SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Exchange Rule 7047


Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),1 and Rule 19b–4 thereunder,2 notice is hereby given that on January 9, 2018, The Nasdaq Stock Market LLC ("Nasdaq" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Exchange Rule 7047 to reflect substantial enhancements to Nasdaq Basic since the current distribution fees were set in 2009.3 Specifically, the Exchange proposes to amend the distribution fees for Nasdaq Basic at Rule 7047, currently set at $1,500 per month for both internal and external distribution, into separate fees of $2,000 per month for external (or both internal and external) distribution and $1,500 per month for internal-only distribution.4

Nasdaq Basic

Nasdaq is a real-time market data product that offers Best Bid and Offer and Last Sale information for all U.S. exchange-listed securities based on liquidity within the Nasdaq Market Center and trades reported to the FINRA/Nasdaq Trade Reporting Facility ("TRF"). It is a subset of the "core" quotation and last sale data provided by securities information processors ("SIPs") under the CTA Plan and the Nasdaq UTP Plan. Nasdaq Basic is separated into three components, which may be purchased individually or in combination: (i) Nasdaq Basic for Nasdaq, which contains the best bid and offer on the Nasdaq Market Center and last sale transaction reports for Nasdaq and the FINRA/Nasdaq TRF for Nasdaq-listed stocks; (ii) Nasdaq Basic for NYSE, which covers NYSE-listed stocks, and (iii) Nasdaq Basic for NYSE American (formerly NYSE MKT), which provides data on stocks listed on NYSE American and other listing venues whose quotes and trade reports are disseminated on Tape B. The specific data elements available through Nasdaq Basic are: (i) Nasdaq Basic Quotes ("QBBO"), the best bid and offer and associated size available in the Nasdaq Market Center, as well as last sale transaction reports; (ii) Nasdaq opening and closing prices, as well as IPO and trading halt crosses; and (iii) general exchange information, including systems status reports, trading halt information, and a stock directory.

The Exchange proposes to adjust the fee schedule for Nasdaq Basic to reflect the improvements implemented to the product since the current distribution fees were set in 2009.3 Specifically, the Exchange proposes to amend the fee schedule for Nasdaq Basic at Rule 7047, currently set at $1,500 per month for both internal and external distribution, into separate fees of $2,000 per month for external (or external and internal) distribution and $1,500 per month for internal-only distribution.4

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Each Distributor of Nasdaq Basic, or Derived Data therefrom, currently pays $1,500 per month for either internal or external distribution or both,5 in addition to user fees set forth under Rule 7047(b).

Proposed Change

Nasdaq Basic is one of a number of market information services offered by the Exchange. Such services are inextricably connected to trade execution: Market information services require trade orders to provide useful information, and investors utilize market information to make trading decisions. Over the eight years that have elapsed since the current distribution fees were set in 2009,6 the Exchange has invested in an array of upgrades to both its trade execution and market information services, which have increased the value of these services overall, and Nasdaq Basic in particular.7

The Exchange proposes to adjust its fee schedule for Nasdaq Basic to reflect the value of the many improvements to the product, which include:

- Enhanced Services. In 2014, the Exchange enhanced the Nasdaq Basic data feed by: (i) Converting to binary codes to make more efficient use of bandwidth and to provide greater timestamp granularity; (ii) adding a symbol directory message to identify a security and its key characteristics; (iii) adding a new IPO message for Nasdaq-listed securities for quotation release time and IPO price; and (iv) adding the Market Wide Circuit Breaker ("MWCB") Decline Level message to inform recipients of the setting for MWCB breach points for the trading day, and an MWCB Status Level Message to inform data recipients when an MWCB has breached an established level.8

- Nanosecond Granularity. In 2016 (sic), Nasdaq introduced a new version of Nasdaq Last Sale which allowed for timestamp granularity to the nanosecond.9


2 See Rule 7047(c)(1).


4 Many of these upgrades are common to several Nasdaq-affiliated exchanges, as improvements to the products and services of one exchange are reproduced in other exchanges.


