

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 42	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - 2016 - * 040 Amendment No. (req. for Amendments *)
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Filing by NASDAQ Stock Market  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input type="checkbox"/>	Section 19(b)(3)(A) * <input checked="" type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
Pilot <input type="checkbox"/>			Rule		
Extension of Time Period for Commission Action * <input type="checkbox"/>			<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
Date Expires * <input type="text"/>			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input checked="" type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 806(e)(1) * <input type="checkbox"/>	Section 806(e)(2) * <input type="checkbox"/>
	Section 3C(b)(2) * <input type="checkbox"/>

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

A proposal to delete from the Rulebook Section 10, Limitations on Dealings, of Chapter VII, Market Participants.

**Contact Information**

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name \* Carla Last Name \* Behnfeldt  
 Title \* Associate General Counsel  
 E-mail \* carla.behnfeldt@nasdaq.com  
 Telephone \* (215) 496-5208 Fax

**Signature**

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title \*)  
 Executive Vice President and General Counsel

Date 03/18/2016  
 By Edward S. Knight  
 (Name \*)

edward.knight@nasdaq.com

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

**Form 19b-4 Information \***

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) The NASDAQ Stock Market LLC (“Exchange”), 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> is filing with the Securities and Exchange Commission (“Commission”) a proposal to delete from the Exchange’s rulebook Section 10, Limitations on Dealings, of Chapter VII, Market Participants.

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1. The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by senior management of the Exchange pursuant to authority delegated by the Board of Directors of The NASDAQ Stock Market (the “Board”) on July 1, 2015. No other action is necessary for the filing of the rule change.

Questions and comments on the proposed rule change may be directed to:

Carla Behnfeldt  
Associate General Counsel  
Nasdaq, Inc.  
215-496-5208

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<sup>1</sup> 15 U.S.C. § 78s(b)(1).

<sup>2</sup> 17 C.F.R. § 240.19b-4.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

a. Purpose

The Exchange is proposing to adopt a principles-based approach to prohibit the misuse of material nonpublic information by NOM Options Market Makers (“Market Makers”) by deleting from the Exchange’s rulebook Section 10, Limitations on Dealings, of Chapter VII, Market Participants (the “Market Maker Restrictions”). In doing so, the Exchange would harmonize its rules governing Exchange Options Participants,<sup>3</sup> generally, and Exchange Market Makers, in particular, relating to protecting against the misuse of material, non-public information.

The Exchange believes that the Market Maker Restrictions are no longer necessary because all Market Makers are subject to the Exchange’s general principles-based requirements governing the protection against the misuse of material, non-public information, pursuant to Chapter III, Business Conduct, Section 4, Prevention of the Misuse of Material Nonpublic Information, discussed below, which obviates the need for separately-prescribed requirements for a subset of market participants on the Exchange.

Additionally, there is no separate regulatory purpose served by having separate rules for Market Makers. The Exchange notes that this proposed rule change will not decrease the protections against the misuse of material, non-public information; instead, it is designed to provide more flexibility to market participants. This is a competitive

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<sup>3</sup> The term “Options Participant” or “Participant” means a firm or organization that is registered with the Exchange pursuant to Chapter II of the NOM Rules for purposes of participating in options trading on NOM as a “Nasdaq Options Order Entry Firm” or “Nasdaq Options Market Maker”.

filing that is based on a proposal recently submitted by NYSE MKT LLC (“NYSE MKT”) and approved by the Commission.<sup>4</sup>

A Market Maker is an Options Participant registered with the Exchange for the purpose of making markets in options contracts traded on the Exchange and that is vested with the rights and responsibilities specified in Chapter VII of the NOM rules.<sup>5</sup>

Importantly, all Market Makers have access to the same information in the Exchange’s order book. Moreover, Market Makers have no agency obligations on the Exchange’s order book. Notwithstanding that Market Makers have access to the same Exchange trading information as all other market participants on the Exchange, the Exchange has specific rules governing how Market Makers may operate.

#### Proposed Rule Change

The Exchange believes that the Market Maker Restrictions are no longer necessary and proposes to delete them. The Exchange also believes that Chapter III, Section 4, governing the misuse of material, non-public information, provides for an appropriate, principles-based approach to prevent the market abuses the Market Maker Restrictions are designed to address.

Specifically, Chapter III, Section 4, provides that every Options Participant shall establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the Participant’s business, to prevent the misuse of

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<sup>4</sup> See Securities Exchange Act Release No. 75432 (July 13, 2015), 80 FR 42597 (July 17, 2015) (Order Approving SR-NYSEMKT-2015-23). See also Securities Exchange Act Release Nos. 75792 (August 31, 2015), 80 FR 53606 (September 4, 2015) (SR-ISE-2015-26) and 76687 (December 18, 2015), 80 FR 80403 (December 24, 2015) (SR-PHLX-2015-85).

<sup>5</sup> See Chapter I, General Provisions, Section 1, Definitions, subsection (a)(26).

material nonpublic information by such Participant or persons associated with such Participant in violation of the federal securities laws or the Rules thereunder, and the Rules of the Exchange.

Chapter III, Section 4, provides that misuse of material nonpublic information includes, but is not limited to: (i) trading in any securities issued by a corporation, or in any related securities or related options or other derivative securities, while in possession of material nonpublic information concerning that corporation; (ii) trading in an underlying security or related options or other derivative securities, while in possession of material nonpublic information concerning imminent transactions in the underlying security or related securities; and (iii) disclosing to another person any material nonpublic information involving a corporation whose shares are publicly traded or disclosing an imminent transaction in an underlying security or related securities for the purpose of facilitating the possible misuse of such material nonpublic information.

Subsection (c) of Chapter III, Section 4, requires each Options Participant to establish, maintain, and enforce certain policies and procedures as appropriate for the nature of each Participant's business.<sup>6</sup> Under the rule, Participants that are required to file

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<sup>6</sup> In particular, the rule requires that ( i) all associated persons must be advised in writing of the prohibition against the misuse of material nonpublic information; (ii) signed attestations from the Participant and all associated persons affirming their awareness of, and agreement to abide by, the aforementioned prohibitions must be maintained for at least three (3) years, the first two (2) years in an easily accessible place; (iii) records of all brokerage accounts maintained by the Participant and all associated persons must be acquired and maintained for at least three (3) years, the first two (2) years in an easily accessible place, and such brokerage accounts must be reviewed periodically by the Participant for the purpose of detecting the possible misuse of material nonpublic information; and (iv) any business dealings the Participant may have with any corporation whose securities are publicly traded, or any other circumstances that may result in the

Form X-17A-5 under the Exchange Act or Rules thereunder, with the Exchange on an annual basis only, shall, contemporaneously with those submissions, file attestations signed by such Participants stating that the procedures mandated by this Section have been established, enforced and maintained. The rule requires any Options Participant or associated person who becomes aware of any possible misuse of material nonpublic information to promptly notify Nasdaq Regulation.

