

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-79228; File No. SR-NASDAQ-2016-144)

November 3, 2016

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Institute a New Fee for the Distribution of Data

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹, and Rule 19b-4 thereunder,² notice is hereby given that on October 20, 2016, The NASDAQ Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by 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 Rule 7047 of the Exchange’s transaction fees to institute a new fee for the distribution of data derived from Nasdaq Basic on third-party websites or other electronic platforms, as described further below.

The changes are being filed for immediate effectiveness and will become operative on October 20, 2016.

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 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 purpose of the proposed rule change is to introduce a new pricing model to keep pace with an evolving practice. Distributors have increasingly used Nasdaq Basic to make “Derived Data” available on a website or other electronic platform that is branded by a third party, or co-branded by a Distributor and a third party, and available to external subscribers.

“Derived Data” is pricing data or other information that is created in whole or in part from Nasdaq information, but which cannot be reverse engineered to recreate Nasdaq information or be used to create other data that is recognizable as a reasonable substitute for Nasdaq information. The type of Derived Data subject to the proposed fee is taken from Nasdaq Basic, a proprietary data product that provides best bid and offer and last sale information for all U.S. exchange-listed stocks using data from the Nasdaq Market Center and the FINRA/Nasdaq Trade Reporting Facility.

The Derived Data subject to the proposed fee is made available to subscribers on a “Hosted Display Solution”: a product, solution or capability provided by a Distributor in which the Distributor makes the Derived Data available on a platform that reflects either a brand of a third party, or is co-branded with a third party and a Distributor, and available for use by external

subscribers of the third party or the Distributor. The Distributor maintains control of the application's data, entitlements and display.

The Hosted Display Solution may take a number of forms. For example, the Distributor may host a "Widget," such as an iframe or applet, in which the Hosted Display Solution is a part or a subset of a website or platform. The Hosted Display Solution may also take the form of a "White Label," in which the Distributor hosts or maintains the website or platform on behalf of a third-party entity. Although the specific forms may vary, Hosted Display Solutions allow Distributors to make Derived Data available on a platform that is branded with a third-party brand, or co-branded with a third party and a Distributor, for the use of external subscribers.

Derived Data on a Hosted Display Solution may be used for a number of different purposes, to be determined by the Distributor. Possible uses include the display of information or data, or the creation of derivative instruments, such as swaps,³ swaptions,⁴ binary options,⁵ or contracts for difference.⁶ The specific use of the data will be determined by the Distributor, as the proposed fee will not depend on the purpose for placing the Derived Data on a Hosted Display Solution.

The Exchange proposes a flat fee of \$400 per month per Hosted Display Solution for each Distributor that makes Derived Data available on a Hosted Display Solution. The monthly

³ A swap is a derivative contract in which two parties agree to exchange financial instruments.

⁴ A swaption, or swap option, is an option to enter into a swap at a specified time.

⁵ A binary option is a type of contract in which the return depends on the outcome of a true/false proposition. If the proposition is true, the option purchaser would be entitled to predetermined compensation; otherwise, the purchaser would receive no compensation.

⁶ A contract for difference is an agreement to exchange the difference between the current value of an asset and its future value. If the price increases, the seller pays the buyer the amount of the increase. If the price decreases, the buyer pays the seller the amount of the decrease.

fee will apply whenever such a Hosted Display Solution is employed at any time during the month. This fee will be in addition to the distributor fee owed for the distribution of Nasdaq Basic under Rule 7047(c)(1), as well as any fee that may be owed under Rule 7047(c)(2). Any Distributor that distributes Nasdaq data that is not Derived Data—*i.e.*, Nasdaq Basic for Nasdaq, Nasdaq Basic for NYSE, or Nasdaq Basic for NYSE Market—on a Hosted Display Solution would be liable for any applicable per-subscriber or per-query fees set forth in Rules 7047(b)(1)-(3), as well as the distribution fee under 7047(c)(1).

The fee is entirely optional, in that it applies only to Distributors that opt to use Derived Data from Nasdaq Basic to create a Hosted Display Solution, as described herein. It does not impact or raise the cost of any other Nasdaq product, nor does it increase the cost of Nasdaq Basic, except in instances where Derived Data is made available on a Hosted Display Solution.

Because “Derived Data” will be a defined term under the proposal, the Exchange also proposes replacing the phrase “data derived” in Rule 7047(c)(2) with the term “Derived Data.”

