

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-79317; File No. SR-NASDAQ-2016-121)

November 15, 2016

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change Related to the Payment of a Credit by Execution Access, LLC Based on Volume Thresholds Met on the NASDAQ Options Market

I. Introduction

On August 29, 2016, The Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), 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> a proposed rule change related to the payment of a credit by Execution Access, LLC (“EA”) that would be based on volume thresholds met on the NASDAQ Options Market LLC (“NOM”). The proposed rule change was published for comment in the Federal Register on September 8, 2016.<sup>3</sup> On October 19, 2016, pursuant to Section 19(b)(2) of the Act,<sup>4</sup> the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.<sup>5</sup> To date, the Commission has received no comment letters on the proposal. This order institutes proceedings

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 78749 (September 1, 2016), 81 FR 62212 (“Notice”).

<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> See Securities Exchange Act Release No. 79118, 81 FR 73186 (October 24, 2016). The Commission designated December 7, 2016 as the date by which the Commission shall either approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change.

under Section 19(b)(2)(B) of the Act<sup>6</sup> to determine whether to approve or disapprove the proposed rule change.

## II. Summary of the Proposed Rule Change

Under the proposal, EA<sup>7</sup> would offer a credit to its clients who are also NOM Participants (“dual access clients”),<sup>8</sup> provided they qualify for one of the two highest Market Access and Routing Subsidy (“MARS”) Payment tiers available on NOM. According to the Exchange, NOM Participants that have System Eligibility<sup>9</sup> and have executed the requisite number of

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<sup>6</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>7</sup> According to the Exchange, EA is a broker-dealer that operates a fully electronic central limit order book known as eSpeed, and it facilitates the matching of client orders in U.S. Treasury securities. See Notice, supra note 3, at 62212 n.3.

<sup>8</sup> As proposed, the dual access client may be an affiliate entity of the NOM Participant. See id. at 62212. Affiliates would include other legal entities under common control. See id. at 62212 n.4.

<sup>9</sup> At the time the Exchange initially submitted this proposal, to qualify for MARS, a Participant’s routing system (“System”) was required to: (1) enable the electronic routing of orders to all of the U.S. options exchanges, including NOM; (2) provide current consolidated market data from the U.S. options exchanges; and (3) be capable of interfacing with NOM’s API to access current NOM match engine functionality. Further, the Participant’s System needed to cause NOM to be one of the top three default destination exchanges for individually executed marketable orders if NOM is at the national best bid or offer (“NBBO”), regardless of size or time, but allow any user to manually override NOM as a default destination on an order-by-order basis. Any NOM Participant was permitted to avail itself of this arrangement, provided that its order routing functionality incorporates the features described above and satisfies NOM that it appears to be robust and reliable. The Participant remained solely responsible for implementing and operating its System. See id. at 62213 n.6. The Commission notes that the Exchange recently modified MARS, including the System Eligibility requirements. See NOM Rules at Chapter XV, Section 2(6). See also Securities Exchange Act Release No. 79251 (November 7, 2016), 81 FR 79536 (November 14, 2016) (SR-NASDAQ-2016-149) (“MARS Amendment”) (modifying the MARS System Eligibility requirements to provide that “the Participant’s System would also need to cause NOM to be the one of the top three default destination exchanges for (a) individually executed marketable orders if NOM is at the [NBBO], regardless of size or time or (b) orders that establish a new NBBO on NOM’s Order Book, but allow any user

Eligible Contracts<sup>10</sup> in a month are paid MARS rebates based on average daily volume (“ADV”) in the month.<sup>11</sup> If a NOM Participant meets these requirements, the Exchange pays a MARS Payment on all executed Eligible Contracts that add liquidity and that are routed to NOM through the NOM Participant’s System.<sup>12</sup>

Under the proposal, if a dual access client qualifies for NOM’s MARS Payment Tier 2 in a given month, EA would credit the dual access client (or the dual access client’s affiliate, if applicable) \$22,000 on its EA bill for the corresponding month.<sup>13</sup> If a dual access client qualifies for NOM’s MARS Payment Tier 3 in a given month, EA would credit the dual access client (or the dual access client’s affiliate, if applicable) \$40,000 on its EA bill for the corresponding month.<sup>14</sup> This credit would be paid by EA, would not be transferable, and would offset transaction fees on EA.<sup>15</sup> According to the Exchange, the purpose of this proposal is to lower

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to manually override NOM as a default destination on an order-by-order basis”) (emphasis added).

<sup>10</sup> MARS Eligible Contracts include electronic Firm, Non-NOM Market Maker, Broker-Dealer, or Joint Back Office orders that add liquidity, excluding Mini Options. See NOM Rules at Chapter XV, Section 2(6); see also Notice, supra note 3, at 62213 n.7.

<sup>11</sup> At the time the Exchange initially submitted this proposal, the Exchange had three tiers of MARS Payments: \$0.07 for ADV of 2,500 Eligible Contracts; \$0.09 for ADV of 5,000 Eligible Contracts (“Payment Tier 2”); and \$0.11 for ADV of 10,000 Eligible Contracts (“Payment Tier 3”). See Notice, supra note 3, at 62213. The Commission notes that, as a result of recent modifications to MARS, the Exchange now has four tiers of MARS Payments, as well as different MARS Payments for penny pilot options and non-penny pilot options. See NOM Rules at Chapter XV, Section 2(6); see also MARS Amendment, supra note 9.