Finally, subsection (f) of Chapter III, Section 4, specifies that it may be considered conduct inconsistent with just and equitable principles of trade for any Participant or person associated with a Participant who has knowledge of all material terms and conditions of (i) an order and a solicited order, (ii) an order being facilitated or submitted to NOM for price improvement (e.g., price improving orders), or (iii) orders being crossed; the execution of which are imminent, to enter, based on such knowledge, an order to buy or sell an option for the same underlying security as any option that is the subject of the order, or an order to buy or sell the security underlying such class, or an order to buy or sell any related instrument until (a) the terms and conditions of the order and any changes in the terms and conditions of the order of which the Participant or person associated with the Participant has knowledge are disclosed, or (b) the trade can no longer reasonably be considered imminent in view of the passage of time since the order was received. It states that the terms of an order are “disclosed” to NOM Option Participants when the order is entered into the NOM Book.

For purposes of subsection (f), an order to buy or sell a “related instrument” means, in reference to an index option, an order to buy or sell securities comprising 10%

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Participant receiving, in the ordinary course of business, material nonpublic information concerning any such corporation, must be identified and documented.

or more of the component securities in the index or an order to buy or sell a futures contract on an economically equivalent index.

Because Options Participants are already subject to the requirements of Chapter III, Section 4, as described above, the Exchange does not believe it necessary to separately require specific limitations on Market Makers. Deleting the Market Maker Restrictions including its requirements for specific procedures would provide Market Makers flexibility to adapt their policies and procedures as appropriate to reflect changes to their business model, business activities, or the securities market in a manner similar to how Options Participants on the Exchange currently operate and consistent with Chapter III, Section 4.

Options Participants registered as Market Makers have certain rights and bear certain responsibilities beyond those of other Options Participants.<sup>7</sup> Market Makers are

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<sup>7</sup> Chapter VII, Section 5, Obligations of Market Makers, of the NOM rules provides that in registering as a Market Maker, an Options Participant commits himself to various obligations and that transactions of a Market Maker in its market making capacity must constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market. The rule states that Market Makers should not make bids or offers or enter into transactions that are inconsistent with such course of dealings and that ordinarily, Market Makers are expected to (i) during trading hours, maintain a two-sided market, pursuant to Section 6(d)(i) of Chapter VII, in those options in which the Market Maker is registered to trade, in a manner that enhances the depth, liquidity and competitiveness of the market, (ii) [Reserved], (iii) engage, to a reasonable degree under the existing circumstances, in dealings for their own accounts when there exists, or it is reasonably anticipated that there will exist, a lack of price continuity, a temporary disparity between the supply of (or demand for) a particular option contract, or a temporary distortion of the price relationships between option contracts of the same class, (iv) compete with other Market Makers in all options in which the Market Maker is registered to trade, (v) make markets that will be honored for the number of contracts entered into NOM's System in all options in which the Market Maker is registered to trade (vi) update quotations in response to changed market conditions in all options in which the Market Maker is registered to trade (vii) maintain active markets in all options in



distinguished under Exchange rules from other Options Participants in that Market Makers have quoting obligations.<sup>8</sup> However, none of these heightened obligations or different entitlements provides different or greater access to nonpublic information than any other Options Participant on the Exchange. Accordingly, because Market Makers do not have any trading advantages at the Exchange due to their market role, the Exchange believes they should be subject to the same rules as other Options Participants regarding the protection against the misuse of material non-public information, which in this case is existing Chapter III, Section 4.<sup>9</sup>

The Exchange is not proposing to change what is considered to be material, nonpublic information that an affiliated brokerage business of a Market Maker could share with such Market Maker. In that regard, the proposed rule change will not permit affiliates of a Market Maker to have access to any non-public order or quote information of the Market Maker, including hidden or undisplayed size or price information of such

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which the Market Maker is registered, and (viii) honor all orders that the Trading System routes to away markets pursuant to Chapter XII of the NOM rules. Section 5 further provides that Market Makers should not effect purchases or sales on NOM except in a reasonable and orderly manner. If Nasdaq Regulation finds any substantial or continued failure by a Market Maker to engage in a course of dealings as specified in paragraph (a) of Section 5, such Market Maker will be subject to disciplinary action or suspension or revocation of registration in one or more of the securities in which the Market Maker is registered.

<sup>8</sup> Section 6, Market Maker Quotations, of Chapter VII, Market Participants, details specific Market Maker quoting obligations.

<sup>9</sup> The Exchange notes that by deleting the Market Maker Restrictions, the Exchange would no longer require specific information barriers for Market Makers or require pre-approval of any information barriers that a Market Maker would erect for purposes of protecting against the misuse of material non-public information. However, the policies and procedures of Market Makers, including those relating to information barriers, would be subject to review by FINRA, on behalf of the Exchange, pursuant to a Regulatory Services Agreement.

orders or quotes. Affiliates of Market Makers would only have access to orders and quotes that are publicly available to all market participants. Members do not expect to receive any additional order or quote information as a result of this proposed rule change.

The Exchange does not believe that there will be any material change to member information barriers as a result of the removal of the Exchange pre-approval requirement. The Exchange has rules prohibiting Options Participants from disadvantaging their customers or other market participants by improperly capitalizing on the Options Participant's access to or receipt of material, non-public information.<sup>10</sup>

Further, the Exchange does not believe there will be any material change to Market Maker information barriers as a result of removal of the Exchange's pre-approval requirements. In fact, the Exchange anticipates that eliminating the pre-approval requirement should facilitate implementation of changes to Market Maker information barriers as necessary to protect against the misuse of material, non-public information. The Exchange also suggests that the pre-approval requirement is unnecessary because Market Makers do not have agency responsibilities to orders in the book, or time and place information advantages because of their market role.

The Exchange notes that its proposed principles-based approach to protecting against the misuse of material non-public information for all its Options Participants is consistent with recently filed and approved rule changes for NYSE MKT, NYSE Arca

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<sup>10</sup> For example, Chapter XI, Doing Business with the Public, Section 8, Supervision of Accounts, provides in part that each member that conducts a public customer options business shall ensure that its written supervisory system policies and procedures pursuant to NASD Rules 3010, 3012, and 3013 adequately address the member's public customer options business. The Exchange has separately filed a proposed rule change to replace references to these NASD rules with FINRA rules which have replaced them. See SR-NASDAQ-2016-038 filed March 14, 2016.

Equities, Inc. (“NYSE Arca”), BATS Exchange, Inc. (“BATS”), and New York Stock Exchange LLC (“NYSE”) governing cash equity market makers on those respective exchanges.<sup>11</sup>

Except for prescribed rules relating to floor-based designated market makers on the NYSE, who have access to specified non-public trading information, each of these exchanges have moved to a principles-based approach to protecting against the misuse of material non-public information. In connection with approving those rule changes, the Commission found that, with adequate oversight by the exchanges of their members, eliminating prescriptive information barrier requirements should not reduce the effectiveness of exchange rules requiring members to establish and maintain systems to supervise the activities of members, including written procedures reasonably designed to ensure compliance with applicable federal securities law and regulations, and with the rules of the applicable exchange.

