

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-66747; File No. SR-NASDAQ-2012-047]

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Modify the Investor Support Program and the Extended Hours Investor Program Under Rule 7014 and To Amend the Liquidity Provider Rebate Schedule Under Rule 7018

April 5, 2012.

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 30, 2012, The NASDAQ Stock Market LLC (“NASDAQ” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”) a 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

NASDAQ proposes (i) to modify the Investor Support Program and the Extended Hours Investor Program under Rule 7014, and (ii) to amend NASDAQ’s liquidity provider rebate schedule under Rule 7018. NASDAQ will implement the proposed change on April 2, 2012. The text of the proposed rule change is available at [nasdaq.cchwallstreet.com](http://nasdaq.cchwallstreet.com), at NASDAQ’s principal office, and at the Commission’s Public Reference Room.

#### 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 the Statutory Basis for, the Proposed Rule Change

##### 1. Purpose

##### Investor Support Program

NASDAQ is proposing to make a minor modification to the Investor Support Program (the “ISP”) under Rule 7014. The ISP enables NASDAQ members to earn a monthly fee credit for providing additional liquidity to NASDAQ and increasing the NASDAQ-traded volume of what are generally considered to be retail and institutional investor orders in exchange-traded securities (“targeted liquidity”). The goal of the ISP is to incentivize members to provide such targeted liquidity to the NASDAQ Market Center.<sup>3</sup> The Exchange noted in its original filing to institute the ISP<sup>4</sup> that maintaining and increasing the proportion of orders in exchange-listed securities executed on a registered exchange (rather than relying on any of the available off-exchange execution methods) would help raise investors’ confidence in the fairness of their transactions and would benefit all investors by deepening NASDAQ’s liquidity pool, supporting the quality of price discovery, promoting market transparency and improving investor protection.

On March 1, 2012, the Exchange added an additional method for members to qualify for an ISP rebate that included a criterion focused on liquidity provision through Public Customer Orders in the NASDAQ

<sup>3</sup> The Commission has recently expressed its concern that a significant percentage of the orders of individual investors are executed at over the counter (“OTC”) markets, that is, at off-exchange markets; and that a significant percentage of the orders of institutional investors are executed in dark pools. Securities Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3594 (January 21, 2010) (Concept Release on Equity Market Structure, “Concept Release”). In the Concept Release, the Commission has recognized the strong policy preference under the Act in favor of price transparency and displayed markets. The Commission published the Concept Release to invite public comment on a wide range of market structure issues, including high frequency trading and un-displayed, or “dark,” liquidity. See also Mary L. Schapiro, Strengthening Our Equity Market Structure (Speech at the Economic Club of New York, Sept. 7, 2010) (“Schapiro Speech,” available on the Commission Web site) (comments of Commission Chairman on what she viewed as a troubling trend of reduced participation in the equity markets by individual investors, and that nearly 30 percent of volume in U.S.-listed equities is executed in venues that do not display their liquidity or make it generally available to the public).

<sup>4</sup> Securities Exchange Act Release No. 63270 (November 8, 2010), 75 FR 69489 (November 12, 2010) (NASDAQ-2010-141) (notice of filing and immediate effectiveness).

Options Market.<sup>5</sup> The Exchange is now proposing a minor modification to this recently introduced aspect of the ISP (the “Options Tier”).

The Options Tier recognized the extent to which members that represent retail and/or institutional investors are active in trading both cash equities and options on behalf of such customers. In fact, to an increasing extent the customers that such members represent simultaneously trade different asset classes within a single investment strategy. NASDAQ also notes that cash equities and options markets are linked, with liquidity and trading patterns on one market affecting those on the other. Accordingly, pricing incentives that encourage market participant activity in both markets recognize that activity in the options markets also supports price discovery and liquidity provision in the NASDAQ Market Center. The NASDAQ Market Center fee schedule for order execution and routing in Rule 7018 also recognizes the convergence between cash equities and options trading through liquidity provider rebate tiers available to members active in both the NASDAQ Market Center and the NASDAQ Options Market.

