

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-85691; File No. SR-BX-2019-002)

April 18, 2019

Self-Regulatory Organizations; Nasdaq BX, Inc.; Notice of Filing of Proposed Rule Change to Reassign Certain Investigation and Enforcement Functions Under the Exchange's Authority and Supervision

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 April 5, 2019, Nasdaq BX, Inc. ("BX" 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 assume operational responsibility for certain investigation and enforcement functions currently performed by the Financial Industry Regulatory Authority ("FINRA") under the Exchange's authority and supervision. BX Rule 0150 requires Commission approval for this transfer of operational responsibility to BX. BX anticipates a phased transition, whereby BX would assume increasing responsibility throughout 2019 and into 2020 for investigation and enforcement activities for certain conduct occurring on the BX market.

The text of the proposed rule change is available on the Exchange's Website at <http://nasdaqbx.chwallstreet.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

Section 6 of the Act requires that national securities exchanges enforce their members' compliance with federal securities laws and rules as well as the exchanges' own rules.<sup>3</sup> As a self-regulatory organization ("SRO"), BX must have a comprehensive regulatory program that includes investigation and prosecution of suspicious activity. Since its acquisition by The NASDAQ OMX Group, Inc., BX has contracted with FINRA through various regulatory services agreements ("RSAs") to perform certain of these regulatory functions on its behalf. However, as the Commission has made clear with respect to BX's affiliate, The Nasdaq Stock Market LLC ("Nasdaq"), "the Nasdaq Exchange bears the responsibility for self-regulatory conduct and primary liability for self-regulatory failures, not the SRO retained to perform regulatory functions on the Exchange's behalf."<sup>4</sup>

Notwithstanding its use of FINRA, the Exchange has also retained operational responsibility for a number of regulatory functions, including real-time surveillance,

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<sup>3</sup> 15 U.S.C. 78(f).

<sup>4</sup> Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550, 3556 (January 23, 2006).

qualification of companies listed on Nasdaq and most surveillance related to its affiliated options markets. Historically, BX retained operational responsibility in areas where BX's expertise regarding its own markets, technology and listed companies enhanced regulation. In recognition of this, on September 30, 2013, the Commission approved BX's proposal to reallocate operational responsibility from FINRA to BX for certain equities surveillance patterns and related review functions, focused on: (1) manipulation patterns that monitor solely BX activity; and (2) monitoring of compliance by member firms with elements of the Commission's Regulation M and Nasdaq Rule 4619 compliance.<sup>5</sup>

Building on BX's experience and expertise, this proposal reflects a natural evolution of BX's proven model to assume and retain operational responsibility in areas where its in-depth knowledge of its markets and members enhances market regulation. For the reasons outlined below, BX now seeks Commission approval to reallocate operational responsibility from FINRA to the Exchange's Regulation Department<sup>6</sup> for certain investigation and enforcement activity, namely:

- investigation and enforcement responsibilities for conduct occurring on The BX Options Market,<sup>7</sup> and
- investigation and enforcement responsibilities for conduct occurring on BX's equity market only, i.e., not also on non-Nasdaq equities markets.<sup>8</sup>

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<sup>5</sup> Securities Exchange Act Release No. 70568 (September 30, 2013), 78 FR 62884 (October 22, 2013) (SR-BX-2013-047).

<sup>6</sup> Under BX Rule 9120(t), the Exchange's Regulation Department includes the Exchange's Enforcement Department. The Exchange notes that the Staff that comprises the Exchange's Regulation Department is the same that comprises the Nasdaq Regulation Department.

<sup>7</sup> As appropriate, the Exchange's Regulation Department will coordinate with other SROs to the extent it is investigating activity occurring on Non-Nasdaq options markets to ensure no regulatory duplication occurs.

Currently, under RSAs, FINRA is responsible for, among other things, the investigation of matters referred from Nasdaq MarketWatch and the Phlx Market Surveillance department.<sup>9</sup> FINRA is also responsible for providing services related to BX's formal disciplinary process, including the issuance of Wells Notices, Cautionary Action Letters, Complaints, and settlement documents.