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<sup>11</sup> See Securities Exchange Act Release No. 75432 (July 13, 2015), 80 FR 42597 (July 17, 2015) (Order Approving Adopting a Principles-Based Approach to Prohibit the Misuse of Material Nonpublic Information by Specialists and e-Specialists by Deleting Rule 927.3NY and Section (f) of Rule 927.5NY). See also Securities Exchange Act Release Nos. 60604 (Sept. 2, 2009), 76 FR 46272 (Sept. 8, 2009) (SR-NYSEArca-2009-78) (Order approving elimination of NYSE Arca rule that required market makers to establish and maintain specifically prescribed information barriers, including discussion of NYSE Arca and Nasdaq rules) (“Arca Approval Order”); 61574 (Feb. 23, 2010), 75 FR 9455 (Mar. 2, 2010) (SR-BATS-2010-003) (Order approving amendments to BATS Rule 5.5 to move to a principles-based approach to protecting against the misuse of material, nonpublic information, and noting that the proposed change is consistent with the approaches of NYSE Arca and Nasdaq) (“BATS Approval Order”); and 72534 (July 3, 2014), 79 FR 39440 (July 10, 2014), SR-NYSE-2014-12) (Order approving amendments to NYSE Rule 98 governing designated market makers to move to a principles-based approach to prohibit the misuse of material non-public information) (“NYSE Approval Order”); and 76687 (December 18, 2015), 80 FR 80403 (December 24, 2015) (SR-PHLX-2015-85).

The Exchange believes that a principles-based rule applicable to members of options markets would be equally effective in protecting against the misuse of material non-public information.<sup>12</sup> Indeed, Chapter III, Section 4, is currently applicable to Market Makers and already requires policies and procedures reasonably designed to protect against the misuse of material nonpublic information, which is similar to the respective NYSE MKT, NYSE Arca Equities, BATS, and NYSE rules governing cash equity market makers. The Exchange believes Chapter III, Section 4, provides appropriate protection against the misuse of material nonpublic information by Market Makers such that there is no further need for prescriptive information barrier requirements as set forth in the Market Maker Restrictions.

The Exchange notes that even with this proposed rule change, pursuant to Chapter III, Section 4, a Market Maker would still be obligated to ensure that its policies and procedures reflect the current state of its business and continue to be reasonably designed to achieve compliance with applicable federal securities law and regulations, including without limitation, Regulation SHO<sup>13</sup> under the Act and Section 15(g) of the Act<sup>14</sup>, and

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<sup>12</sup> International Securities Exchange, Inc. (“ISE”) and BOX Options Exchange LLC (“BOX”) have recently taken a similar approach. See Notice of Filing and Immediate Effectiveness of Proposed Rule Change Adopting a Principles-Based Approach to Prohibit the Misuse of Material, Non-public Information by Market Makers by Deleting Rule 810, Securities Exchange Act Release No. 75792 (August 31, 2015), 80 FR 53606 (September 4, 2015) (SR-ISE-2015-26). See also Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt a Principles-based Approach to Prohibit the Misuse of Material Nonpublic Information by Market Makers, Securities Exchange Act Release No. 75916 (September 14, 2015), 80 FR 56503 (September 18, 2015) (SR-BOX-2015-31).

<sup>13</sup> The Commission adopted a narrow exception to Regulation SHO’s “locate” requirement only for market makers engaged in bona fide market making in the security at the time they effect the short sale. See 17 CFR 242.203(b)(2)(iii). See also Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48015 (Aug. 6, 2004); Exchange Act Release No. 58775 (Oct. 14, 2008), 73 FR 61690, 61698-

with applicable Exchange rules, including being reasonably designed to protect against the misuse of material, non-public information.

While information barriers would not specifically be required under the proposal, Chapter III, Section 4, already requires that an Options Participant consider its business model or business activities in structuring its policies and procedures, which may dictate that an information barrier or a functional separation be part of the appropriate set of policies and procedures that would be reasonably designed to achieve compliance with applicable securities law and regulations, and with applicable Exchange rules.

The Exchange believes that the proposed reliance on principles-based Chapter III, Section 4 would ensure that a Market Maker would be required to protect against the misuse of any material non-public information. Chapter III, Section 4 already requires that firms refrain from trading while in possession of material non-public information concerning imminent transactions in the security or related product.

The Exchange believes that moving to a principles-based approach rather than prescribing how and when to wall off a Market Maker from the rest of the firm would provide Market Makers with flexibility when managing risk across a firm, including

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9 (Oct. 17, 2008). Broker-dealers would not be able to rely on the Exchange's or any self-regulatory organization's designation of market marking for eligibility for the bona-fide market making exception to the "locate" requirement, as such designations are distinct and independent from Regulation SHO. Eligibility for the bona-fide market making exception depends on the facts and circumstances and a determination of bona-fide market making is based on the Commission's factors outlined in the aforementioned Regulation SHO releases. It should also be noted that a determination of bona-fide market making is relevant for the purposes of close-out obligations under Rule 204 of Regulation SHO. See 17 CFR 242.204(a)(3).

integrating options positions with other positions of the firm or, as applicable, by the respective independent trading unit.

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>15</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>16</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. The Exchange believes that the proposed rule change would remove impediments to and perfect the mechanism of a free and open market by adopting a principles based approach to permit a member or member organization to maintain and enforce policies and procedures to, among other things, prohibit the misuse of material non-public information and provide flexibility on how a Market Maker structures its operations.

The Exchange notes that the proposed rule change is based on an approved rule of the Exchange to which members and member organizations are subject – Section 4, Prevention of the Misuse of Material Nonpublic Information, of Chapter III, Business Conduct – and harmonizes the rules governing Options Participants. Moreover, Market Makers would continue to be subject to federal and Exchange requirements for protecting material non-public order information.<sup>17</sup>

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

<sup>16</sup> 15 U.S.C. 78f(b)(5).

<sup>17</sup> See 15 U.S.C. 78o(g) and Chapter III, Section 4 of the Exchange's rulebook.

The Exchange believes that the proposed rule change would remove impediments to and perfect the mechanism of a free and open market because it would harmonize the Exchange's approach to protecting against the misuse of material nonpublic information and no longer subject Market Makers to prescriptive requirements. The Exchange does not believe that the existing prescriptive requirements applicable to Market Makers are narrowly tailored to their roles because Market Makers do not have access to Exchange trading information in a manner different from any other market participant on the Exchange.

