

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-79431; File No. SR-Nasdaq-2016-120)

November 30, 2016

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend Rules 7034 and 7051 to Establish the Third Party Connectivity Service

I. Introduction

On August 16, 2016, the Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (“Act”)² and Rule 19b-4 thereunder,³ a proposed rule change to establish the Third Party Connectivity Service under Rules 7034 and 7051. The proposed rule change was published for comment in the Federal Register on September 2, 2016.⁴ The Commission received one comment letter regarding the proposal.⁵ Nasdaq responded to the comment letter.⁶ Subsequently, the Commission received three additional comment letters regarding the proposal: One from Bats responding to Nasdaq’s Letter, another from Virtu

¹ 15 U.S.C.78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b-4.

⁴ See Securities Exchange Act Release No. 78713 (August 29, 2016), 81 FR 60768 (“Notice”).

⁵ See letter from Eric Swanson, Esq., General Counsel, Bats Global Markets, Inc., dated September 12, 2016 (“Bats Letter”) to Brent J. Fields, Secretary, Securities and Exchange Commission.

⁶ See letter from Jeffrey S. Davis, Vice President and General Counsel, NASDAQ Stock Market LLC, to Brent J. Fields, Secretary, Commission, dated October 4, 2016 (“Nasdaq Letter”).

Financial, and a third from SIFMA.⁷ This order institutes proceedings under Section 19(b)(2)(B) of the Act⁸ to determine whether to approve or disapprove the proposed rule change.

II. Description of the Proposed Rule Change

Proposed New Connectivity

As described in the Notice, the Exchange is proposing to amend Rules 7034 and 7051 to establish the Third Party Connectivity Service. Under the proposal, the Exchange would segregate connectivity to the Exchange and its proprietary data feeds from connectivity to third party services and data feeds, including SIP data feeds. The Third Party Connectivity Service will provide customers third party market data feeds, including SIP data, and other non-exchange services.⁹ The Exchange is proposing to offer the Third Party Connectivity Service to co-location and non-co-location customers and will offer the service to customers in 10 Gb Ultra and 1 Gb Ultra hand-offs.¹⁰ To receive the SIP feeds, customers must subscribe to the 10 Gb Ultra connectivity option under either Rule 7034(b) or 7051(b). The proposed 1 Gb Ultra Third Party Connectivity Service option under Rules 7034(b) and 7051(b) will only support data feeds from other exchanges and markets.¹¹ Customers seeking connectivity to the Exchange and its

⁷ See letters from Eric Swanson, dated October 12, 2016 (“Bats Response”), Douglas A. Cifu, Chief Executive Officer, Virtu Financial, dated October 6, 2016 (“Virtu Letter”), and Melissa McGregor, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated November 23, 2016 (“SIFMA Letter”), to Brent J. Fields, Secretary, Commission.

⁸ 15 U.S.C. 78s(b)(2)(B).

⁹ See Notice, 81 FR at 60769 n.10.

¹⁰ See Notice, 81 FR at 60769 n.12.

¹¹ See Notice, 81 FR at 60769 n.10.

proprietary data feeds may continue to do so through existing connectivity options under Rules 7034(b) and Rule 7051(a).¹²

Proposed New Fees¹³

The Exchange is proposing to assess fees for the Third Party Connectivity Service under Rules 7034(b) and 7051(b), including a fee of \$1,500 for installation of either a 10 Gb Ultra or 1 Gb Ultra Third Party Services co-location or direct connectivity subscription and an ongoing monthly fee of \$5,000 for 10 Gb Ultra connection and \$2,000 for a 1 Gb Ultra connection.

III. Comment Letters and Nasdaq's Response

The Commission received a total of four comments on the proposed rule change.¹⁴ All of the commenters object to the proposal. The Commission also received a response to the Bats Letter from Nasdaq.¹⁵

In its comment letter, Bats stated that the proposed rule change constitutes a UTP access services fee for direct access to UTP data, and, as such, the fee should have been approved by the UTP Operating Committee.¹⁶ SIFMA noted its agreement with BATS's position on this issue.¹⁷

¹² See Notice, 81 FR at 60769 n.13.

¹³ In the notice, the Exchange also states that it will offer services currently available to Direct Connectivity subscribers under Rule 7051 to subscribers to the Third Party Connectivity Service.

