

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>26</sup>

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Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-72620; File No. SR-NASDAQ-2014-070]

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Modify Fees for NASDAQ Basic and To Correct an Error in the Text of Rule 7023

July 16, 2014.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 1, 2014, The NASDAQ Stock Market LLC ("NASDAQ" or the "Exchange") filed with the Securities and Exchange Commission ("Commission") 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

NASDAQ is filing a proposed rule change to modify fees for the NASDAQ Basic data product under Rule 7047 and to correct an error in the text of Rule 7023 (governing NASDAQ Depth-of-Book data). The proposal is immediately effective and will be implemented as of July 1, 2014.

The text of the proposed rule change is below. Proposed new language is italicized; proposed deletions are in brackets.

\* \* \* \* \*

#### 7023. NASDAQ Depth-of-Book Data

(a)–(b) No change.

(c) Enterprise License Fees

(1) A Distributor that is also a broker-dealer pays a monthly fee of \$25,000 for the right to provide NASDAQ TotalView and NASDAQ OpenView for Display Usage for Internal Distribution [to Non-Professional Subscribers for Internal Distribution], or for External Distribution to *Non-Professional*

Subscribers with whom the firm has a brokerage relationship. This Enterprise License shall not apply to relevant Level 1 and NASDAQ Level 2 fees.

(2) A Distributor that is also a broker-dealer pays a monthly fee of \$100,000 for the right to provide NASDAQ TotalView and NASDAQ OpenView for Display Usage [by Professional and Non-Professional Subscribers] for Internal Distribution, or for External Distribution to *both Professional and Non-Professional* Subscribers with whom the firm has a brokerage relationship. This Enterprise License shall not apply to relevant Level 1 and NASDAQ Level 2 fees.

(3) No change.

(d)–(e) No change.

\* \* \* \* \*

#### 7047. Nasdaq Basic

(a) No change.

(b) User Fees

(1)–(4) No change.

(5) As an alternative to (b)(1) and (b)(2), a broker-dealer may purchase an enterprise license at a rate of [\$100,000/\$350,000 per month for distribution *through an electronic system approved by NASDAQ to an unlimited number of Professional and Non-Professional Subscribers with whom the broker-dealer has a brokerage relationship. A separate license would be required for each discrete electronic system used by the broker-dealer.* [The enterprise license entitles a Distributor to provide Nasdaq Basic to an unlimited number of Non-Professional Subscribers with whom the firm has a brokerage relationship.] *The enterprise license would allow distribution to the broker-dealer's employees through the approved electronic system, but would not cover distribution through any Distributor other than the broker-dealer obtaining the license and its approved system. In order to qualify for the enterprise license, the broker-dealer must also (i) distribute NASDAQ Last Sale for NASDAQ and/or NASDAQ Last Sale for NYSE/NYSE MKT via an internet-based electronic system approved by NASDAQ pursuant to Rule 7039(b)(2)(B), at a level that allows it to qualify for the fee cap provided for in Rule 7039(b), (ii) distribute NASDAQ TotalView and/or NASDAQ OpenView data under an enterprise license pursuant to Rule 7023(c)(1), and (iii) pay [The enterprise license is in addition to] the Distributor Fee for NASDAQ Basic [listed in] under paragraph (c)(1) or for NASDAQ Last Sale under Rule 7039(c). The broker-dealer must also report the number of Subscribers receiving NASDAQ Basic*

*under the license to NASDAQ at least once per calendar year.*

(6) No change.

(c)–(d) No change.

\* \* \* \* \*

#### 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 self-regulatory organization 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 those 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 parts of such statements.

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

###### 1. Purpose

NASDAQ Basic is a proprietary data product that provides best bid and offer information from the NASDAQ Market Center and last sale transaction reports from the NASDAQ Market Center and from the FINRA/NASDAQ Trade Reporting Facility ("FINRA/NASDAQ TRF"). As such, NASDAQ Basic is a "non-core" product that provides a subset of the "core" quotation and last sale data provided by securities information processors ("SIPs") under the CQ/CT Plan and the NASDAQ UTP Plan. In this filing, NASDAQ is proposing to modify the existing enterprise license for a broker-dealer ("BD") to provide NASDAQ Basic to Non-Professional Subscribers with whom it has a brokerage relationship so that it covers distribution through the BD's approved electronic system to both Professional and Non-Professional Subscribers with whom it has a brokerage relationship, subject to certain other conditions described below and in the proposed rule.