BX now proposes to perform the functions described in the bullet points above and is seeking Commission approval to do so. BX believes that its expertise in its own market structure coupled with its expertise in surveillance activities will enable it to conduct investigation and enforcement responsibilities for the Exchange effectively, efficiently and with immediacy. In addition, this proposal represents an incremental reallocation of operational responsibility because Nasdaq Regulation Staff currently performs investigative and enforcement work on behalf of Phlx, ISE, GEMX, and MRX, providing it with relevant experience to perform these functions for the Exchange as well.<sup>10</sup> Most recently, Phlx filed for immediate effectiveness amendments to the Phlx's rules that set forth an investigatory and disciplinary process identical in all material respects to the investigatory and disciplinary processes of Nasdaq and BX.<sup>11</sup> The

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<sup>8</sup> With respect to the operational responsibilities described in both bullet points, Nasdaq Regulation Staff currently performs these functions for the Nasdaq PHLX LLC ("Phlx"), Nasdaq ISE, LLC ("ISE"), Nasdaq GEMX, LLC ("GEMX"), and Nasdaq MRX, LLC ("MRX") because there is no comparable rule to Rule 0150 on those markets.

<sup>9</sup> The Phlx Market Surveillance department performs surveillance work for all of Nasdaq's options markets (i.e. Nasdaq Options, BX Options, Phlx Options, ISE, GEMX, and MRX).

<sup>10</sup> As noted above, because BX is an affiliate of Nasdaq, the Staff that comprises the Exchange's Regulation Department is the same that comprises the Nasdaq Regulation Department.

<sup>11</sup> See Securities Exchange Act Release No. 82143 (November 22, 2017), 82 FR 56672 (November 29, 2017) (SR-Phlx-2017-92) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Adopt Investigatory and Disciplinary Processes Substantially Similar to Nasdaq BX, Inc. and The Nasdaq Stock Market LLC for Phlx,

amendments also had the effect of granting Phlx’s Regulation Department investigation and enforcement authority.<sup>12</sup> BX now seeks Commission approval to exercise this same authority for conduct on the Exchange that its Staff already exercises for Phlx, ISE, GEMX, and MRX.<sup>13</sup>

Notwithstanding this proposal, FINRA will continue to perform certain functions, including, among other things: (1) the investigation and enforcement of conduct occurring on the BX equity market that also relates to cross market activity on non-Nasdaq exchanges; (2) the handling of contested disciplinary proceedings arising out of BX Regulation-led investigation and enforcement activities<sup>14</sup>; and (3) matters covered by agreements to allocate regulatory

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which, among other things, similarly enabled Phlx’s Regulation Department to perform these functions).

<sup>12</sup> See Securities Exchange Act Release No. 82143 (November 22, 2017), 82 FR 56672 (November 29, 2017) (SR-Phlx-2017-92) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Adopt Investigatory and Disciplinary Processes Substantially Similar to Nasdaq BX, Inc. and The Nasdaq Stock Market LLC for Phlx, which, among other things, similarly enabled Phlx’s Regulation Department to perform these functions).

<sup>13</sup> In a separate filing Nasdaq also proposed to reallocate operational responsibility from FINRA to Nasdaq Regulation for investigation and enforcement responsibilities for conduct occurring on The Nasdaq Options Market and investigation and enforcement responsibilities for conduct occurring on the Nasdaq equity market only, i.e., not also on non-Nasdaq equities markets. See SR-Nasdaq-2019-007. The Commission approved that rule filing on April 3, 2019. See Securities and Exchange Act Release No. 34-85505 (Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 2, to Reassign Certain Investigation and Enforcement Functions Under the Exchange’s Authority and Supervision.)