Participants in the ISP are required to designate specific NASDAQ order entry ports for use under the ISP and to meet specified criteria focused on market participation, liquidity provision, and high rates of order execution. For members qualifying for the Options Tier, NASDAQ pays a credit of \$0.0003 per share with respect to shares of displayed liquidity executed at a price of \$1 or more and entered through ISP-designated ports, and \$0.0001 per share with respect to all other shares of displayed liquidity executed at a price of \$1 or more. The specific criteria for the Options Tier are as follows:

(1) The member’s Participation Ratio<sup>6</sup> for the month exceeds its Baseline Participation Ratio<sup>7</sup> by at least 0.30%.

<sup>5</sup> Securities Exchange Act Release No. 66544 (March 8, 2012), 77 FR 15163 (March 14, 2012) (SR-NASDAQ-2012-032).

<sup>6</sup> “Participation Ratio” is defined as follows: “[F]or a given member in a given month, the ratio of (A) the number of shares of liquidity provided in orders entered by the member through any of its Nasdaq ports and executed in the Nasdaq Market Center during such month to (B) the Consolidated Volume.” “Consolidated Volume” is defined as follows: “[F]or a given member in a given month, the consolidated volume of shares of System Securities in executed orders reported to all consolidated transaction reporting plans by all exchanges and trade reporting facilities during such month.” “System Securities” means all securities listed on NASDAQ and all securities subject to the Consolidated Tape Association Plan and the Consolidated Quotation Plan.

<sup>7</sup> “Baseline Participation Ratio” is defined as follows: “[W]ith respect to a member, the lower of

Continued

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

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

In general terms, the Baseline Participation Ratio is the ratio of shares of liquidity provided by the member in NASDAQ for the month of August 2010 or August 2011 (whichever is lower) to the total consolidated volume for that month. To the extent that a member's participation in NASDAQ equals or exceeds its Baseline Participation Ratio (*i.e.*, to the extent that the member at least matches its participation in NASDAQ during the lower of August 2010 or August 2011), the member may be eligible for the program. Exceeding the Baseline Participation Ratio by specified amounts may qualify the member for higher credits under the ISP. The requirement reflects the expectation that a member participating in the program must maintain or increase its participation in NASDAQ as compared with an historical baseline.

(2) The member's "ISP Execution Ratio" for the month must be less than 10. The ISP Execution Ratio is defined as "the ratio of (A) the total number of liquidity-providing orders entered by a member through its ISP-designated ports during the specified time period to (B) the number of liquidity-providing orders entered by such member through its ISP-designated ports and executed (in full or partially) in the Nasdaq Market Center during such time period; provided that: (i) No order shall be counted as executed more than once; and (ii) no Pegged Orders, odd-lot orders, or MIOC or SIOC orders shall be included in the tabulation."<sup>8</sup> Thus, the definition requires a ratio between the total number of orders that post to the NASDAQ book and the number of such orders that actually execute that is low, a characteristic that NASDAQ believes to be reflective of retail and institutional order flow.

(3) The shares of liquidity provided through ISP-designated ports during the month are equal to or greater than 0.2% of Consolidated Volume during the month, reflecting the ISP goals of

encouraging higher levels of liquidity provision.

(4) At least 80% of the liquidity provided by the member during the month is provided through ISP-designated ports. This requirement is designed to mitigate "gaming" of the program by firms that do not generally represent retail or institutional order flow but that nevertheless are able to channel a portion of their orders that they intend to execute through ISP-designated ports and thereby receive a credit with respect to those orders.

(5) The member has an average daily volume during the month of 100,000 or more contracts of liquidity provided through one or more of its Nasdaq Option Market participant identifiers ("MPIDs"), provided that such liquidity is provided through Public Customer Orders, as defined in Chapter I, Section 1 of the Nasdaq Options Market Rules. That rule defines Public Customer Order as an order for the account of a person that is not a broker or a dealer. Thus, in keeping with the goal of the ISP to encourage participation by retail and institutional investors and the members that represent them in exchange markets, the criterion focused on options requires a specified level of liquidity provision through orders that are directly identified under Nasdaq Options Market rules as having characteristics consistent with this goal.