NASDAQ Basic contains three separate 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 contains the best bid and offer on the NASDAQ Market Center and last sale transaction reports for NASDAQ and the FINRA/NASDAQ TRF for NYSE-listed

<sup>26</sup> 17 CFR 200.30-3(a)(12).

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

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

stocks, and (iii) NASDAQ Basic for NYSE MKT, 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 stocks listed on NYSE MKT and other listing venues whose quotes and trade reports are disseminated on Tape B.

The fee structure for NASDAQ Basic features a fee for Professional Subscribers and a reduced fee for Non-Professional Subscribers.<sup>3</sup> The current monthly fees for Non-Professional Subscribers are \$0.50 per Subscriber for NASDAQ Basic for NASDAQ, \$0.25 per Subscriber for NASDAQ Basic for NYSE, and \$0.25 per Subscriber for NASDAQ Basic for NYSE MKT. The current monthly fees for Professional Subscribers are \$13 per Subscriber for NASDAQ Basic for NASDAQ, \$6.50 per Subscriber for NASDAQ Basic for NYSE, and \$6.50 per Subscriber for NASDAQ Basic for NYSE MKT. For use cases that do not require a monthly subscription for unlimited usage, there is a Per Query option, with a fee of \$0.0025 for NASDAQ Basic for NASDAQ, \$0.0015 for NASDAQ Basic for NYSE, and \$0.0015 for NASDAQ Basic for NYSE MKT.

Distributors<sup>4</sup> of NASDAQ Basic may also be assessed a monthly Distributor Fee. The fee is \$1,500 per month for either internal or external distribution; however, a credit for Subscriber or Per Query fees may be applied against the Distributor Fee at the Distributor's request. A Distributor of data derived from NASDAQ Basic (but that is not distributing raw NASDAQ Basic content

itself) may pay a fee of \$1,500 per month (plus the applicable monthly Distributor fee) to distribute the derived data to an unlimited number of Non-Professional Subscribers. This type of Distributor will typically distribute data to a large number of downstream customers through web-based applications.

As an alternative to monthly Subscriber fees for Non-Professional Subscribers, NASDAQ currently offers an enterprise license under which a BD may distribute NASDAQ Basic to an unlimited number of Non-Professional Subscribers with whom the BD has a brokerage relationship at a rate of \$100,000 per month (as well as the applicable monthly Distributor fee).<sup>5</sup> NASDAQ is proposing to modify the license provision to focus its availability on BD Distributors that achieve wide distribution of a variety of NASDAQ data to a range of investors, including both Non-Professional and Professional Subscribers. Under the proposed modification, the enterprise license fee will increase to \$350,000 per month, but the license will allow distribution of NASDAQ Basic to an unlimited number of Professional or Non-Professional Subscribers with whom the BD has a brokerage relationship, through an electronic system approved by NASDAQ (such as a password-protected Web site for customers to access their accounts and submit orders to the BD). A separate enterprise license with a separate fee would be required for each discrete electronic system used by the broker-dealer. The enterprise license would allow Internal Distribution to the BD's employees, but only through the approved system. The license would not cover distribution through any Distributor other than the BD obtaining the license through its approved system. Thus, a BD could not use the license to eliminate fees payable with respect to the distribution of data to its customers or employees through a third-party data provider.

Because the focus of the license is to achieve the broad distribution of data to many investors by providing a volume discount, the licensee is also required to distribute NASDAQ Last Sale for NASDAQ and/or NASDAQ Last Sale for NYSE/NYSE MKT ("NLS") via the internet pursuant to Rule 7039(b)(2)(B), at a level that allows it to qualify for the \$50,000 fee cap provided for in Rule 7039(b). The NLS data feeds contain last sale activity in U.S. equities within the NASDAQ Market Center and reported to

the FINRA/NASDAQ TRF. In certain instances, NLS is distributed under a per Subscriber or per query model, under which a fee is charged for each person that receives the data or for each instance in which a user accesses last sale information about a particular stock. In order to achieve broad distribution of the information to investors, NASDAQ also offers fee models for NLS for distribution via the internet or television, with fees based on the number of Web site visitors or the estimated number of households reached via television. In all instances, the fee payable for NLS is capped at \$50,000 per month (plus applicable distributor fees, as discussed below). Although the information included in NLS is also included in NASDAQ Basic, the requirement for internet distribution of NLS would accomplish different transparency goals than distribution of NASDAQ Basic under the license. Specifically, while NASDAQ Basic would be distributed to BD customers via an electronic system for account access, NLS would be distributed broadly via the BD's public Web site, to allow for broad distribution of the information to current customers, potential customers, and interested members of the public and retail investment community.