The Exchange further believes the proposal is designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade because existing rules make clear to members and member organizations the type of conduct that is prohibited by the Exchange. While the proposal eliminates prescriptive requirements relating to the misuse of material non-public information, Market Makers would remain subject to existing Exchange rules requiring them to establish and maintain systems to supervise their activities, and to create, implement, and maintain written procedures that are reasonably designed to comply with applicable securities laws and Exchange rules, including the prohibition on the misuse of material, nonpublic information. Additionally, the policies and procedures of Market Makers, including those relating to information barriers, would be subject to review by FINRA, on behalf of the Exchange.

The Exchange notes that the proposed rule change would still require that Market Makers maintain and enforce policies and procedures reasonably designed to ensure

compliance with applicable federal securities laws and regulations and with Exchange rules.

Even though there would no longer be pre-approval of Market Maker information barriers, any Market Maker written policies and procedures would continue to be subject to oversight by the Exchange and therefore the elimination of prescribed restrictions should not reduce the effectiveness of the Exchange rules to protect against the misuse of material non-public information. Rather, Options Participants will be able to utilize a flexible, principles-based approach to modify their policies and procedures as appropriate to reflect changes to their business model, business activities, or to the securities market itself.

Moreover, while specified information barriers may no longer be required, an Options Participant's business model or business activities may dictate that an information barrier or functional separation be part of the appropriate set of policies and procedures that would be reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable Exchange rules. The Exchange therefore believes that the proposed rule change will maintain the existing protection of investors and the public interest that is currently applicable to Market Makers, while at the same time removing impediments to and perfecting a free and open market by moving to a principles-based approach to protect against the misuse of material non-public information.

4. 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. As indicated above, the rule change is being proposed as a competitive response to a filing submitted by NYSE MKT that was recently approved by the Commission.

The Exchange believes that the proposal will enhance competition by allowing Market Makers to comply with applicable Exchange rules in a manner best suited to their business models, business activities, and the securities markets, thus reducing regulatory burdens while still ensuring compliance with applicable securities laws and regulations and Exchange rules. The Exchange believes that the proposal will foster a fair and orderly marketplace without being overly burdensome upon Market Makers.

Moreover, the Exchange believes that the proposed rule change would eliminate a burden on competition for Options Participants which currently exists as a result of disparate rule treatment between options and equities markets regarding how to protect against the misuse of material non-public information. For those members and member organizations that are also members of equity exchanges, their respective equity market maker operations are now subject to a principles-based approach to protecting against the misuse of material non-public information.

The Exchange believes it would remove a burden on competition to enable members and member organizations to similarly apply a principles-based approach to protecting against the misuse of material nonpublic information in the options space as ISE has recently done. To this end, the Exchange notes that Chapter III, Section 4, still requires a Market Maker to evaluate its business to assure that its policies and procedures are reasonably designed to protect against the misuse of material nonpublic information. However, with this proposed rule change, an Options Participant that trades equities and options could look at its firm more holistically to structure its operations in a manner that

provides it with better tools to manage its risks across multiple security classes, while at the same time protecting against the misuse of material non-public information.

5. 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.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)<sup>18</sup> of the Act and Rule 19b-4(f)(6) thereunder<sup>19</sup> in that it effects a change that: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) by its terms, does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest.

The proposed rule change does not significantly affect the protection of investors or the public interest and does not impose any significant burden on competition because it merely deletes prescriptive information barrier requirements in favor of a principles-based approach to prohibiting the misuse of material, non-public information by Market Makers in the same manner that proposed rule changes of other options exchanges have recently done.<sup>20</sup>

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<sup>18</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>19</sup> 17 CFR 240.19b-4(f)(6).

<sup>20</sup> See the BOX and ISE proposed rule changes cited above. Similar to those filings, the proposed rule change would still require that Market Makers maintain and

Furthermore, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to give the Commission written notice of its intent to file a proposed rule change under that subsection at least five business days prior to the date of filing, or such shorter time as designated by the Commission. The Exchange has provided such notice.

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.

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of filing. Rule 19b-4(f)(6)(iii), however, permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange requests that the Commission waive the 30-day operative delay contained in Rule 19b-4(f)(6)(iii) so that members of the Exchange may immediately structure their operations more efficiently following removal of the unnecessary prescriptive information barriers.

As discussed above, similar unnecessary prescriptive information barrier rules have already been removed from other options markets' rulebooks. Removal of the Exchange's unnecessary prescriptive information barrier rules immediately would result

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enforce policies and procedures reasonably designed to ensure compliance with applicable federal securities laws and regulations and with Exchange rules. This proposed rule change is also like the BOX and ISE proposals in that it does not affect the continuing obligations of Market Makers under federal requirements regarding protection of material non-public information.

in harmonization of rules across options exchanges in this regard, to the benefit especially of common members of multiple options markets whose efficiency of operations may be enhanced by the increased flexibility the immediate effectiveness of the proposal will afford them.

Also as discussed above, Chapter III, Section 4, will still require a Market Maker to evaluate its business to assure that its policies and procedures are reasonably designed to protect against the misuse of material nonpublic information. Additionally, this proposed rule change will not decrease the protections against the misuse of material, non-public information; instead, it is designed to provide more flexibility to market participants. The Exchange therefore believes that no investor protection or other purpose would be served by a thirty day operative delay of the proposed rule change.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The proposed rule change is based upon the NYSE MKT, NYSE Arca, BATS, NYSE, and ISE proposed rule changes discussed above.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

1. Notice of proposed rule for publication in the Federal Register.

5. Text of the proposed rule change.

**EXHIBIT 1**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. \_\_\_\_\_ ; File No. SR-NASDAQ-2016-040)

March \_\_, 2016

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Delete From the Rulebook Section 10, Limitations on Dealings, of Chapter VII, Market Participants.

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 March 18, 2016, The NASDAQ Stock Market LLC (“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 delete from the Exchange’s rulebook Section 10, Limitations on Dealings, of Chapter VII, Market Participants.

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 is proposing to adopt a principles-based approach to prohibit the misuse of material nonpublic information by NOM Options Market Makers (“Market Makers”) by deleting from the Exchange’s rulebook Section 10, Limitations on Dealings, of Chapter VII, Market Participants (the “Market Maker Restrictions”). In doing so, the Exchange would harmonize its rules governing Exchange Options Participants,<sup>3</sup> generally, and Exchange Market Makers, in particular, relating to protecting against the misuse of material, non-public information.

The Exchange believes that the Market Maker Restrictions are no longer necessary because all Market Makers are subject to the Exchange’s general principles-based requirements governing the protection against the misuse of material, non-public information, pursuant to Chapter III, Business Conduct, Section 4, Prevention of the

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<sup>3</sup> The term “Options Participant” or “Participant” means a firm or organization that is registered with the Exchange pursuant to Chapter II of the NOM Rules for purposes of participating in options trading on NOM as a “Nasdaq Options Order Entry Firm” or “Nasdaq Options Market Maker”.