In 2015, the Exchange modified the data feed for Nasdaq Basic to accommodate an ETMF, a type of investment vehicle that combines the features of an open-end mutual fund and an Exchange Traded Fund (“ETF”) to support an actively managed-investment strategy.10 ETMF trading differs from other types of equity trading in that it uses a trading protocol called “Net Asset Value-Based Trading,” in which all bids, offers, and execution prices are expressed as a premium or discount to the ETFM’s next-determined Net Asset Value (“NAV”). This distinct pricing format requires an entirely new set of data fields in which to distribute information related to prices and trades, and the Exchange modified Nasdaq Basic to accommodate that format.11

- **Qualified Contingent Trade Modifier.** In 2015, Nasdaq introduced a new field to Nasdaq Basic to identify a Qualified Contingent Trades [sic] (“QCT”).12 a transaction consisting of two or more component orders executed as agent or principal where the execution of one component is contingent upon the execution of all other component orders at or near the same time, and the price is determined by the relationship between the component orders and not the current market price for the security.13 The additional field identifies whether a particular transaction is part of a QCT.

- **Adjusted Closing Price.** In 2013, Nasdaq introduced the adjusted closing price as a field to reflect a security’s previous day official closing price, adjusted for corporate actions. For Nasdaq-listed securities, the Nasdaq Official Closing Price is used,14 and the consolidated close from the security’s listing exchange is used for non-Nasdaq securities.15

- **New System Event Messages.** In 2013, Nasdaq began disseminating event messages to indicate the start and end of system hours.16

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,20 in general, and furthers the objectives of Sections 6(b)(4) and 6(b)(5) of the Act,21 in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Commission and the courts have repeatedly expressed their preference for competition over regulatory intervention in determining prices, products, and services in the securities markets. In Regulation NMS, while adopting a series of steps to improve the current market model, the Commission highlighted the importance of market forces in determining prices and self-regulatory organization (“SRO”) revenues and, also, recognized that current regulation of the market system “has been remarkably successful in promoting market competition in its broader forms that are most important to investors and listed companies.”22 Likewise, in NetCoalition v. Securities and Exchange Commission23 (“NetCoalition”) the D.C. Circuit upheld the Commission’s use of a market-based approach in evaluating the fairness of market data fees against a challenge claiming that Congress mandated a cost-based approach.24 As the court emphasized, the Commission “intended in Regulation NMS that ‘market forces, rather than regulatory requirements’ play a role in determining the market data . . . to be made available to investors and at what cost.”25

Further, “[n]o one disputes that competition for order flow is ‘fierce’. . . .”26 As the SEC explained, “[i]n the U.S. national market system, buyers and sellers of securities, and the broker-dealers that act as their order-routing agents, have a wide range of choices of where to route orders for execution”27; and ‘no exchange can afford to take its market share percentages for granted’ because ‘no exchange possesses a monopoly, regulatory or otherwise, in the execution of order flow from broker dealers’. . . .”28

The Exchange proposes to separate the internal and external distribution fees for Nasdaq Basic, increasing external (and combined internal and external) distribution fees unchanged. Given these specific enhancements to Nasdaq Basic, and to the Exchange’s system generally, and given the fact that the Exchange has not increased the distributor fees since 2009, the Exchange believes that the proposed fee increase is appropriate.

Nasdaq Basic is optional in that the Exchange is not required to offer it and broker-dealers are not required to purchase it. Firms can discontinue use at any time and for any reason, including an assessment of the fees charged.

The proposed change does not change the cost of any other Exchange product.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,20 in general, and furthers the objectives of Sections 6(b)(4) and 6(b)(5) of the Act,21 in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Exchange proposes to separate the internal and external distribution fees for Nasdaq Basic, increasing external (and combined internal and external) distribution fees unchanged. Given these specific enhancements to Nasdaq Basic, and to the Exchange’s system generally, and given the fact that the Exchange has not increased the distributor fees since 2009, the Exchange believes that the proposed fee increase is appropriate.

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The Exchange proposes to separate the internal and external distribution fees for Nasdaq Basic, increasing external (and combined internal and
external) distribution fees from $1,500 to $2,000 per month, and leaving internal distribution fees unchanged. The Exchange believes that the proposed fee increase is reasonable. While the Exchange has not increased such fees since 2009, the Exchange has added a number of enhancements since that time to Nasdaq Basic and the Exchange systems that support it. These enhancements, which are described in greater detail above, increase the value of Nasdaq Basic. The proposed fee increase is therefore reflective of, and closely aligned to, these enhancements and the corresponding increased value of the data feed.

