Commission to revisit or rethink this determination. Indeed, the proposal will not alter the fundamental design of these Order Types, the manner in which they operate, or their effects.

Even with shortened 10 millisecond Holding Periods, M-ELOs and M-ELO+CBs will continue to provide their users with protection against information leakage and adverse selection

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<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> M-ELO Approval Order, supra 83 FR at 10938–39; M-ELO+CB Approval Order, supra, 84 FR at 48980.

– and they will do so at levels which are substantially undiminished from that which they provide now.<sup>10</sup> The 10 millisecond Holding Periods, moreover, will remain longer than any delay mechanisms which the Exchange’s competitors presently employ.

At the same time, however, the proposal will benefit market participants and investors by reducing the opportunity costs of utilizing M-ELOs and M-ELO+CBs. The proposal, in other words, will re-calibrate the lengths of the Holding Periods so that M-ELOs and M-ELO+CBs will operate in the “Goldilocks” zone – their Holding Periods will not be so short as to render them unable to provide meaningful protections against information leakage and adverse selection, but the Holding Periods also will not be too long so as to cause participants and investors to miss out on favorable execution opportunities. Nasdaq believes the proposal will render M-ELOs and M-ELO+CBs more useful and attractive to market participants and investors, and this increased utility and attractiveness, in turn, will spur an increase in M-ELO and M-ELO+CB use cases on the Exchange, both from new and existing users of M-ELOs and M-ELO+CBs. Ultimately, the proposal should enhance market quality by opening up more use cases for midpoint executions on the Exchange.

The Exchange notes that use of M-ELOs and M-ELO+CBs remains voluntary for all market participants. Accordingly, if any market participant feels that the shortened Holding Period is still too long or too short or because competing venues offer more attractive delay mechanisms, then the participants are free to pursue other trading strategies or utilize other trading venues. They need not utilize M-ELOs or M-ELO+CBs.

Finally, the Exchange notes that it will continue to conduct real-time surveillance to monitor the use of M-ELOs and M-ELO+CBs to ensure that such usage remains appropriately

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<sup>10</sup> See note 6, supra.

ted to the intent of the Order Types. If, as a result of such surveillance, the Exchange determines that the shortened Holding Periods do not serve their intended purposes, or adversely impact market quality, then the Exchange will seek to make further re-calibrations.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. To the contrary, the Exchange believes that this proposal will promote the competitiveness of the Exchange by rendering its M-ELO and M-ELO+CB Order Types more attractive to participants.

The Exchange adopted the M-ELO and M-ELO+CB as pro-competitive measures intended to increase participation on the Exchange by allowing certain market participants that may currently be underserved on regulated exchanges to compete based on elements other than speed. The proposed change continues to achieve this purpose. With shortened 10 millisecond Holding Periods, both M-ELOs and M-ELO+CBs will afford their users with a level of protection from information leakage and adverse selection that is not materially different from what they presently provide.<sup>11</sup> At the same time, the shortened Holding Period will increase opportunities to interact with other like-minded investors with longer time horizons while also lowering the opportunity costs for participants that utilize M-ELOs and M-ELO+CBs, particularly for securities that trade within the “Goldilocks” zone. In sum, the proposed changes will not burden competition, but instead may promote competition for liquidity in M-ELOs and M-ELO+CBs by broadening the circumstances in which market participants may find such Orders to be useful. With the proposed changes, market

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<sup>11</sup> See id.



participants will be more likely to determine that the benefits of entering M-ELOs and M-ELO+CBs outweigh the risks of doing so.

The proposed change will not place a burden on competition among market venues, as any market may adopt an order type that operates similarly to a M-ELO or a M-ELO+CB with a 10 millisecond Holding Period.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate 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 the 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-NASDAQ-2020-011 on the subject line.

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-2020-011. 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. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All

submissions should refer to File Number SR-NASDAQ-2020-011, 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>12</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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