¹⁴ See supra notes 5 and 7.

¹⁵ See supra note 6.

¹⁶ See Bats Letter at 1-2. The Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis ("The UTP Plan") is administered by its participants through an operating committee ("UTP Operating Committee") which is composed of one representative designated by each participant of the plan. See, e.g., Sections IV.A., B.3, and IV.C.2 of the UTP Plan, and Securities Exchange Act Release No.55647 (April 19, 2007), 72 FR 20891 (April 26, 2007).

¹⁷ See SIFMA Letter at 2.

More specifically, Bats stated its belief that because Nasdaq is the sole provider of direct access to UTP Data, the proposal targets UTP Data recipients and extends the scope of the UTP system to include customer connectivity, because firms desiring direct access to UTP Data would be required to subscribe to and pay for the proposed Third Party Connectivity Service.¹⁸ Bats also stated its views that the proposal is anti-competitive, in that it benefits Nasdaq's proprietary data products over UTP data, and is technically unnecessary.¹⁹ Virtu Financial and SIFMA also questioned whether the proposal is technically necessary.²⁰

Nasdaq responded to the Bats Letter, stating that Nasdaq has controlled the network and network connectivity without input from the UTP Operating Committee for over 25 years,²¹ and that neither the UTP Plan nor the processor agreement grants the UTP Operating Committee authority over the network or network connectivity associated with SIP Data.²²

Nasdaq also stated that SIP Data can be obtained from multiple extranet providers that compete with Nasdaq's data distribution services.²³ Nasdaq further stated that extranet providers are not at a competitive disadvantage because extranet providers and Nasdaq receive SIP Data via the same switches, and therefore clients that receive SIP Data via direct connections do not have an advantage with respect to location or speed.²⁴ Nasdaq also stated that the proposal does not target UTP data recipients because UTP SIP Data is combined with and carried on the same

¹⁸ See Bats Letter at 1-2.

¹⁹ See Bats Letter at 1, 3-5.

²⁰ See Virtu Letter at 1-2 and SIFMA Letter at 2-3.

²¹ See Nasdaq Letter at 2-4.

²² Id.

²³ See Nasdaq Letter at 4.

²⁴ See Nasdaq Letter at 4-5.

network as data from other sources.²⁵ Nasdaq argued that it “is proposing to charge firms less for access to SIP Data than it will charge for access to Nasdaq Data” because the “proposed monthly fees for direct connections to the Third Party Data are \$2000 for 1G connections and \$5000 for 10G connections, where the current fees for direct connections to Nasdaq Data are \$2500 and \$7500 for the same services.”²⁶

With respect to technical necessity, Nasdaq stated that it has “done substantial analysis to support the recommendation, and it believes the recommendation is consistent with its limited experience with the new Processor.”²⁷ Nasdaq further stated that the UTP Operating Committee has “input into the bandwidth recommendation” and can act to lower it further.²⁸

In its response to Nasdaq, Bats stated its views that the Nasdaq Letter fails to: (i) address Bats’ assertions that the proposal is anti-competitive; (ii) explain why the proposed rule change is technically necessary; and (iii) show that the proposed rule change does not constitute an access services fee for UTP Data. Specifically, Bats stated that under the proposal, Nasdaq members who maintain direct connections to Nasdaq for trading and quoting purposes would continue to receive Nasdaq proprietary products at no additional cost, while those wishing to also obtain UTP Data would be required to purchase an additional connection via the proposed Third Party Connectivity Service, and pay a separate fee for that connection, thereby making access to

²⁵ See Nasdaq Letter at 3.

²⁶ See Nasdaq Letter at 5.

²⁷ See Nasdaq Letter at 5. In its letter, Nasdaq also states that “[d]uring a one month period (23 trading days) this summer, Nasdaq observed the new UTP Trade Data binary feed exceeding a 1G capacity for a 1 microsecond timeframe in 18 of the trading days. If you add the new UTP Quote Data binary feed to that same connection, the combined feeds exceed 1G capacity for 1 microsecond timeframe in 23 trading days.” See id.

²⁸ See id.