The proposed changes are equitable allocations of reasonable dues, fees and other charges because the Exchange makes all services and products subject to these fees available on a non-discriminatory basis to similarly-situated recipients, and the proposed fee increase here will apply equally to all members that are external (or combined internal and external) Distributors. As noted above, the Exchange has made a number of product and system enhancements to Nasdaq Basic, and, while internal Distributors have also received the benefit of these enhancements, the Exchange is not increasing the fee for internal Distributors at this time. This distinction is not unreasonable because a higher fee for external, as opposed to internal, distribution is based on the observation that external distributors typically charge fees for external distribution, while internal distributors usually do not. As such, external distributors have the opportunity to derive greater value from such distribution, and that greater value is reflected in higher external distribution fees. The differential between external and internal distribution fees is well-recognized in the financial services industry as a reasonable distinction, and has been repeatedly accepted by the Commission as an equitable allocation of reasonable dues, fees and other charges.27 The Act does not prohibit all reasonable dues, fees and other charges.28 The Exchange believes that efficiency is promoted when broker-dealers who do not need the data beyond the prices, sizes, market center identifications of the NBBO and consolidated last sale information are not required to receive (and pay for) such data. The Commission also believes that efficiency is promoted when broker-dealers may choose to receive (and pay for) additional market data based on their own internal analysis of the need for such data.29

The Commission was speaking to the question of whether BDs should be subject to a regulatory requirement to purchase data, such as depth-of-book data, that is in excess of the data provided through the consolidated tape feeds, and the Commission concluded that the choice should be left to them. Accordingly, Regulation NMS removed unnecessary regulatory restrictions on the ability of exchanges to sell their own data, thereby advancing the goals of the Act and the principles reflected in its legislative history. If the free market should determine whether proprietary data is sold to BDs at all, it follows that the price at which such data is sold should be set by the market as well. Accordingly, “the existence of significant competition provides a substantial basis for finding that the terms of an exchange’s fee proposal are equitable, fair, reasonable, and not unreasonably or unfairly discriminatory.”30

The proposed fees, like all market data fees, are constrained by the Exchange’s need to compete for order flow, as discussed below, and are subject to competition from other exchanges and among broker-dealers for customers. If Nasdaq is incorrect in its assessment of price, it may lose market share as a result.

B. Self-Regulatory Organization’s Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. In terms of inter-market competition, the Exchange notes that it operates in a highly competitive market in which market participants can readily favor competing venues if they deem fee levels at a particular venue to be excessive, or rebate opportunities available at other venues to be more favorable. In such an environment, the Exchange must continually adjust its fees to remain competitive with other exchanges and with alternative trading systems that have been exempted from compliance with the statutory standards applicable to exchanges. Because competitors are free to modify their own fees in response, and because market participants may readily adjust their order routing practices, the Exchange believes that the degree to which fee changes in this market may impose any burden on competition is extremely limited.

Nasdaq Basic is a type of “non-core” data that provides a subset of the core quotation and last sale data provided by securities information processors under the CTA Plan and the Nasdaq UTP Plan. In 2016, an Administrative Law Judge in an application for review by the Securities Industry and Financial Markets Association of actions taken by Self-Regulatory Organizations examined whether another non-core product, Depth-of-Book data, is constrained by competitive forces.31 After a four-day hearing and presentation of substantial evidence, the administrative law judge stated that “competition plays a significant role in restraining exchange pricing of depth-of-book products”32 because “depth-of-book products from different exchanges function as substitutes for each other,”33 and, as such, “the threat of substitution from depth-of-book customers constrains...”
their depth-of-book prices.” As a result, “[s]hifts in order flow and threats of shifting order flow provide a significant competitive force in the pricing of . . . depth-of-book data.”

The judge concluded that “[u]nder the standards articulated by the Commission and D.C. Circuit, the Exchanges have shown that they are subject to significant competitive forces in setting fees for depth-of-book data: the availability of alternatives to the Exchanges’ depth-of-book products, and the Exchanges’ need to attract order flow from market participants constrains prices.” As such, Nasdaq’s depth-of-book fees are “constrained by significant competitive forces.”

As an example of the impact of market forces on the price of proprietary data, the Exchange just last year lowered the Nasdaq Basic Enterprise License fee for the distribution of certain information by broker-dealers from $350,000 to $100,000.

Market forces constrain the price of Nasdaq Basic, just as they do other market data fees, in the competition among exchanges and other entities to attract order flow and in the competition among Distributors for customers. Order flow is the “lifeblood” of the exchanges. Broker-dealers currently have numerous alternative venues for their order flow, including SRO markets, as well as internalizing BDs and various forms of alternative trading systems (“ATSs”), including dark pools and electronic communication networks (“ECNs”).

Each SRO market competes to produce transaction reports via trade executions, and two FINRA-regulated TRFs compete to attract internalized transaction reports. The existence of fierce competition for order flow implies a high degree of price sensitivity on the part of BDs, which may readily reduce costs by directing orders toward the lowest-cost trading venues.