(6) The member's ratio between shares of liquidity provided through ISP-designated ports and total shares accessed, provided, or routed through ISP-designated ports during the month is at least 0.80. This additional criterion reflects a goal of ensuring that the qualifying member is using its ISP-designated ports substantially for liquidity provision, in keeping with the ISP's overall goal of drawing liquidity-providing orders to exchange markets. In this proposed rule change, NASDAQ is proposing to reduce the required ratio to 0.70. NASDAQ believes that the change will encourage more members to seek to qualify for the Options Tier. Therefore, even though the change will reduce the liquidity requirement for qualifying members, NASDAQ believes that the change is still consistent with the Exchange's goal of drawing liquidity-providing orders to exchange markets.

#### Extended Hours Investor Program

NASDAQ is also proposing to make a similar change to its Extended Hours Investor Program (the "EHIP"). The EHIP is designed to encourage greater use of NASDAQ's facilities for trading before the market open at 9:30 a.m.,

after the market close at 4 p.m., and throughout the trading day. The goal of the program is to encourage the development of a deeper, more liquid trading book during pre-market and post-market hours, while also recognizing the correlation observed by NASDAQ between levels of liquidity provided during these trading sessions and levels provided during regular trading hours.

Under the program, a member is required to designate one or more MPIDs for use under the program. The member then qualifies for an extra rebate of \$0.0002 per share executed with respect to all displayed liquidity provided through a designated MPID that executes at a price of \$1 or more during the month if the following conditions are met:

(1) the MPID's "EHIP Execution Ratio" for the month is less than 10. The EHIP Execution Ratio is defined as "the ratio of (A) the total number of liquidity-providing orders entered by a member through an EHIP-designated MPID during the specified time period to (B) the number of liquidity-providing orders entered by such member through such EHIP-designated MPID and executed (in full or partially) in the Nasdaq Market Center during such time period; provided that: (i) no order shall be counted as executed more than once; and (ii) no Pegged Orders, odd-lot orders, or MIOC or SIOC orders<sup>9</sup> shall be included in the tabulation." Thus, the requirement stipulates that a high proportion of potentially liquidity-providing orders entered through the MPID actually execute and provide liquidity. This requirement is designed to focus the availability of the program on members representing retail and institutional customers.

(2) The member must provide (i) an average daily volume of 2 million or more shares of liquidity during the month using orders that are entered through its designated MPID and executed prior to NASDAQ's Opening Cross, or (ii) an average daily volume of 3 million or more shares of liquidity during the month using orders that are entered through its designated MPID and executed prior to the Nasdaq Opening Cross and/or after the Nasdaq Closing Cross. NASDAQ has observed that members that provide higher volumes of liquidity-providing orders during the pre-market or post-market hours generally do so throughout the rest of the trading day. Accordingly, the program pays a credit with respect to all liquidity-providing orders, but only in the event that comparatively large

such member's Participation Ratio for the month of August 2010 or the month of August 2011, provided that in calculating such Participation Ratios, the numerator shall be increased by the amount (if any) of the member's Indirect Order Flow for such month, and provided further that if the result is zero for either month, the Baseline Participation Ratio shall be deemed to be 0.485% (when rounded to three decimal places). "Indirect Order Flow" is defined as follows: "[F]or a given member in a given month, the number of shares of liquidity provided in orders entered into the Nasdaq Market Center at the member's direction by another member with minimal substantive intermediation by such other member and executed in the Nasdaq Market Center during such month."

<sup>8</sup> These terms have the meanings assigned to them in Rule 4751. MIOC and SIOC orders are forms of "immediate or cancel" orders and therefore cannot be liquidity-providing orders.

<sup>9</sup> See *supra* n.8.

volumes of such orders execute outside of regular market hours.

(3) The ratio between shares of liquidity provided through the MPID and total shares accessed, provided, or routed through the MPID during the month is at least 0.80. This requirement reflects the program's goal of encouraging members that provide high levels of liquidity in the pre-market and/or after-hours trading sessions to also do so during the rest of the trading day. In this proposed rule change, NASDAQ proposes to reduce the required ratio to 0.70. NASDAQ believes that the change will encourage more members to seek to qualify for the EHIP. Therefore, even though the change will reduce the liquidity requirement for qualifying members, NASDAQ believes that the change is still consistent with the Exchange's goal of using the EHIP to encourage high levels of liquidity provision throughout the trading day.