Misuse of Material Nonpublic Information, discussed below, which obviates the need for separately-prescribed requirements for a subset of market participants on the Exchange.

Additionally, there is no separate regulatory purpose served by having separate rules for Market Makers. The Exchange notes that this proposed rule change will not decrease the protections against the misuse of material, non-public information; instead, it is designed to provide more flexibility to market participants. This is a competitive filing that is based on a proposal recently submitted by NYSE MKT LLC (“NYSE MKT”) and approved by the Commission.<sup>4</sup>

A Market Maker is an Options Participant registered with the Exchange for the purpose of making markets in options contracts traded on the Exchange and that is vested with the rights and responsibilities specified in Chapter VII of the NOM rules.<sup>5</sup> Importantly, all Market Makers have access to the same information in the Exchange’s order book. Moreover, Market Makers have no agency obligations on the Exchange’s order book. Notwithstanding that Market Makers have access to the same Exchange trading information as all other market participants on the Exchange, the Exchange has specific rules governing how Market Makers may operate.

#### Proposed Rule Change

The Exchange believes that the Market Maker Restrictions are no longer necessary and proposes to delete them. The Exchange also believes that Chapter III,

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<sup>4</sup> See Securities Exchange Act Release No. 75432 (July 13, 2015), 80 FR 42597 (July 17, 2015) (Order Approving SR-NYSEMKT-2015-23). See also Securities Exchange Act Release Nos. 75792 (August 31, 2015), 80 FR 53606 (September 4, 2015) (SR-ISE-2015-26) and 76687 (December 18, 2015), 80 FR 80403 (December 24, 2015) (SR-PHLX-2015-85).

<sup>5</sup> See Chapter I, General Provisions, Section 1, Definitions, subsection (a)(26).

Section 4, governing the misuse of material, non-public information, provides for an appropriate, principles-based approach to prevent the market abuses the Market Maker Restrictions are designed to address.

Specifically, Chapter III, Section 4, provides that every Options Participant shall establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the Participant's business, to prevent the misuse of material nonpublic information by such Participant or persons associated with such Participant in violation of the federal securities laws or the Rules thereunder, and the Rules of the Exchange.

Chapter III, Section 4, provides that misuse of material nonpublic information includes, but is not limited to: (i) trading in any securities issued by a corporation, or in any related securities or related options or other derivative securities, while in possession of material nonpublic information concerning that corporation; (ii) trading in an underlying security or related options or other derivative securities, while in possession of material nonpublic information concerning imminent transactions in the underlying security or related securities; and (iii) disclosing to another person any material nonpublic information involving a corporation whose shares are publicly traded or disclosing an imminent transaction in an underlying security or related securities for the purpose of facilitating the possible misuse of such material nonpublic information.

Subsection (c) of Chapter III, Section 4, requires each Options Participant to establish, maintain, and enforce certain policies and procedures as appropriate for the



nature of each Participant's business.<sup>6</sup> Under the rule, Participants that are required to file Form X-17A-5 under the Exchange Act or Rules thereunder, with the Exchange on an annual basis only, shall, contemporaneously with those submissions, file attestations signed by such Participants stating that the procedures mandated by this Section have been established, enforced and maintained. The rule requires any Options Participant or associated person who becomes aware of any possible misuse of material nonpublic information to promptly notify Nasdaq Regulation.

Finally, subsection (f) of Chapter III, Section 4, specifies that it may be considered conduct inconsistent with just and equitable principles of trade for any Participant or person associated with a Participant who has knowledge of all material terms and conditions of (i) an order and a solicited order, (ii) an order being facilitated or submitted to NOM for price improvement (e.g., price improving orders), or (iii) orders being crossed; the execution of which are imminent, to enter, based on such knowledge, an order to buy or sell an option for the same underlying security as any option that is the subject of the order, or an order to buy or sell the security underlying such class, or an order to buy or sell any related instrument until (a) the terms and conditions of the order

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<sup>6</sup> In particular, the rule requires that ( i) all associated persons must be advised in writing of the prohibition against the misuse of material nonpublic information; (ii) signed attestations from the Participant and all associated persons affirming their awareness of, and agreement to abide by, the aforementioned prohibitions must be maintained for at least three (3) years, the first two (2) years in an easily accessible place; (iii) records of all brokerage accounts maintained by the Participant and all associated persons must be acquired and maintained for at least three (3) years, the first two (2) years in an easily accessible place, and such brokerage accounts must be reviewed periodically by the Participant for the purpose of detecting the possible misuse of material nonpublic information; and (iv) any business dealings the Participant may have with any corporation whose securities are publicly traded, or any other circumstances that may result in the Participant receiving, in the ordinary course of business, material nonpublic information concerning any such corporation, must be identified and documented.

and any changes in the terms and conditions of the order of which the Participant or person associated with the Participant has knowledge are disclosed, or (b) the trade can no longer reasonably be considered imminent in view of the passage of time since the order was received. It states that the terms of an order are “disclosed” to NOM Option Participants when the order is entered into the NOM Book.

For purposes of subsection (f), an order to buy or sell a “related instrument” means, in reference to an index option, an order to buy or sell securities comprising 10% or more of the component securities in the index or an order to buy or sell a futures contract on an economically equivalent index.

Because Options Participants are already subject to the requirements of Chapter III, Section 4, as described above, the Exchange does not believe it necessary to separately require specific limitations on Market Makers. Deleting the Market Maker Restrictions including its requirements for specific procedures would provide Market Makers flexibility to adapt their policies and procedures as appropriate to reflect changes to their business model, business activities, or the securities market in a manner similar to how Options Participants on the Exchange currently operate and consistent with Chapter III, Section 4.

Options Participants registered as Market Makers have certain rights and bear certain responsibilities beyond those of other Options Participants.<sup>7</sup> Market Makers are

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<sup>7</sup> Chapter VII, Section 5, Obligations of Market Makers, of the NOM rules provides that in registering as a Market Maker, an Options Participant commits himself to various obligations and that transactions of a Market Maker in its market making capacity must constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market. The rule states that Market Makers should not make bids or offers or enter into transactions that are inconsistent with such course of dealings and that ordinarily, Market Makers are

distinguished under Exchange rules from other Options Participants in that Market Makers have quoting obligations.<sup>8</sup> However, none of these heightened obligations or different entitlements provides different or greater access to nonpublic information than any other Options Participant on the Exchange. Accordingly, because Market Makers do not have any trading advantages at the Exchange due to their market role, the Exchange believes they should be subject to the same rules as other Options Participants regarding the protection against the misuse of material non-public information, which in this case is existing Chapter III, Section 4.<sup>9</sup>