UTP data materially more expensive.²⁹ Bats also stated that it is the access to UTP Data that is at issue, and not the coupling of UTP Data with other third party services, or the percentage of clients that also take another data product via a direct connection to Nasdaq.³⁰

Bats also stated its view that Nasdaq SIP bandwidth recommendations are excessive, inconsistent with current peak UTP message traffic, and much higher than recommendations for Nasdaq's own proprietary data products.³¹ SIFMA states that Nasdaq has not provided any "reasonable justification for requiring member firms to use a 10Gb connection to receive SIP data."³² Bats stated its belief that using a one microsecond burst to determine a bandwidth recommendation is misplaced, as the observed peak is not sustained over a full second.³³ Bats further stated its belief that the UTP Operating Committee has historically acquiesced in the current framework only because by "leveraging a single physical connection to access to both Nasdaq and UTP services, firms can save on the total cost of access, which is a worthwhile benefit to direct UTP data recipients,"³⁴ and that this ability to leverage existing connectivity was a factor in the selection of Nasdaq as SIP processor.³⁵

In its letter, SIFMA agreed with issues raised by other commenters and asserted that the proposed rule change is not consistent with the statutory standards that govern fees.³⁶

²⁹ See Bats Response at 1-2.

³⁰ See Bats Response at 4.

³¹ See Bats Response at 2-3.

³² See SIFMA Letter at 2.

³³ See Bats Response at 2-3.

³⁴ See Bats Response at 3-4.

³⁵ Id.

³⁶ See SIFMA Letter.

IV. Proceedings to Determine Whether to Approve or Disapprove SR-NASDAQ-2016-120 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act³⁷ to determine whether the proposed rule change should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change, as discussed. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described in greater detail below, the Commission seeks and encourages interested persons to provide additional comment on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,³⁸ the Commission is providing notice of the grounds for disapproval under consideration. Specifically, the Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the proposed rule change's consistency with Section 6(b)(4) of the Act, 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,"³⁹ Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be "designed to perfect the operation of a free and open market and a national market system" and "protect investors and the public interest," and not be "designed

³⁷ 15 U.S.C. 78s(b)(2)(B). Section 19(b)(2)(B) of the Act also provides that proceedings to determine whether to disapprove a proposed rule change must be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change. The time for conclusion of the proceedings may be extended for up to 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding.

³⁸ 15 U.S.C. 78s(b)(2)(B).

³⁹ 15 U.S.C. 78f(b)(4).

to permit unfair discrimination between customers, issuers, brokers, or dealers,”⁴⁰ and Section 6(b)(8) of the Act, 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].”⁴¹

V. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their data, views, and arguments with respect to the concerns identified above, as well as any other concerns they may have with the proposed rule change. In particular, the Commission invites the written views of interested persons concerning whether the proposal is consistent with Sections 6(b)(4)⁴², 6(b)(5),⁴³ 6(b)(8)⁴⁴, or any other provision of the Act, or the rules and regulations thereunder. Although there does not appear to be any issue relevant to approval or disapproval which would be facilitated by an oral presentation of data, views, and arguments, the Commission will consider, pursuant to Rule 19b-4 under the Act,⁴⁵ any request for an opportunity to make an oral presentation.⁴⁶ Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by

⁴⁰ 15 U.S.C. 78f(b)(5).

⁴¹ 15 U.S.C. 78f(b)(8).

⁴² 15 U.S.C. 78f(b)(4).

⁴³ 15 U.S.C. 78f(b)(5).

⁴⁴ 15 U.S.C. 78f(b)(8).

⁴⁵ 17 CFR 240.19b-4.

⁴⁶ Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants to 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 Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

[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].

In light of the issues raised by the proposed rule change, as discussed above, the Commission invites additional comment on the proposal, as the Commission continues its analysis of the proposed rule change's consistency with the Act, or the rules and regulations thereunder. More specifically, the Commission asks that any commenters address the sufficiency and merit of the Exchange's statements in support of the proposed rule change. In addition, the Commission seeks comment on the relative merits and advantages or disadvantages of obtaining UTP Data from sources other than directly from Nasdaq via the proposed Third Party Connectivity Service.

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 No. SR-Nasdaq-2016-120 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 No. SR-Nasdaq-2016-120. The 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 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 Nasdaq. 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 No. SR-Nasdaq-2016-120, and should be submitted by [insert date 21 days from the date of publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁷

Eduardo A. Aleman
Assistant Secretary

⁴⁷ 17 CFR 200.30-3(a)(57).