The licensee would also be required to distribute NASDAQ TotalView and/or NASDAQ OpenView under an enterprise license pursuant to Rule 7023(c)(1). NASDAQ TotalView provides, for NASDAQ-listed securities, all orders and quotes from all NASDAQ members displayed in the NASDAQ Market Center as well as the aggregate size of such orders and quotes at each price level in the execution functionality of the NASDAQ Market Center. NASDAQ OpenView provides the same information as NASDAQ TotalView with respect to stocks listed on exchanges other than NASDAQ. Under the applicable enterprise license, a Distributor that is also a BD pays a monthly fee of \$25,000 for the right to provide NASDAQ TotalView and NASDAQ OpenView for distribution to an unlimited number of Non-Professional Subscribers with whom the BD has a brokerage relationship.<sup>6</sup> Thus,

<sup>6</sup> NASDAQ is also proposing to correct several obvious errors in the text of Rule 7023. In Securities Exchange Act Release No. 66740 (April 4, 2012), 77 FR 21609 (April 10, 2012) (SR-NASDAQ-2012-042), NASDAQ reorganized the text of Rule 7023, stating that "[s]ubsections (c)(1), (c)(2), and (c)(4) [of Rule 7023] reflect the enterprise licenses currently set forth in NASDAQ Rule (a)(1)(C) and (D)." NASDAQ further stated that the proposed changes were "technical and administrative changes that will not impact the fees assessed to any

<sup>3</sup> A "Non-Professional Subscriber" is "a natural person who is not (i) registered or qualified in any capacity with the Commission, the Commodity Futures Trading Commission, any state securities agency, any securities exchange or association, or any commodities or futures contract market or association; (ii) engaged as an "investment adviser" as that term is defined in Section 201(11) of the Investment Advisers Act of 1940 (whether or not registered or qualified under that Act); or (iii) employed by a bank or other organization exempt from registration under federal or state securities laws to perform functions that would require registration or qualification if such functions were performed for an organization not so exempt." A "Professional Subscriber" is "any Subscriber other than a Non-Professional Subscriber." Thus, the term includes both natural persons that do not fit within the definition of Non-Professional Subscriber, as well as Subscribers that are not natural persons.

<sup>4</sup> The definition of the term "Distributor" is "any entity that receives NASDAQ Basic data directly from NASDAQ or indirectly through another entity and then distributes it to one or more Subscribers." Distributors may either be "Internal Distributors", which are "Distributors that receive NASDAQ Basic data and then distribute that data to one or more Subscribers within the Distributor's own entity," or "External Distributors", which are "Distributors that receive NASDAQ Basic data and then distribute that data to one or more Subscribers outside the Distributor's own entity."

<sup>5</sup> NASDAQ also offers an enterprise license for BDs to distribute to internal Professional Subscribers (*i.e.*, employees of the BD).

similar to the NASDAQ Basic license, the applicable TotalView/OpenView license is designed to allow wide distribution of data to brokerage customers to facilitate informed trading decisions.

The licensee must also pay Distributor Fees for NASDAQ Basic, under Rule 7047(c)(1), or for NASDAQ Last Sale under Rule 7039(c). The applicable fees are \$1,500 per month for each product, but the licensee is required to pay the fee only with respect to one of the products. Thus, if a prospective distributor of NASDAQ Basic under the license is already distributing NASDAQ Last Sale and paying the fee with respect to that product, it is not required to pay an additional Distributor Fee.

The existing license for distribution of NASDAQ Basic to Non-Professional Subscribers is not currently being used by any customer. Therefore, the change will neither advantage nor disadvantage current Subscribers. Based on input from the retail investment community and members, NASDAQ has determined that the lack of demand for the license may be attributable to the reluctance of BDs to distinguish among their customers in the manner required to ensure that the data is not distributed to Professional Subscribers. Accordingly, by widening the scope of the license to any Subscriber that is a brokerage customer, NASDAQ believes that the license may allow BDs to achieve wide distribution of NASDAQ Basic, NASDAQ Last Sale, and NASDAQ TotalView/OpenView without the need to distinguish Professional and Non-Professional Subscribers or to pay individual fees for any single Subscriber. Accordingly, although the

modified license may reflect a price increase in comparison with the existing license, NASDAQ believes that demand for the license will increase because of the associated reduction of administrative costs and the cost certainty provided by an enterprise license. The proposed Enterprise License will, however, require firms to report the number of Subscribers receiving NASDAQ Basic a minimum of once per calendar year to provide NASDAQ with accurate information to understand the scope of distribution.