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expected to (i) during trading hours, maintain a two-sided market, pursuant to Section 6(d)(i) of Chapter VII, in those options in which the Market Maker is registered to trade, in a manner that enhances the depth, liquidity and competitiveness of the market, (ii) [Reserved], (iii) engage, to a reasonable degree under the existing circumstances, in dealings for their own accounts when there exists, or it is reasonably anticipated that there will exist, a lack of price continuity, a temporary disparity between the supply of (or demand for) a particular option contract, or a temporary distortion of the price relationships between option contracts of the same class, (iv) compete with other Market Makers in all options in which the Market Maker is registered to trade, (v) make markets that will be honored for the number of contracts entered into NOM's System in all options in which the Market Maker is registered to trade (vi) update quotations in response to changed market conditions in all options in which the Market Maker is registered to trade (vii) maintain active markets in all options in which the Market Maker is registered, and (viii) honor all orders that the Trading System routes to away markets pursuant to Chapter XII of the NOM rules. Section 5 further provides that Market Makers should not effect purchases or sales on NOM except in a reasonable and orderly manner. If Nasdaq Regulation finds any substantial or continued failure by a Market Maker to engage in a course of dealings as specified in paragraph (a) of Section 5, such Market Maker will be subject to disciplinary action or suspension or revocation of registration in one or more of the securities in which the Market Maker is registered.

<sup>8</sup> Section 6, Market Maker Quotations, of Chapter VII, Market Participants, details specific Market Maker quoting obligations.

<sup>9</sup> The Exchange notes that by deleting the Market Maker Restrictions, the Exchange would no longer require specific information barriers for Market Makers or require pre-approval of any information barriers that a Market Maker would erect for purposes of protecting against the misuse of material non-public information.

The Exchange is not proposing to change what is considered to be material, nonpublic information that an affiliated brokerage business of a Market Maker could share with such Market Maker. In that regard, the proposed rule change will not permit affiliates of a Market Maker to have access to any non-public order or quote information of the Market Maker, including hidden or undisplayed size or price information of such orders or quotes. Affiliates of Market Makers would only have access to orders and quotes that are publicly available to all market participants. Members do not expect to receive any additional order or quote information as a result of this proposed rule change.

The Exchange does not believe that there will be any material change to member information barriers as a result of the removal of the Exchange pre-approval requirement. The Exchange has rules prohibiting Options Participants from disadvantaging their customers or other market participants by improperly capitalizing on the Options Participant's access to or receipt of material, non-public information.<sup>10</sup>

Further, the Exchange does not believe there will be any material change to Market Maker information barriers as a result of removal of the Exchange's pre-approval requirements. In fact, the Exchange anticipates that eliminating the pre-approval requirement should facilitate implementation of changes to Market Maker information

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However, the policies and procedures of Market Makers, including those relating to information barriers, would be subject to review by FINRA, on behalf of the Exchange, pursuant to a Regulatory Services Agreement.

<sup>10</sup> For example, Chapter XI, Doing Business with the Public, Section 8, Supervision of Accounts, provides in part that each member that conducts a public customer options business shall ensure that its written supervisory system policies and procedures pursuant to NASD Rules 3010, 3012, and 3013 adequately address the member's public customer options business. The Exchange has separately filed a proposed rule change to replace references to these NASD rules with FINRA rules which have replaced them. See SR-NASDAQ-2016-038 filed March 14, 2016.

barriers as necessary to protect against the misuse of material, non-public information. The Exchange also suggests that the pre-approval requirement is unnecessary because Market Makers do not have agency responsibilities to orders in the book, or time and place information advantages because of their market role.

The Exchange notes that its proposed principles-based approach to protecting against the misuse of material non-public information for all its Options Participants is consistent with recently filed and approved rule changes for NYSE MKT, NYSE Arca Equities, Inc. (“NYSE Arca”), BATS Exchange, Inc. (“BATS”), and New York Stock Exchange LLC (“NYSE”) governing cash equity market makers on those respective exchanges.<sup>11</sup>

Except for prescribed rules relating to floor-based designated market makers on the NYSE, who have access to specified non-public trading information, each of these exchanges have moved to a principles-based approach to protecting against the misuse of material non-public information. In connection with approving those rule changes, the

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<sup>11</sup> See Securities Exchange Act Release No. 75432 (July 13, 2015), 80 FR 42597 (July 17, 2015) (Order Approving Adopting a Principles-Based Approach to Prohibit the Misuse of Material Nonpublic Information by Specialists and e-Specialists by Deleting Rule 927.3NY and Section (f) of Rule 927.5NY). See also Securities Exchange Act Release Nos. 60604 (Sept. 2, 2009), 76 FR 46272 (Sept. 8, 2009) (SR-NYSEArca-2009-78) (Order approving elimination of NYSE Arca rule that required market makers to establish and maintain specifically prescribed information barriers, including discussion of NYSE Arca and Nasdaq rules) (“Arca Approval Order”); 61574 (Feb. 23, 2010), 75 FR 9455 (Mar. 2, 2010) (SR-BATS-2010-003) (Order approving amendments to BATS Rule 5.5 to move to a principles-based approach to protecting against the misuse of material, nonpublic information, and noting that the proposed change is consistent with the approaches of NYSE Arca and Nasdaq) (“BATS Approval Order”); and 72534 (July 3, 2014), 79 FR 39440 (July 10, 2014), SR-NYSE-2014-12) (Order approving amendments to NYSE Rule 98 governing designated market makers to move to a principles-based approach to prohibit the misuse of material non-public information) (“NYSE Approval Order”); and 76687 (December 18, 2015), 80 FR 80403 (December 24, 2015) (SR-PHLX-2015-85).

Commission found that, with adequate oversight by the exchanges of their members, eliminating prescriptive information barrier requirements should not reduce the effectiveness of exchange rules requiring members to establish and maintain systems to supervise the activities of members, including written procedures reasonably designed to ensure compliance with applicable federal securities law and regulations, and with the rules of the applicable exchange.

The Exchange believes that a principles-based rule applicable to members of options markets would be equally effective in protecting against the misuse of material non-public information.<sup>12</sup> Indeed, Chapter III, Section 4, is currently applicable to Market Makers and already requires policies and procedures reasonably designed to protect against the misuse of material nonpublic information, which is similar to the respective NYSE MKT, NYSE Arca Equities, BATS, and NYSE rules governing cash equity market makers. The Exchange believes Chapter III, Section 4, provides appropriate protection against the misuse of material nonpublic information by Market Makers such that there is no further need for prescriptive information barrier requirements as set forth in the Market Maker Restrictions.