<sup>14</sup> For example, pursuant to Rule 9216, if at the conclusion of a BX Regulation-led investigation, BX Regulation has reason to believe that a violation occurred but the Respondent disputes the violation and therefore does not execute an Acceptance, Waiver, and Consent (“AWC”) letter, or if the Respondent executes the AWC letter but the Exchange Review Council, Review Subcommittee or FINRA’s Office of Disciplinary Affairs does not accept the executed letter, the Exchange may decide to pursue formal disciplinary proceedings. In such a case, the Exchange would refer the matter to FINRA to handle the formal disciplinary proceedings on its behalf. FINRA’s Office of Hearing Officers will continue to be responsible for the administration of the hearing process.

responsibility under Rule 17d-2 of the Act. As with all investigation and enforcement work, all tasks delegated to FINRA are subject to BX's supervision and ultimate responsibility.

BX Regulation has instituted the requisite infrastructure to accommodate the internalization of investigative and enforcement work on behalf of the Exchange. Specifically, BX created a new investigation and enforcement group to perform the functions covered by this proposal, which included hiring additional staff. BX is also leveraging its existing staff of experienced analysts, lawyers, programmers, and market structure experts to assist, where necessary, with performing the new functions covered by this proposal. In addition, BX Regulation has developed comprehensive plans covering the transition and has met regularly for more than one year to ensure a smooth transition of the work and prevent any gaps in regulatory coverage. Finally, BX filed for immediate effectiveness amendments to its rules that aligned its existing investigatory and disciplinary processes with the investigatory and disciplinary processes of Phlx. The amendments also granted the Exchange's Enforcement Department with the investigative and enforcement authority that it now seeks approval to exercise.<sup>15</sup>

BX anticipates a phased transition of investigative and enforcement responsibility, whereby BX would assume increasing investigation and enforcement responsibility throughout 2019 and into 2020 for the conduct occurring on the Exchange.<sup>16</sup> BX also anticipates transitioning certain matters currently pending with FINRA to the Exchange's Enforcement Department if the Exchange's Regulation Department believes doing so is consistent with ensuring prompt resolution of regulatory matters.

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<sup>15</sup> Securities Exchange Act Release No. 84354 (October 3, 2018), 83 FR 50723 (October 9, 2018) (SR-BX-2018-042).

<sup>16</sup> The Exchange notes that the investigatory and disciplinary processes and related rules applicable to its Members that FINRA currently follows on the Exchange's behalf (i.e. the Series 8000 and 9000 Rules) will remain the same.

BX Rule 0150 requires that BX obtain Commission approval if regulatory functions subject to RSAs in effect at the time BX executed the agreement in 2008 are no longer performed by FINRA or an affiliate thereof, or by another independent self-regulatory organization. For the reasons stated above, BX believes that the reassignment of the specified investigation and enforcement responsibility will further its regulatory program and benefit investors and the markets. Commission approval of the proposal would allow BX to better leverage its surveillance, investigation, and enforcement teams; to deliver increased efficiencies in the regulation of its market; and to act promptly and provide more effective regulation.

In addition, BX notes that its proposal is consistent with, but more limited than, investigation and enforcement work performed by other national securities exchanges. For example, in 2015, the SEC approved the New York Stock Exchange's ("NYSE") application whereby NYSE amended certain of its disciplinary rules to facilitate the reintegration of certain market surveillance, investigation and enforcement functions performed on behalf of NYSE by FINRA.<sup>17</sup> Unlike NYSE, however, BX will also continue to rely on FINRA to prosecute contested matters before a Hearing Panel.<sup>18</sup>

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<sup>17</sup> See Securities Exchange Act Release No. 75721 (August 18, 2015), 80 FR 51334 (August 24, 2015) and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1, 3 and 5, Amending Exchange Disciplinary Rules to Facilitate the Reintegration of Certain Regulatory Functions from Financial Industry Regulatory Authority, Inc., Securities Exchange Act Release No. 76436 (November 13, 2015), 80 FR 72460 (November 19, 2015) (SR-NYSE-2015-35).