#### Rebate Schedule

Finally, NASDAQ is amending Rule 7018(a) to make a minor modification to two of its liquidity-provider rebate tiers.<sup>10</sup> Currently, NASDAQ pays a rebate of \$0.0010 per share executed for non-displayed quotes/orders, and \$0.0025 per share executed for other quotes/orders, if a member satisfies the following criteria: (i) the member provides shares of liquidity in all securities during the month representing more than 0.10% of Consolidated Volume<sup>11</sup> during the month, through one or more of its NASDAQ Market Center MPIDs, and (ii) the member has an average daily volume during the month of more than 115,000 contracts of liquidity accessed or provided through one or more of its NASDAQ Options Market MPIDs. NASDAQ is proposing to reduce the options contract requirement from 115,000 to 100,000, to reflect lower overall trading volumes in options markets and thereby make the rebate tier available to a wider number of market participants. Similarly, NASDAQ pays a rebate of \$0.0015 per share executed for non-displayed quotes/orders, and \$0.0029 per share executed for other quotes/orders, if a member satisfies the following criteria: (i) the member provides shares of liquidity in all securities during the month representing more than 0.15% of Consolidated Volume during the month,

through one or more of its Nasdaq Market Center MPIDs, and (ii) the member has an average daily volume during the month of more than 115,000 contracts of liquidity accessed or provided through one or more of its Nasdaq Options Market MPIDs. NASDAQ is also proposing to reduce the options contract requirement of this tier from 115,000 to 100,000, for identical reasons.

#### 2. Statutory Basis

NASDAQ believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>12</sup> in general, and with Sections 6(b)(4) and 6(b)(5) of the Act,<sup>13</sup> 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 or system which NASDAQ operates or controls, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The ISP encourages members to add targeted liquidity that is executed in the NASDAQ Market Center. Although the proposed change lowers the amount of liquidity that a member must provide through ISP-designated ports in order to qualify for the Options Tier, NASDAQ believes that the change may result in an even greater amount of targeted liquidity being provided to the NASDAQ Market Center and the NASDAQ Options Market, because more members will seek to qualify for the tier by routing targeted liquidity to NASDAQ rather than other trading venues.

The rule change proposal, like the original ISP, is not designed to permit unfair discrimination, but rather is intended to promote submission of liquidity-providing orders to NASDAQ, which benefits all NASDAQ members and all investors. Thus, the modified Options Tier will make the incentive provided by the tier available to a wider range of market participants, and thereby seeks to benefit all market participants by encouraging more members to provide targeted liquidity to the Exchange.

Likewise, the proposal, like the ISP, is consistent with the Act's requirement for the equitable allocation of reasonable dues, fees, and other charges. Members who choose to significantly increase the volume of liquidity-providing orders that they submit in order to qualify for the modified Options Tier would be benefitting all investors, and therefore providing credits to them, as

contemplated by the ISP, is equitable. Moreover, NASDAQ believes that the level of the credit available through the Options Tier—\$0.0003 per share for displayed liquidity provided through ISP-designated ports and \$0.0001 per share for other displayed liquidity—is reasonable, in that it is comparable to the added rebates of \$0.0001, \$0.0003, or \$0.0004 per share executed provided under other ISP tiers, and does not reflect a disproportionate increase above the rebates provided to all members with respect to the provision of displayed liquidity under Rule 7018, which range from \$0.0020 to \$0.00295 per share executed. NASDAQ further notes that by modifying the Options Tier, NASDAQ is effectively reducing fees for members qualifying for the modified tier without making any offsetting fee increases.