## 2. Statutory Basis

NASDAQ believes that the proposed rule change is consistent with the provisions of Section 6 of the Act<sup>7</sup> in general, and with Sections 6(b)(4) and (5) of the Act<sup>8</sup> in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among recipients of NASDAQ data and is not designed to permit unfair discrimination between them. In adopting Regulation NMS, the Commission granted self-regulatory organizations (“SROs”) and BDs increased authority and flexibility to offer new and unique market data to the public. It was believed that this authority would expand the amount of data available to consumers, and also spur innovation and competition for the provision of market data. NASDAQ believes that its NASDAQ Basic market data product is precisely the sort of market data product that the Commission envisioned when it adopted Regulation NMS. The Commission concluded that Regulation NMS—by deregulating the market in proprietary data—would itself further the Act’s goals of facilitating efficiency and competition:

[E]fficiency 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.<sup>9</sup>

By removing unnecessary regulatory restrictions on the ability of exchanges to sell their own data, Regulation NMS advanced the goals of the Act and the principles reflected in its legislative history. If the free market should determine whether proprietary data is sold at all, it follows that the price at

which such data is sold should be set by the market as well. NASDAQ Basic exemplifies the optional nature of proprietary data, since, depending on a customer’s specific goals, it may opt to purchase core SIP data or only the subset provided through NASDAQ Basic. Moreover, as discussed in more detail below, the price that NASDAQ is able to charge is constrained by the existence of substitutes in the form of SIP data and competitive products offered by other SROs.

The decision of the United States Court of Appeals for the District of Columbia Circuit in *NetCoalition v. SEC*, 615 F.3d 525 (D.C. Cir. 2010) (“*NetCoalition I*”), upheld the Commission’s reliance upon competitive markets to set reasonable and equitably allocated fees for market data. “In fact, the legislative history indicates that the Congress intended that the market system ‘evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed’ and that the SEC wield its regulatory power ‘in those situations where competition may not be sufficient,’ such as in the creation of a ‘consolidated transactional reporting system.’” *NetCoalition I*, at 535 (quoting H.R. Rep. No. 94–229, at 92 (1975), as reprinted in 1975 U.S.C.C.A.N. 321, 323). The court agreed with the Commission’s conclusion that “Congress intended that ‘competitive forces should dictate the services and practices that constitute the U.S. national market system for trading equity securities.’”<sup>10</sup>

The Court in *NetCoalition I*, while upholding the Commission’s conclusion that competitive forces may be relied upon to establish the fairness of prices, nevertheless concluded that the record in that case did not adequately support the Commission’s conclusions as to the competitive nature of the market for NYSE Arca’s data product at issue in that case. As explained below in NASDAQ’s Statement on Burden on Competition, however, NASDAQ believes that there is substantial evidence of competition in the marketplace for data that was not in the record in the *NetCoalition I* case, and that the Commission is entitled to rely upon such evidence in concluding fees are the product of competition, and therefore in accordance with the relevant statutory standards.<sup>11</sup>

<sup>10</sup> *NetCoalition I*, at 535.

<sup>11</sup> It should also be noted that Section 916 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”) has amended paragraph (A) of Section 19(b)(3) of the Act, 15 U.S.C. 78s(b)(3), to make it clear that all exchange fees, including fees for market data, may

Subscriber.” Rule 7023(A)(1)(C) had formerly provided for “an enterprise license at a rate of \$25,000 for non-professional subscribers or \$100,000 per month for both professional and non-professional subscribers.” The license further stated that it applied to “an unlimited number of internal users . . . and external uses with whom the firm has a brokerage relationship.” Employees of a BD that receive market data in connection with their employment do not subscribe as individuals; rather the BD subscribes on their behalf, such that all such subscriptions are Professional. However, in adopting Rule 7023(c)(1) and (c)(2), which are derived from former Rule 7023(a)(1)(C), SR–NASDAQ–2012–042 construed the language “unlimited number of internal users” as allowing distribution to “Non-Professional Subscribers for Internal Distribution.” Because all Internal Distribution by a BD would, by definition, constitute Professional usage, the language is clearly erroneous and not in accordance with the stated intention of SR–NASDAQ–2014–042 to make no substantive changes. Accordingly, NASDAQ is amending Rule 7023 to eliminate the erroneous language, and make it clear that with respect to both 7023(c)(1) and (c)(2), the applicable licenses permit Internal Distribution for Display Usage (*i.e.*, display of the data on a screen or other visualization mechanism for access or use by a natural person or persons).