Transaction execution and proprietary data products are complementary in that market data is both an input and a byproduct of the execution service. In fact, market data and trade execution are a paradigmatic example of joint products with joint costs. The decision whether and on which platform to post an order will depend on the attributes of the platform where the order can be posted, including the execution fees, data quality and price, and distribution of its data products. Without trade executions, exchange data products cannot exist. Moreover, data products are valuable to many end users only insofar as they provide information that end users expect will assist them or their customers in making trading decisions.

The costs of producing market data include not only the costs of the data distribution infrastructure, but also the costs of designing, maintaining, and operating the exchange’s transaction execution platform and the cost of regulating the exchange to ensure its fair operation and maintain investor confidence. The total return that a trading platform earns reflects the revenues it receives from both trading execution and data products and the joint costs it incurs to provide both.

Moreover, the operation of the exchange is characterized by high fixed costs and low marginal costs. This cost structure is common in content and content distribution industries such as software, where developing new software typically requires a large initial investment (and continuing large investments to upgrade the software), but once the software is developed, the incremental cost of providing that software to an additional user is typically small, or even zero (e.g., if the software can be downloaded over the internet after being purchased).

In Nasdaq’s case, it is costly to build and maintain a trading platform, but the incremental cost of trading each additional share on an existing platform, or distributing an additional instance of data, is very low. Market information and executions are each produced jointly (in the sense that the activities of trading and placing orders are the source of the information that is distributed) and are each subject to significant scale economies. In such cases, marginal cost pricing is not feasible because if all sales were priced at the margin, Nasdaq would be unable to defray its platform costs of providing the joint products.

An exchange’s BD customers view the costs of transaction executions and of data as a unified cost of doing business with the exchange. A BD will disfavor a particular exchange if the expected revenues from executing trades on the exchange do not exceed net transaction execution costs and the cost of data that the BD chooses to buy to support its trading decisions (or those of its customers). The choice of data products is, in turn, a product of the value of the products in making profitable trading decisions. If the cost of the product exceeds its expected value, the BD will choose not to buy it. Moreover, as a BD chooses to direct fewer orders to a particular exchange, the value of the product to that BD decreases, for two reasons. First, the product will contain less information, because executions of the BD’s trading activity will not be reflected in it. Second, and perhaps more important, the product will be less valuable to that BD because it does not provide information about the venue to which it is directing its orders. Data from the competing venue to which the BD is directing more orders will become correspondingly more valuable.

Competition among trading platforms can be expected to constrain the aggregate return each platform earns from the sale of its joint products, but different platforms may choose from a range of possible, and equally reasonable, pricing strategies as the means of recovering total costs. Nasdaq pays rebates to attract orders, charges relatively low prices for market information and charges relatively high prices for accessing posted liquidity. Other platforms may choose a strategy of paying lower liquidity rebates to attract orders, setting relatively low prices for accessing posted liquidity, and setting relatively high prices for market information. Still others may provide most data free of charge and rely exclusively on transaction fees to recover their costs. Finally, some platforms may incentivize use by providing opportunities for equity ownership, which may allow them to charge lower direct fees for executions and data.

In this environment, there is no economic basis for regulating maximum prices for one of the joint products in an industry in which suppliers face competitive constraints with regard to the joint offering. Such regulation is unnecessary because an “excessive” price for one of the joint products will ultimately have to be reflected in lower prices for other products sold by the firm, or otherwise the firm will experience a loss in the volume of its sales that will be adverse to its overall profitability. In other words, an increase in the price of data will ultimately have to be accompanied by a decrease in the
At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) Necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission’s internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an email to rule-comments@sec.gov. Please include File Number SR–NASDAQ–2018–004 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission (''SEC'' or ''Commission'') at 100 F Street NE, Washington, DC 20549–1090. All submissions should refer to File Number SR–NASDAQ–2018–004 on the subject line.

The Exchange proposes to amend its Statement of Substance of the Proposed Rule Change to describe the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend its listing standard for warrants as set forth in Section 703.12 of the Exchange’s Listed Company Manual (the “Manual”) to create an exception to the prohibition on reducing the exercise price of listed warrants so as to permit exercise price reductions that are widely publicized and that continue in effect for at least 20 business days (or such longer period as may be required under the tender offer rules of the Securities and Exchange Commission) to reduce the exercise price to create an exception to the prohibition on reducing the exercise price of listed warrants so as to permit exercise price reductions that are widely publicized and that continue in effect for at least 20 business days (or such longer period as may be required under the tender offer rules of the Securities and Exchange Commission).