The EHIP is not unfairly discriminatory because it is intended to promote submission of liquidity-providing orders to NASDAQ, which benefits all NASDAQ members and all investors. The proposed modifications to the program will make the EHIP incentive available to a wider range of market participants, and thereby seeks to benefit all market participants by encouraging more members to provide liquidity to the Exchange. Likewise, the EHIP, and the proposed modifications to the EHIP, are consistent with the Act's requirement for the equitable allocation of reasonable dues, fees, and other charges. Members that choose to significantly increase the volume of EHIP-eligible liquidity-providing orders that they submit to NASDAQ would be benefitting all investors, and therefore providing credits to such members, as contemplated in the proposed modified program, is equitable. Although the liquidity-provision requirements of the program are being reduced, NASDAQ believes that the modification may increase the overall level of liquidity provision by encouraging more members to participate. Moreover, NASDAQ believes that the level of the credit—\$0.0002 per share, in addition to credits ranging from \$0.0020 to \$0.00295 per share for displayed liquidity under NASDAQ's regular transaction execution fee and rebate schedule—is reasonable. NASDAQ further notes that by modifying the EHIP, NASDAQ is effectively reducing fees for members qualifying for the modified tier without making any offsetting fee increases.

With respect to the amendment to the rebate tiers in Rule 7018 for members active on both the NASDAQ Market Center and the NASDAQ Options Market, NASDAQ has noted in its prior

<sup>10</sup> Rule 7018(a) governs executions of securities priced at \$1 or more. Fees and rebates applicable to securities priced under \$1 are unchanged.

<sup>11</sup> "Consolidated Volume" is defined as "the total consolidated volume reported to all transaction reporting plans by all exchanges and trade reporting facilities."

<sup>12</sup> 15 U.S.C. 78f.

<sup>13</sup> 15 U.S.C. 78f(b)(4) and (5).

filings with regard to these tiers that they are responsive to the convergence of trading in which members simultaneously trade different asset classes within a single strategy.<sup>14</sup> NASDAQ also notes that cash equities and options markets are linked, with liquidity and trading patterns on one market affecting those on the other. Accordingly, pricing incentives that encourage market participant activity in both markets recognize that activity in the options markets also supports price discovery and liquidity provision in the NASDAQ Market Center.

NASDAQ believes that the modifications to the tiers are reasonable because by reducing the levels of Nasdaq Options Market activity required to qualify for the tiers, the change will ensure that the tiers remain accessible by a range of market participants, despite reduced trading volumes in options markets. NASDAQ further believes that the change is consistent with an equitable allocation of fees because it will provide for the continued availability of pricing incentives designed to benefit the market by encouraging liquidity provision. Finally, NASDAQ believes that the modified tiers are not unreasonably discriminatory, because the change provides for continued availability of the incentive offered through the tiers without modifying other rebate tiers that provide alternative means to achieve the same rebate levels but without use of the NASDAQ Options Market.

Finally, NASDAQ 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, NASDAQ 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. NASDAQ believes that the proposed rule change reflects this competitive environment because the changes are intended to increase the availability of rebates that are designed to attract liquidity and thereby enhance NASDAQ's market quality.

#### *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. Because the market for order execution is extremely competitive, members may readily opt to disfavor NASDAQ's execution services if they believe that alternatives offer them better value. For this reason and the reasons discussed in connection with the statutory basis for the proposed rule change, NASDAQ does not believe that the proposed changes will impair the ability of members or competing order execution venues to maintain their competitive standing in the financial markets. In fact, because the proposed changes increase the availability of rebates, NASDAQ believes that the changes will enhance the degree of competition between NASDAQ and other trading venues.

#### *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)(ii) of the Act.<sup>15</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. 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](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2012-047 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2012-047. 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 a.m. and 3 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-2012-047 and should be submitted on or before May 2, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>16</sup>

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

[FR Doc. 2012-8712 Filed 4-10-12; 8:45 am]

**BILLING CODE 8011-01-P**

<sup>14</sup> Securities Exchange Act Release No. 64003 (March 2, 2011), 76 FR 12784 (March 8, 2011) (SR-NASDAQ-2011-028); Securities Exchange Act Release No. 59879 (May 6, 2009), 74 FR 22619 (May 13, 2009) (SR-NASDAQ-2009-041).

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

<sup>16</sup> 17 CFR 200.30-3(a)(12).