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,⁷ in general, and furthers the objectives of Sections 6(b)(4) and 6(b)(5) of the Act,⁸ 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 its facility, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Commission and the courts have repeatedly expressed their preference for competition over regulatory intervention in determining prices, products, and services in the securities markets. In Regulation NMS, while adopting a series of steps to improve the current

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(4) and (5).

market model, the Commission highlighted the importance of market forces in determining prices and SRO revenues and, also, recognized that current regulation of the market system “has been remarkably successful in promoting market competition in its broader forms that are most important to investors and listed companies.”⁹

Likewise, in NetCoalition v. Securities and Exchange Commission¹⁰ (“NetCoalition”) the D.C. Circuit upheld the Commission’s use of a market-based approach in evaluating the fairness of market data fees against a challenge claiming that Congress mandated a cost-based approach.¹¹ As the court emphasized, the Commission “intended in Regulation NMS that ‘market forces, rather than regulatory requirements’ play a role in determining the market data . . . to be made available to investors and at what cost.”¹²

Further, “[n]o one disputes that competition for order flow is ‘fierce.’ . . . As the SEC explained, ‘[i]n the U.S. national market system, buyers and sellers of securities, and the broker-dealers that act as their order-routing agents, have a wide range of choices of where to route orders for execution’; [and] ‘no exchange can afford to take its market share percentages for granted’ because ‘no exchange possesses a monopoly, regulatory or otherwise, in the execution of order flow from broker dealers’”¹³

⁹ Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37499 (June 29, 2005) (“Regulation NMS Adopting Release”).

¹⁰ NetCoalition v. SEC, 615 F.3d 525 (D.C. Cir. 2010).

¹¹ See NetCoalition at 534 – 535; see also Sec. Indus. Fin. Mkts. Ass’n (SIFMA), Initial Decision Release No. 1015, 2016 SEC LEXIS 2278 (ALJ June 1, 2016) (applying a market-based approach to the Regulation NMS analysis).

¹² NetCoalition at 537.

¹³ Id. at 539 (quoting Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770, 74782-83 (December 9, 2008) (SR-NYSEArca-2006-21)).

The Exchange believes that the introduction of a fee for the use of Derived Data on Hosted Display Solutions is reasonable because: (i) all proprietary data fees are constrained by the Exchange's need to compete for order flow; (ii) proprietary data fees are subject to market competition from substitute products; and (iii) the proposed fee will be constrained by downstream competition among Distributors and third-party firms. The Exchange does not currently have a specific fee for making Derived Data available on Hosted Display Solutions for external subscribers; the proposed fee will be \$400 per month for any use of a Hosted Display Solution to display Derived Data at any time during that month. A Distributor who makes Derived Data available on a Hosted Display Solution would not be subject to the per-Subscriber or per-query user fees set forth in Rules 7047(b)(1)-(3) because Derived Data, by definition, cannot be reverse engineered to recreate the data that is fee-liable under those rules. This is in contrast to any firm that distributes Nasdaq data that is not Derived Data on a Hosted Display Solution, which would be subject to such user fees. The Exchange believes that this fee is an equitable allocation and is not unfairly discriminatory because the Exchange will apply the same fee to all similarly situated distributors.

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. In terms of inter-market competition, the Exchange 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, the Exchange 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. Because competitors are

free to modify their own fees in response, and because market participants may readily adjust their order routing practices, the Exchange believes that the degree to which fee changes in this market may impose any burden on competition is extremely limited.

The proposed fee in this case applies to data derived from Nasdaq Basic, which is subject to competition from the NYSE, BATS, and other exchanges that offer similar products. In sum, if the changes proposed herein are unattractive to market participants, it is likely that the Exchange will lose market share as a result. Accordingly, the Exchange does not believe that the proposed changes will impair the ability of members or competing order execution venues to maintain their competitive standing in the financial markets.

Market forces constrain the proposed fee in three specific respects. First, all fees related to Nasdaq Basic are constrained by competition among exchanges and other entities in attracting order flow. Firms make decisions regarding Nasdaq Basic and other proprietary data based on the total cost of interacting with the Exchange, and order flow would be harmed by the supracompetitive pricing of any proprietary data product. Second, the price of Nasdaq Basic is constrained by the existence of multiple substitutes that are offered, or may be offered, by entities that offer proprietary or non-proprietary data. Third, the proposed fee will be constrained by competition among Distributors and third parties for subscribers.

Competition for Order Flow

Fees related to Nasdaq Basic are constrained by competition among exchanges and other entities seeking to attract order flow. Order flow is the “life blood” of the exchanges. Broker-dealers currently have numerous alternative venues for their order flow, including thirteen self-regulatory organization (“SRO”) markets, as well as internalizing broker-dealers (“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. The existence of fierce competition for order flow implies a high degree of price sensitivity on the part of BDs, which may readily reduce costs by directing orders toward the lowest-cost trading venues.