<sup>18</sup> See BX Rule 9120(q) ("The term "Hearing Panel" means an Adjudicator that is constituted under Rule 9231 to conduct a disciplinary proceeding governed by the Rule 9200 Series, that is constituted under the Rule 9520 Series or the Rule 9550 Series to conduct a proceeding, or that is constituted under the Rule 9800 Series to conduct a temporary cease and desist proceeding."). See also supra note 14.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>19</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>20</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. In addition, the Exchange believes that the proposal furthers the objectives of Section 6(b)(7) of the Act,<sup>21</sup> in particular, in that these changes will continue to provide for fair procedures for the disciplining of members and persons associated with members, the denial of membership to any person seeking membership therein, the barring of any person from becoming associated with a member thereof, and the prohibition or limitation by the Exchange of any person with respect to access to services offered by the Exchange or a member thereof.

The Exchange believes that this proposal is in keeping with those principles because it leverages BX's extensive operational experience and expertise in regulating its markets and marries BX's surveillance capabilities with its surveillance, investigation and enforcement staff, thereby increasing effectiveness and enabling prompt action. BX believes that it can achieve these important objectives because it is uniquely positioned to understand conduct on its own markets and take timely action when appropriate to investigate potential violations and enforce the rules to punish and deter misconduct, hold bad actors accountable, and protect investors and market integrity. In this regard, the Exchange's surveillance, investigative and enforcement teams work together to identify and review potentially violative conduct. This results in more

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<sup>19</sup> 15 U.S.C. 78f(b).

<sup>20</sup> 15 U.S.C. 78f(b)(5).

<sup>21</sup> 15 U.S.C. 78f(b)(7).

effective regulation because it facilitates timely and more efficient action. Indeed, the underlying driving force for the current proposal is BX's belief that it can conduct this regulatory work more effectively and efficiently given its technology, structure and in-depth knowledge of its markets and members. For these reasons, BX believes it can conduct investigative and enforcement functions specified above in a thorough and timely manner, thereby promoting the fair and orderly operation of the markets and serving the interests of market participants and investors. In so doing, BX will fulfill the Commission's mandate that BX's affiliate, Nasdaq, bear responsibility for self-regulatory conduct.<sup>22</sup>

BX will continue to refer certain potentially violative conduct to FINRA for further review, including matters covered by agreements to allocate regulatory responsibility under Rule 17d-2 of the Act. Moreover, FINRA will continue to have responsibility for, among other things, the investigation and enforcement of conduct occurring on the BX equity market that also occurs on non-Nasdaq exchanges, as well as the handling of contested disciplinary proceedings arising out of BX Regulation-led investigation and enforcement activities.<sup>23</sup> All referrals to FINRA remain subject to BX's supervision and ultimate responsibility.

BX also believes that the proposal is consistent with the Act because, as the Commission has made clear, BX's affiliate, Nasdaq, bears the ultimate responsibility for self-regulatory conduct and primary liability for self-regulatory failures.<sup>24</sup> In addition, BX notes that its proposal is consistent with, but more limited than, investigation and enforcement work performed by NYSE. As noted above, the SEC approved NYSE's application to amend certain of its disciplinary rules to facilitate the reintegration of certain market surveillance, investigation

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<sup>22</sup> See supra note 4.

<sup>23</sup> See supra note 14.

<sup>24</sup> See supra note 4.

and enforcement functions performed on behalf of NYSE by FINRA.<sup>25</sup> BX believes it would therefore be consistent with the Act for BX to perform more limited investigation and enforcement work than NYSE.

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. The proposed rule change is not intended to address competitive issues but rather to enable the Exchange to directly investigate and initiate disciplinary actions for the specified conduct discussed above following the integration of certain regulatory functions from FINRA.

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

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<sup>25</sup> See supra note 17.

#### 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-BX-2019-002 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-BX-2019-002. 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-BX-2019-002 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>26</sup>

Jill M. Peterson  
Assistant Secretary

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