<sup>7</sup> 15 U.S.C. 78f.

<sup>8</sup> 15 U.S.C. 78f(b)(4), (5).

<sup>9</sup> Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

Moreover, NASDAQ further notes that the product at issue in this filing—a NASDAQ quotation and last sale data product that replicates a subset of the information available through “core” data products whose fees have been reviewed and approved by the SEC—is quite different from the NYSE Arca depth-of-book data product at issue in *NetCoalition I*. Accordingly, any findings of the court with respect to that product may not be relevant to the product at issue in this filing. As the Commission noted in approving the initial pilot for NASDAQ Basic, all of the information available in NASDAQ Basic is included in the core data feeds made available pursuant to the joint-SRO plans.<sup>12</sup> As the Commission further determined, “the availability of alternatives to NASDAQ Basic significantly affect the terms on which NASDAQ can distribute this market data. In setting the fees for its NASDAQ Basic service, NASDAQ must consider the extent to which market participants would choose one or more alternatives instead of purchasing the exchange’s data.”<sup>13</sup> Thus, to the extent that the fees for core data have been established as reasonable under the Act, it follows that the fees for NASDAQ Basic are also reasonable, since charging unreasonably high fees would cause market participants to rely solely on core data or purchase proprietary products offered by other exchanges rather than purchasing NASDAQ Basic.

Moreover, as discussed in the order approving the initial pilot, and as further discussed below in NASDAQ’s Statement on Burden on Competition, data products such as NASDAQ Basic are a means by which exchanges compete to attract order flow. To the extent that exchanges are successful in such competition, they earn trading revenues and also enhance the value of their data products by increasing the amount of data they are able to provide. Conversely, to the extent that exchanges are unsuccessful, the inputs needed to add value to data products are diminished. Accordingly, the need to compete for order flow places substantial pressure upon exchanges to keep their fees for both executions and data reasonable.

The proposed changes do not alter the reasonableness of the fees for NASDAQ

Basic. Although the enterprise license will be modified to increase the applicable fee, the modified license will also broaden the range of customers to which a BD can distribute the data, to include Professional Subscribers for which the fees for individual distribution are higher. In addition, the modified fee will reduce the associated administrative cost of the license by eliminating the need for a BD to distinguish between Professionals and Non-Professionals within its customer base. NASDAQ also notes that the individual fees associated with Professional use of both NASDAQ Basic and SIP data recently increased.<sup>14</sup> As a result, it is also reasonable that an enterprise license to allow unlimited distribution to Professional Subscribers would also be higher than the fees for the current license.

The changed license fee also continues to reflect an equitable allocation and continues not to be unfairly discriminatory, because NASDAQ Basic is a voluntary product for which market participants can readily substitute core data feeds that provide additional quotation and last sale information not available through NASDAQ Basic. Accordingly, NASDAQ is constrained from pricing the product in a manner that would be inequitable or unfairly discriminatory. Moreover, the broadening of the license to allow distribution to both Professional and Non-Professional Subscribers reflects an equitable allocation of fees because it increases the usefulness of the license to member firms and thereby has the potential to broaden the distribution of NASDAQ Basic to customers. Similarly, the requirements for licensees also to distribute NLS and NASDAQ TotalView and/or NASDAQ OpenView are reasonable because an enterprise license is in essence a volume discount for BDs that distribute data to a wide extent. Because the goal of the license is to encourage wide distribution at a fee that is more reasonable than per Subscriber fees, NASDAQ believes that is reasonable to offer this fee reduction to members that are, in fact, achieving wide distribution of data to customers and the public. Similarly, NASDAQ believes that the requirements are consistent with an equitable allocation of fees and not unreasonably discriminatory because they limit the volume discount to those members that can both benefit from a fee cap due to

their scope of distribution and that are achieving the goal of providing customers and the public with a range of market data.

The proposed changes to the text of Rule 7023 are consistent with the Act because they are intended solely to correct clearly erroneous language in the text of the rule, and therefore do not modify the fees payable by BDs that obtain subscriptions through the applicable enterprise licenses thereunder. Accordingly, the changes are reasonable, equitable, and not unfairly discriminatory because they serve to promote clarity but do not alter the rights or obligations of Subscribers.

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

NASDAQ does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. NASDAQ’s ability to price NASDAQ Basic is constrained by (1) competition among exchanges, other trading platforms, and TRFs that compete with each other in a variety of dimensions; (2) the existence of inexpensive real-time consolidated data and market-specific data and free delayed consolidated data; and (3) the inherent contestability of the market for proprietary data.