The Exchange notes that even with this proposed rule change, pursuant to Chapter III, Section 4, a Market Maker would still be obligated to ensure that its policies and

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<sup>12</sup> International Securities Exchange, Inc. (“ISE”) and BOX Options Exchange LLC (“BOX”) have recently taken a similar approach. See Notice of Filing and Immediate Effectiveness of Proposed Rule Change Adopting a Principles-Based Approach to Prohibit the Misuse of Material, Non-public Information by Market Makers by Deleting Rule 810, Securities Exchange Act Release No. 75792 (August 31, 2015), 80 FR 53606 (September 4, 2015) (SR-ISE-2015-26). See also Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt a Principles-based Approach to Prohibit the Misuse of Material Nonpublic Information by Market Makers, Securities Exchange Act Release No. 75916 (September 14, 2015), 80 FR 56503 (September 18, 2015) (SR-BOX-2015-31).

procedures reflect the current state of its business and continue to be reasonably designed to achieve compliance with applicable federal securities law and regulations, including without limitation, Regulation SHO<sup>13</sup> under the Act and Section 15(g) of the Act<sup>14</sup>, and with applicable Exchange rules, including being reasonably designed to protect against the misuse of material, non-public information.

While information barriers would not specifically be required under the proposal, Chapter III, Section 4, already requires that an Options Participant consider its business model or business activities in structuring its policies and procedures, which may dictate that an information barrier or a functional separation be part of the appropriate set of policies and procedures that would be reasonably designed to achieve compliance with applicable securities law and regulations, and with applicable Exchange rules.

The Exchange believes that the proposed reliance on principles-based Chapter III, Section 4 would ensure that a Market Maker would be required to protect against the misuse of any material non-public information. Chapter III, Section 4 already requires

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<sup>13</sup> The Commission adopted a narrow exception to Regulation SHO's "locate" requirement only for market makers engaged in bona fide market making in the security at the time they effect the short sale. See 17 CFR 242.203(b)(2)(iii). See also Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48015 (Aug. 6, 2004); Exchange Act Release No. 58775 (Oct. 14, 2008), 73 FR 61690, 61698-9 (Oct. 17, 2008). Broker-dealers would not be able to rely on the Exchange's or any self-regulatory organization's designation of market marking for eligibility for the bona-fide market making exception to the "locate" requirement, as such designations are distinct and independent from Regulation SHO. Eligibility for the bona-fide market making exception depends on the facts and circumstances and a determination of bona-fide market making is based on the Commission's factors outlined in the aforementioned Regulation SHO releases. It should also be noted that a determination of bona-fide market making is relevant for the purposes of close-out obligations under Rule 204 of Regulation SHO. See 17 CFR 242.204(a)(3).

<sup>14</sup> 15 U.S.C. 78o(g).

that firms refrain from trading while in possession of material non-public information concerning imminent transactions in the security or related product.

The Exchange believes that moving to a principles-based approach rather than prescribing how and when to wall off a Market Maker from the rest of the firm would provide Market Makers with flexibility when managing risk across a firm, including integrating options positions with other positions of the firm or, as applicable, by the respective independent trading unit.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>15</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>16</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. The Exchange believes that the proposed rule change would remove impediments to and perfect the mechanism of a free and open market by adopting a principles based approach to permit a member or member organization to maintain and enforce policies and procedures to, among other things, prohibit the misuse of material non-public information and provide flexibility on how a Market Maker structures its operations.

The Exchange notes that the proposed rule change is based on an approved rule of the Exchange to which members and member organizations are subject – Section 4, Prevention of the Misuse of Material Nonpublic Information, of Chapter III, Business

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

<sup>16</sup> 15 U.S.C. 78f(b)(5).



Conduct – and harmonizes the rules governing Options Participants. Moreover, Market Makers would continue to be subject to federal and Exchange requirements for protecting material non-public order information.<sup>17</sup>

The Exchange believes that the proposed rule change would remove impediments to and perfect the mechanism of a free and open market because it would harmonize the Exchange's approach to protecting against the misuse of material nonpublic information and no longer subject Market Makers to prescriptive requirements. The Exchange does not believe that the existing prescriptive requirements applicable to Market Makers are narrowly tailored to their roles because Market Makers do not have access to Exchange trading information in a manner different from any other market participant on the Exchange.

The Exchange further believes the proposal is designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade because existing rules make clear to members and member organizations the type of conduct that is prohibited by the Exchange. While the proposal eliminates prescriptive requirements relating to the misuse of material non-public information, Market Makers would remain subject to existing Exchange rules requiring them to establish and maintain systems to supervise their activities, and to create, implement, and maintain written procedures that are reasonably designed to comply with applicable securities laws and Exchange rules, including the prohibition on the misuse of material, nonpublic information. Additionally, the policies and procedures of Market Makers, including

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<sup>17</sup> See 15 U.S.C. 78o(g) and Chapter III, Section 4 of the Exchange's rulebook.

those relating to information barriers, would be subject to review by FINRA, on behalf of the Exchange.

The Exchange notes that the proposed rule change would still require that Market Makers maintain and enforce policies and procedures reasonably designed to ensure compliance with applicable federal securities laws and regulations and with Exchange rules.

Even though there would no longer be pre-approval of Market Maker information barriers, any Market Maker written policies and procedures would continue to be subject to oversight by the Exchange and therefore the elimination of prescribed restrictions should not reduce the effectiveness of the Exchange rules to protect against the misuse of material non-public information. Rather, Options Participants will be able to utilize a flexible, principles-based approach to modify their policies and procedures as appropriate to reflect changes to their business model, business activities, or to the securities market itself.

Moreover, while specified information barriers may no longer be required, an Options Participant's business model or business activities may dictate that an information barrier or functional separation be part of the appropriate set of policies and procedures that would be reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable Exchange rules. The Exchange therefore believes that the proposed rule change will maintain the existing protection of investors and the public interest that is currently applicable to Market Makers, while at the same time removing impediments to and perfecting a free and open market by

moving to a principles-based approach to protect against the misuse of material non-public information.

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. As indicated above, the rule change is being proposed as a competitive response to a filing submitted by NYSE MKT that was recently approved by the Commission.

The Exchange believes that the proposal will enhance competition by allowing Market Makers to comply with applicable Exchange rules in a manner best suited to their business models, business activities, and the securities markets, thus reducing regulatory burdens while still ensuring compliance with applicable securities laws and regulations and Exchange rules. The Exchange believes that the proposal will foster a fair and orderly marketplace without being overly burdensome upon Market Makers.

Moreover, the Exchange believes that the proposed rule change would eliminate a burden on competition for Options Participants which currently exists as a result of disparate rule treatment between options and equities markets regarding how to protect against the misuse of material non-public information. For those members and member organizations that are also members of equity exchanges, their respective equity market maker operations are now subject to a principles-based approach to protecting against the misuse of material non-public information.

The Exchange believes it would remove a burden on competition to enable members and member organizations to similarly apply a principles-based approach to protecting against the misuse of material nonpublic information in the options space as ISE has recently done. To this end, the Exchange notes that Chapter III, Section 4, still

requires a Market Maker to evaluate its business to assure that its policies and procedures are reasonably designed to protect against the misuse of material nonpublic information. However, with this proposed rule change, an Options Participant that trades equities and options could look at its firm more holistically to structure its operations in a manner that provides it with better tools to manage its risks across multiple security classes, while at the same time protecting against the misuse of material non-public information.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>18</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>19</sup>

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

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<sup>18</sup> 15 U.S.C. 78s(b)(3)(a)(iii).