<sup>12</sup> See NOM Rules at Chapter XV, Section 2(6); see also Notice, supra note 3, at 62213.

<sup>13</sup> See Notice, supra note 3, at 62213.

<sup>14</sup> See id.

<sup>15</sup> See id. at 62213 n.8.

prices to transact U.S. Treasury securities on EA in response to competitive forces in the Treasury markets, and to increase trading on NOM.<sup>16</sup>

III. Proceedings to Determine Whether to Approve or Disapprove SR-NASDAQ-2016-121 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>17</sup> to determine whether the proposed rule change should be approved or disapproved. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described below, the Commission seeks and encourages interested persons to provide comments on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,<sup>18</sup> the Commission is providing notice of the grounds for disapproval under consideration. As discussed above, under the proposal, EA would provide credits to dual access clients who meet certain volume thresholds on NOM. The Act requires that exchange rules provide for the equitable allocation of reasonable fees among members, issuers, and other persons using its facilities; that exchange rules not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers; and that exchange rules do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The Commission intends to assess whether the Exchange's proposal is consistent with these and other requirements of the Act.

The Commission believes it is appropriate to institute disapproval proceedings at this time in view of the legal and policy issues raised by the proposal. The sections of the Act applicable to the proposed rule change include:

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<sup>16</sup> See id. at 62212-13.

<sup>17</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>18</sup> Id.

- Section 6(b)(4) of the Act,<sup>19</sup> which requires that the rules of a national securities exchange “provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.”
- Section 6(b)(5) of the Act,<sup>20</sup> which requires that the rules of a national securities exchange be designed to, among other things, “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” and not be “designed to permit unfair discrimination between customers, issuers, brokers, or dealers.”
- Section 6(b)(8) of the Act,<sup>21</sup> which requires that the rules of a national securities exchange “not impose any burden on competition not necessary or appropriate” in furtherance of the purposes of the Act.

#### IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.<sup>22</sup> Interested persons are invited to submit written data,

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<sup>19</sup> 15 U.S.C. 78f(b)(4).

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

<sup>21</sup> 15 U.S.C. 78f(b)(8).

<sup>22</sup> Section 19(b)(2) of the Act, as amended by the Securities Acts Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See

views, and arguments regarding whether the proposal should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

The Commission invites the written views of interested persons concerning whether the proposal is consistent with Sections 6(b)(4), 6(b)(5), 6(b)(8), or any other provision of the Act, or the rules and regulations thereunder. The Commission asks that commenters address the sufficiency and merit of the Exchange's statements in support of the proposal, in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on the following:

1. Do commenters agree with the Exchange's belief that the proposal: (a) provides for the equitable allocation of reasonable dues, fees, and other charges among its members and issuer and other persons using its facilities; (b) is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers; and (c) will not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act? Why or why not?

2. What are commenters' views on the impact that the proposal would have on the current market structure? Please explain.

3. What are commenters' views on the likely effect of the proposal on competition? Specifically, what are commenters' views on the likely effect on the fees, volume, and quality of trading on NOM, EA, and the platforms that compete with NOM or EA for volume? In

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Securities Acts Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

providing an answer, please consider any effect on the structure and process of competition, including number of competitors and/or any exit from the market that might arise from the proposal.

4. What are commenters' views on how the proposal would affect NOM Participants and EA clients? Would the "dual access" requirement affect the number NOM Participants or EA clients?

5. What are commenters' views on the impact of the proposal on NOM Participants who would meet the required MARS thresholds but are not dual access clients and thus would not be able to benefit from the credit on EA?

6. What are commenters' views on the impact of the proposal on EA clients who are not NOM Participants and thus would not be eligible for the credits?

7. What are commenters' views on how EA would likely recoup the cost of the proposed credit?

8. What are commenters' views on whether the proposal would affect competitors to NOM and EA or clients of such competitors? Specifically, what are commenters' views on the impact of the proposal on exchanges that do not have affiliated broker-dealers/Alternative Trading Systems that transact securities not listed on a national securities exchange – e.g., U.S. Treasury securities? Would the proposal lead to a decline in number of clients, or client volume for competitors?

9. What are commenters' views on how the proposal would impact the incentives for existing exchanges or new entities to create multiple trading venues or broker-dealers/Alternative Trading Systems under one group?

10. What are commenters' views on the impact the proposal would have, if any, on

the trading of options orders across multiple options exchanges? Please explain. What are commenters' views on the impact the proposal would have, if any, on the best execution of investor orders, including the implicit costs of executing their orders (such as spreads and price impact)? Please explain.

Commenters are requested to provide empirical data and other factual support for their views.

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-2016-121 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-2016-121. 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-2016-121 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>23</sup>

Brent J. Fields  
Secretary

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<sup>23</sup> 17 CFR 200.30-3(a)(57).