The market for proprietary data products is currently competitive and inherently contestable because there is fierce competition for the inputs necessary to the creation of proprietary data and strict pricing discipline for the proprietary products themselves. Numerous exchanges compete with each other for listings, trades, and market data itself, providing virtually limitless opportunities for entrepreneurs who wish to produce and distribute their own market data. This proprietary data is produced by each individual exchange, as well as other entities, in a vigorously competitive market. Similarly, with respect to the TRF data component of NASDAQ Basic, allowing exchanges to operate TRFs has permitted them to earn revenues by providing technology and data in support of the non-exchange segment of the market. This revenue opportunity has also resulted in fierce competition between the two current TRF operators, with both TRFs charging extremely low trade reporting fees and rebating the majority of the revenues they receive from core market data to the parties reporting trades.

Transaction executions and proprietary data products are complementary in that market data is

be filed by exchanges on an immediately effective basis. See also *NetCoalition v. SEC*, 715 F.3d 342 (D.C. Cir. 2013) (“*NetCoalition II*”) (finding no jurisdiction to review Commission’s non-suspension of immediately effective fee changes).

<sup>12</sup> Securities Exchange Act Release No. 12425 (March 16, 2009), 74 FR 12423, 12425 (March 24, 2009) (SR-NASDAQ-2008-102).

<sup>13</sup> *Id.* at 12425.

<sup>14</sup> Securities Exchange Act Release No. 71507 (February 7, 2014), 79 FR 8763 (February 13, 2014) (SR-NASDAQ-2014-011); Securities Exchange Act Release No. 70953 (November 27, 2013), 78 FR 72932 (December 4, 2014) (File No. S7-24-89).

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.<sup>15</sup> 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 products and the joint costs it incurs. 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).<sup>16</sup> 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. Similarly, data products cannot make use of TRF trade reports without the raw material of the trade reports themselves, and therefore necessitate the costs of operating, regulating,<sup>17</sup> and maintaining a trade reporting system, costs that must be covered through the fees charged for use of the facility and sales of associated data.

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 direct orders to a particular exchange only if the expected revenues from executing trades on the exchange 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 orders will become correspondingly more valuable.

Similarly, in the case of products such as NASDAQ Basic that may be distributed through market data vendors, the vendors provide price discipline for proprietary data products because they control a means of access to end users. Vendors impose price restraints based upon their business models. For example, vendors such as Bloomberg and Thomson Reuters that assess a surcharge on data they sell may refuse to offer proprietary products that end users will not purchase in sufficient numbers. Internet portals, such as Google, impose a discipline by providing only data that will enable them to attract "eyeballs" that contribute to their advertising revenue.

Retail BDs, such as Charles Schwab and Fidelity, offer their customers proprietary data only if it promotes trading and generates sufficient commission revenue. Although the business models may differ, these vendors' pricing discipline is the same: they can simply refuse to purchase any proprietary data product that fails to provide sufficient value. Exchanges, TRFs, and other producers of proprietary data products must understand and respond to these varying business models and pricing disciplines in order to market proprietary data products successfully. Moreover, NASDAQ believes that products such as NASDAQ Basic can enhance order flow to NASDAQ by providing more widespread distribution of information about transactions in real time, thereby encouraging wider participation in the market by investors with access to the data through their brokerage firm or other distribution sources. Conversely, the value of such products to distributors and investors decreases if order flow falls, because the products contain less content.

Analyzing the cost of market data distribution in isolation from the cost of all of the inputs supporting the creation of market data will inevitably underestimate the cost of the data. Thus, because it is impossible to create exchange data without a fast, technologically robust, and well-regulated execution system, system costs and regulatory costs affect the price of market data. It would be equally misleading, however, to attribute all of the exchange's costs to the market data portion of an exchange's joint product. Rather, all of the exchange's costs are incurred for the unified purposes of attracting order flow, executing and/or routing orders, and generating and selling data about market activity. The total return that an exchange earns reflects the revenues it receives from the joint products and the total costs of the joint products. Similarly, the inclusion of trade reporting data in a product such as NASDAQ Basic may assist in attracting customers to the product, thereby assisting in covering the additional costs associated with operating and regulating a TRF.

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

<sup>15</sup> A complete explanation of the pricing dynamics associated with joint products is presented in a study that NASDAQ originally submitted to the Commission in SR-NASDAQ-2011-010. See Statement of Janusz Ordovery and Gustavo Bamberger at 2-17 (December 29, 2010) (available at <http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2011/SR-NASDAQ-2011-010.pdf>).