The level of competition and contestability in the market for order flow is demonstrated by the numerous 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 BATS/Direct Edge. A proliferation of dark pools and other ATs operate profitably with fragmentary shares of consolidated market volume. For a variety of reasons, competition from new entrants, especially for order execution, has increased dramatically over the last decade.

Each SRO, TRF, ATS, and BD that competes for order flow is permitted to produce proprietary data products. Many currently do or have announced plans to do so, including NYSE, NYSE Amex, NYSE Arca, and BATS. This is because Regulation NMS deregulated the market for proprietary data. While BDs had 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. Order routers and market data vendors can facilitate production of proprietary data products for single or multiple BDs. The potential sources of proprietary products are virtually limitless.

The markets for order flow and proprietary data are inextricably linked: a trading platform cannot generate market information unless it receives trade orders. As a result, the competition for order flow constrains the prices that platforms can charge for proprietary data

products. Firms make decisions on how much and what types of data to consume based on the total cost of interacting with Nasdaq and other exchanges. Data fees are but one factor in a total platform analysis. If the cost of the product exceeds its expected value, the broker-dealer will choose not to buy it. A supracompetitive increase in the fees charged for either transactions or proprietary data has the potential to impair revenues from both products. In this manner, the competition for order flow will constrain prices for proprietary data products, including charges relating to Nasdaq Basic.

Substitute Products

The price of data derived from Nasdaq Basic is constrained by the existence of multiple substitutes offered by numerous entities, including both proprietary data offered by other SROs or other entities, and non-proprietary data disseminated by Nasdaq in its capacity as a Securities Information Processor (“SIP”) for the national market system plan governing securities listed on Nasdaq as a national securities exchange (“Nasdaq UTP Plan”).

The information provided through Nasdaq Basic is a subset of the best bid and offer and last sale data provided by the SIP. The “core” data disseminated by the SIP consists of best-price quotations and last sale information from all markets in U.S.-listed equities; Nasdaq Basic provides best bid and offer and last sale information for all U.S. exchange-listed stocks based on trade reports from the Nasdaq Market Center and the FINRA/Nasdaq Trade Reporting Facility. Many customers that purchase SIP data do not also purchase Nasdaq Basic because they are substitutes; moreover, in cases where customers buy both products, they may shift the extent to which they purchase one or the other based on price changes. The SIP constrains the price of Nasdaq Basic because no purchaser would pay an excessive price for Nasdaq Basic when substitute data is also available from the SIP.

Proprietary data sold by other exchanges also constrain the price of Nasdaq Basic. NYSE and BATS, like Nasdaq, sell proprietary non-core data that include best bid and offer and last sale data. Customers do not typically purchase proprietary best bid and offer and last sale data from multiple exchanges. Other proprietary data products constrain the price of Nasdaq Basic because no customer would pay an excessive price for Nasdaq Basic when substitute data is available from other proprietary sources. The effectiveness of competition in constraining prices for Nasdaq Basic is demonstrated by the fact that the fee to distribute data derived from Nasdaq Basic to non-professional subscribers has remained unchanged since July 29, 2011.¹⁴

Competitive Market Structure

The fee for making Derived Data available on a Hosted Display Solution is also constrained by competition among Distributors and third-party firms placing their brand names on Hosted Display Solutions. Distributors must compete for customers. Firms placing their brand on Hosted Display Solutions must compete for subscribers. If the price of Hosted Display Solutions were to exceed competitive levels, thereby placing Distributors and third party firms at a competitive disadvantage relative to firms that did not purchase Nasdaq products, Distributors and the third party firms would take their business elsewhere. There are no legal, regulatory, or other requirements restricting their ability to do so.

In summary, market forces constrain the proposed fee through competition for order flow, competition from substitute data products, and in the competition among Distributors and third party for subscribers. For these reasons, the Exchange has provided a substantial basis demonstrating that the fee is equitable, fair, reasonable, and not unreasonably discriminatory, and therefore consistent with and in furtherance of the purposes of the Exchange Act.

¹⁴ See Securities Exchange Act Release No. 64994 (July 29, 2011), 76 FR 47621 (August 5, 2011) (SR-NASDAQ-2011-091).

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.¹⁵

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: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) 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. Please include File Number SR-NASDAQ-2016-144 on the subject line.

Paper comments:

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

¹⁵ 15 U.S.C. 78s(b)(3)(A)(ii).

All submissions should refer to File Number SR-NASDAQ-2016-144. 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-2016-144 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.¹⁶

Brent J. Fields
Secretary

¹⁶ 17 CFR 200.30-3(a)(12).