<sup>19</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

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](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2016-040 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.

All submissions should refer to File Number SR-NASDAQ-2016-040. 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 Web site (<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-2016-040 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>20</sup>

Robert W. Errett  
Deputy Secretary

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<sup>20</sup> 17 CFR 200.30-3(a)(12).

**Exhibit 5**

Deleted text is [bracketed]. New text is underlined.

**NASDAQ Stock Market Rules**

\* \* \* \* \*

**Options Rules**

\* \* \* \* \*

**Chapter VII Market Participants**

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**Sec. 10 Reserved Limitations on Dealings**

(a) *General Rule*. A Market Maker on NOM may engage in Other Business Activities, or it may be affiliated with a broker-dealer that engages in Other Business Activities, only if there is an Information Barrier between the market making activities and the Other Business Activities. "Other Business Activities" means:

- i. conducting an investment banking or public securities business;
- ii. making markets in the stocks underlying the options in which it makes markets; or
- iii. functioning as an Order Entry Firm, except where such Market Maker, or broker-dealer with which such Market Maker is affiliated: (A) engages solely in proprietary trading and does not, under any circumstance, maintain customer accounts or solicit or accept orders or funds from or on behalf of customers, including broker-dealers and other securities firms, and (B) does not place or accept or utilize any order types which call for the participation of, or interaction with, public customers, including brokerdealers and other securities firms.

(b) "*Information Barrier*". For the purposes of this Section, an Information Barrier is an organizational structure in which:

- i. The market making functions are conducted in a physical location separate from the locations in which the Other Business Activities are conducted, in a manner that effectively impedes the free flow of communications between designated representatives of an Options Participant performing the function of a Market Maker and persons

conducting the Other Business Activities. However, upon request and not on his own initiative, a designated representative of an Options Participant performing the function of a Market Maker may furnish to a person performing the function of an OEF or other persons at the same firm or an affiliated firm ("affiliated persons"), the same market or trading information, so long as the Market Maker also may make available such information to non-affiliated persons with whom the Market Maker may have the same type of business relationship. The designated representative of a Market Maker must provide such information to affiliated persons in the same manner that he would make such information available to a non-affiliated person.

ii. There are procedures implemented to prevent the use of material non-public corporate or market information in the possession of persons on one side of the barrier from influencing the conduct of persons on the other side of the barrier. These procedures, at a minimum, must provide that:

1) the designated representative of an Options Participant performing the function of a Market Maker does not take advantage of knowledge of pending transactions, order flow information, corporate information or recommendations arising from the Other Business Activities; and

2) all information pertaining to the Market Maker's positions and trading activities is kept confidential and not made available to persons on the other side of the Information Barrier, except as provided in Paragraph (b)(i) of this Section 10.

(c) Persons on one side of the barrier may not exercise influence or control over persons on the other side of the barrier, provided that:

i. the market making function and the Other Business Activities may be under common management as long as any general management oversight does not conflict with or compromise the Market Maker's responsibilities under the Rules of the Exchange; and

ii. the same person or persons (the "Supervisor") may be responsible for the supervision of the market making and OEF functions of the same firm or affiliated firms in order to monitor the overall risk exposure of the firm or affiliated firms. While the Supervisor may establish general trading parameters with respect to both market making and other proprietary trading other than on an order-specific basis, the Supervisor may not:

1) actually perform the function of either a Market Maker or OEF;

2) provide to any person performing the function of an OEF any information relating to market making activity beyond the information that a designated representative of an Options Participant performing the function of a Market Maker may provide under subparagraph (b)(i), above; nor



3) provide a designated representative of an Options Participant performing the function of Market Maker with specific information regarding the firm's pending transactions or order flow arising out of its OEF activities.

(d) *Documenting and Reporting of Information Barrier Procedures.* An Options Participant implementing an Information Barrier pursuant to this Section shall submit to NOM a written statement setting forth:

i. The manner in which it intends to satisfy the conditions in paragraph

(b) of this Section, and the compliance and audit procedures it proposes to implement to ensure that the Information Barrier is maintained;

ii. The names and titles of the person or persons responsible for maintenance and surveillance of the procedures;

iii. A commitment to provide Nasdaq Regulation with such information and reports as Nasdaq Regulation may request relating to its transactions;

iv. A commitment to take appropriate remedial action against any person violating this Section or the Participant's internal compliance and audit procedures adopted pursuant to paragraph (c)(i) of this Section, and that it recognizes that Nasdaq Regulation may take appropriate remedial action, including (without limitation) reallocation of securities in which it serves as a Market Maker, in the event of such a violation;

v. Whether the Participant or an affiliate intends to clear its proprietary trades and, if so, the procedures established to ensure that information with respect to such clearing activities will not be used to compromise the Participant's Information Barrier, which procedures, at a minimum, must be the same as those used by the Participant or the affiliate to clear for unaffiliated third parties; and

vi. That it recognizes that any trading by a person while in possession of material, non-public information received as a result of the breach of the internal controls required under this Section may be a violation of Rules 10b-5 and 14e-3 under the Exchange Act or one or more other provisions of the Exchange Act, the Rules thereunder or the Rules of the Exchange, and that Nasdaq Regulation intends to review carefully any such trading of which it becomes aware to determine whether a violation has occurred.

(e) *Exchange Approval of Information Barrier Procedures.* The written statement required by paragraph (d) of this Section must detail the internal controls that the Participant will implement to satisfy each of the conditions stated in that Rule, and the compliance and audit procedures proposed to implement and ensure that the controls are maintained. If Nasdaq Regulation determines that the organizational structure and the compliance and audit procedures proposed by the Participant are acceptable under this Section, Nasdaq Regulation shall so inform the Participant, in writing. Absent Nasdaq

Regulation finding a Participant's Information Barrier procedures acceptable, a Market Maker may not conduct Other Business Activities.

(f) *Clearing Arrangements*. Paragraph (c)(v) permits a Options Participant or an affiliate of the Options Participant to clear the Participant's Market Maker transactions if it establishes procedures to ensure that information with respect to such clearing activities will not be used to compromise the Information Barrier. In this regard:

- i. The procedures must provide that any information pertaining to Market Maker securities positions and trading activities, and information derived from any clearing and margin financing arrangements, may be made available only to those employees (other than employees actually performing clearing and margin functions) specifically authorized under this Section to have access to such information or to other employees in senior management positions who are involved in exercising general managerial oversight with respect to the market making activity.
- ii. Any margin financing arrangements must be sufficiently flexible so as not to limit the ability of any Market Maker to meet market making or other obligations under the Exchange's and NOM Rules.]

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