<sup>16</sup> See William J. Baumol and Daniel G. Swanson, "The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power," *Antitrust Law Journal*, Vol. 70, No. 3 (2003).

<sup>17</sup> It should be noted that the costs of operating the FINRA/NASDAQ TRF borne by NASDAQ include regulatory charges paid by NASDAQ to FINRA.

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 unreasonable increase in the price of data will ultimately have to be accompanied by a decrease in the cost of executions, or the volume of both data and executions will fall.

The level of competition and contestability in the market is evident in the numerous alternative venues that compete for order flow, including eleven 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. It is common for BDs to further and exploit this competition by sending their order flow and transaction reports to multiple markets, rather than providing them all to a single market. Competitive markets for order flow, executions, and transaction reports provide pricing discipline for the inputs of proprietary data products.

The large number of SROs, TRFs, BDs, and ATSs that currently produce proprietary data or are currently capable of producing it provides further pricing discipline for proprietary data products. Each SRO, TRF, ATS, and BD is currently permitted to produce proprietary data products, and many currently do or have announced plans to do so, including NASDAQ, NYSE, NYSE MKT, NYSE Arca, BATS, and Direct Edge.

Any ATS or BD can combine with any other ATS, BD, or multiple ATSs or BDs to produce joint proprietary data products. Additionally, order routers and market data vendors can facilitate single or multiple BDs’ production of proprietary data products. The potential sources of proprietary products are virtually limitless. Notably, the potential sources of data include the BDs that submit trade reports to TRFs and that have the ability to consolidate and distribute their data without the involvement of FINRA or an exchange-operated TRF.

The fact that proprietary data from ATSs, BDs, and vendors can by-pass SROs is significant in two respects. First, non-SROs can compete directly with SROs for the production and sale of proprietary data products, as BATS and Arca did before registering as exchanges by publishing proprietary book data on the internet. Second, because a single order or transaction report can appear in a core data product, an SRO proprietary product, and/or a non-SRO proprietary product, the data available in proprietary products is exponentially greater than the actual number of orders and transaction reports that exist in the marketplace. Indeed, in the case of NASDAQ Basic, the data provided through that product appears both in (i) real-time core data products offered by the SIPs for a fee, and (ii) free SIP data products with a 15-minute time delay, and finds a close substitute in similar products of competing venues.

In addition to the competition and price discipline described above, the market for proprietary data products is also highly contestable because market entry is rapid, inexpensive, and profitable. The history of electronic trading is replete with examples of entrants that swiftly grew into some of the largest electronic trading platforms and proprietary data producers: Archipelago, Bloomberg Tradebook, Island, REDIBook, Attain, TracECN, BATS Trading and Direct Edge. A proliferation of dark pools and other ATSs operate profitably with fragmentary shares of consolidated market volume.

Regulation NMS, by deregulating the market for proprietary data, has increased the contestability of that market. While BDs have previously published their proprietary data individually, Regulation NMS encourages market data vendors and BDs to produce proprietary products cooperatively in a manner never before possible. Multiple market data vendors already have the capability to aggregate data and disseminate it on a profitable

scale, including Bloomberg and Thomson Reuters. In Europe, Markit aggregates and disseminates data from over 50 brokers and multilateral trading facilities.<sup>18</sup>

In the case of TRFs, the rapid entry of several exchanges into this space in 2006–2007 following the development and Commission approval of the TRF structure demonstrates the contestability of this aspect of the market.<sup>19</sup> Given the demand for trade reporting services that is itself a by-product of the fierce competition for transaction executions—characterized notably by a proliferation of ATSs and BDs offering internalization—any supra-competitive increase in the fees associated with trade reporting or TRF data would shift trade report volumes from one of the existing TRFs to the other<sup>20</sup> and create incentives for other TRF operators to enter the space. Alternatively, because BDs reporting to TRFs are themselves free to consolidate the market data that they report, the market for over-the-counter data itself, separate and apart from the markets for execution and trade reporting services—is fully contestable.

Moreover, consolidated data provides substantial pricing discipline for proprietary data products that are a subset of the consolidated data stream. Because consolidated data contains marketwide information, it effectively places a cap on the fees assessed for proprietary data (such as quotation and last sale data) that is simply a subset of the consolidated data. The availability provides a powerful form of pricing discipline for proprietary data products that contain data elements that are a subset of the consolidated data, by highlighting the optional nature of proprietary products.

The competitive nature of the market for non-core “sub-set” products such as NASDAQ Basic is borne out by the performance of the market. In May 2008, the internet portal Yahoo! began offering its Web site viewers real-time last sale data (as well as best quote data) provided by BATS. In June 2008, NASDAQ launched NLS, which was initially subject to an “enterprise cap” of \$100,000 for customers receiving only one of the NLS products, and \$150,000 for customers receiving both products. The majority of NASDAQ’s sales were at

<sup>18</sup> <http://www.markit.com/en/products/data/boat/boat-boat-data.page>.

<sup>19</sup> The low cost exit of two TRFs from the market is also evidence of a contestible market, because new entrants are reluctant to enter a market where exit may involve substantial shut-down costs.

<sup>20</sup> It should be noted that the FINRA/NYSE TRF has, in recent weeks, received reports for over 8% of all over-the-counter volume in NMS stocks.



the capped level. In early 2009, BATS expanded its offering of free data to include depth-of-book data. Also in early 2009, NYSE Arca announced the launch of a competitive last sale product with an enterprise price of \$30,000 per month. In response, NASDAQ combined the enterprise cap for the NLS products and reduced the cap to \$50,000 (*i.e.*, a reduction of \$100,000 per month). Similarly, the enterprise license being offered for NASDAQ Basic through this proposed rule change reflects a means by which the overall cost of the product is limited in accordance with the existence of competitive alternatives, including both core and proprietary data.

In this environment, a super-competitive increase in the fees charged for either transactions or data has the potential to impair revenues from both products. “No one disputes that competition for order flow is ‘fierce.’” *NetCoalition I* at 539. The existence of fierce competition for order flow implies a high degree of price sensitivity on the part of BDs with order flow, since they may readily reduce costs by directing orders toward the lowest-cost trading venues. A BD that shifted its order flow from one platform to another in response to order execution price differentials would both reduce the value of that platform’s market data and reduce its own need to consume data from the disfavored platform. If a platform increases its market data fees, the change will affect the overall cost of doing business with the platform, and affected BDs will assess whether they can lower their trading costs by directing orders elsewhere and thereby lessening the need for the more expensive data. Similarly, increases in the cost of NASDAQ Basic would impair the willingness of distributors to take a product for which there are numerous alternatives, impacting NASDAQ Basic data revenues, the value of NASDAQ Basic as a tool for attracting order flow, and ultimately, the volume of orders routed to NASDAQ and reported to the FINRA/NASDAQ TRF and the value of its other data products.

Competition has also driven NASDAQ continually to improve its data offerings and to cater to customers’ data needs. The NASDAQ Basic product itself is a product of this competition, offering a subset of core data to users that may not wish to receive or pay for all consolidated data. The existence of numerous alternatives to NASDAQ Basic, including real-time consolidated data, free delayed consolidated data, and proprietary data from other sources ensures that NASDAQ cannot set unreasonable fees, or fees that are

unreasonably discriminatory, without losing business to these alternatives. Accordingly, NASDAQ believes that the acceptance of the NASDAQ Basic product in the marketplace demonstrates the consistency of these fees with applicable statutory standards. Likewise, the fee changes proposed herein will be subject to these same competitive forces. If the proposed change is deemed to result in an excessive fee, only NASDAQ will suffer, since its customers will merely migrate to competitive alternatives.

*C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others*

Written comments were neither solicited nor received.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>21</sup> and paragraph (f) of Rule 19b-4 thereunder.<sup>22</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 necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

**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](mailto:rule-comments@sec.gov). Please include File Number SR–NASDAQ–2014–070 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090. All submissions should refer to File Number SR–NASDAQ–2014–070. This file number should be included on the subject line if email 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 Web site 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 Nasdaq. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NASDAQ–2014–070 and should be submitted on or before August 12, 2014.

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

**Kevin M. O’Neill,**  
*Deputy Secretary.*

[FR Doc. 2014–17144 Filed 7–21–14; 8:45 am]

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34–72633; File No. SR–Phlx–2013–113]

**Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Order Disapproving Proposed Rule Change To Offer a Rebate Based on Members’ Aggregate Customer Volume in Multiply-Listed Options Transacted on NASDAQ OMX PHLX LLC or Its Affiliated Options Exchanges**

July 16, 2014.

**I. Introduction**

On October 31, 2013, NASDAQ OMX PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule

<sup>21</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>22</sup> 17 CFR 240.19b–4(f).

<sup>23</sup> 17 CFR 200.30–3(a)(12).

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