

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-66951; File No. SR-NASDAQ-2012-055]

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Institute an Excess Order Fee

May 9, 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 April 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 the Substance of the Proposed Rule Change

NASDAQ proposes to institute an excess order fee. NASDAQ will implement the proposed change on June 1, 2012. The text of the proposed rule change is available at <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 III 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 is concerned that the inefficient order entry practices of certain market participants may be placing excessive burdens on the

systems of NASDAQ and its members and may negatively impact the usefulness and life cycle cost of market data.<sup>3</sup> Market participants that flood the market with orders that are rapidly cancelled or that are priced away from the inside market do little to support meaningful price discovery, and in fact may create investor confusion about the extent of trading interest in a stock. In extreme instances, inefficient order entry may constitute “layering,” the manipulative practice of using multiple orders at different price levels to move the price of a stock. While NASDAQ has an active program to detect and prosecute manipulative schemes, including layering,<sup>4</sup> it also believes that market quality can be improved through the imposition of a fee on market participants that engage in extremely inefficient order entry practices. Because NASDAQ believes that inefficient order entry is a problem associated with a relatively small number of market participants, and is therefore not a pervasive characteristic of today’s markets, the impact of the fee will be narrow. In fact, it is NASDAQ’s expectation that the fee will encourage potentially affected market participants to modify their order entry practices in order to avoid the fee, thereby improving the market for all participants. Accordingly, NASDAQ does not expect to earn significant revenues from the fee.

The fee will be imposed on market participant identifiers (“MPID”) that have characteristics indicative of inefficient order entry practices. In general, the determination of whether to impose the fee on a particular MPID will be made by calculating the ratio between (i) entered orders, weighted by the distance of the order from the national best bid or offer (“NBBO”), and (ii) orders that execute in whole or in

part. The fee is imposed on MPIDs with an “Order Entry Ratio” of more than 100. The Order Entry Ratio is calculated, and the Excess Order Fee imposed, on a monthly basis.

For each MPID, the Order Entry Ratio is the ratio of (i) the MPID’s “Weighted Order Total” to (ii) the greater of one (1) or the number of displayed, non-marketable orders<sup>5</sup> sent to NASDAQ through the MPID that execute in full or in part.<sup>6</sup> The Weighted Order Total is the number of displayed, non-marketable orders sent to NASDAQ through the MPID, as adjusted by a “Weighting Factor.” The applicable Weighting Factor is applied to each order based on its price in comparison to the NBBO at the time of order entry:

Order’s price versus NBBO at entry	Weighting factor
Less than 0.20% away .....	0x
0.20% to 0.99% away .....	1x
1.00% to 1.99% away .....	2x
2.00% or more away .....	3x

Thus, in calculating the Weighted Order Total, an order that was more than 2.0% away from the NBBO would be equivalent to three orders that were 0.50% away. Due to the applicable Weighting Factor of 0x, orders entered less than 0.20% away from the NBBO would not be included in the Weighted Order Total, but would be included in the “executed” orders component of the Order Entry Ratio if they execute in full or part. Orders sent by market makers in securities in which they are registered, through the MPID applicable to the registration, are excluded from both components of the ratio.<sup>7</sup> In addition, MPIDs with a daily average Weighted Order Total of less than 100,000 during the month will not be subject to the Excess Order Fee.<sup>8</sup>

<sup>5</sup> The fee focuses on displayed orders since they have the most significant impact on investor confusion and the quality of market data.

<sup>6</sup> Thus, in an extreme case where no orders entered through the MPID executed, this component of the ratio would be assumed to be 1, so as to avoid the impossibility of dividing by zero.

<sup>7</sup> This is the case because market makers are already subject to rule-based standards designed to promote the efficiency and quality of their order entry practices. See Rule 4613. Although Rule 4613 allows market makers to quote at spreads much wider than 2%, NASDAQ’s assessment of market maker performance has led it to conclude that market makers do not generally engage in the inefficient practices at which the new fee is aimed. NASDAQ will continually assess this data and revisit the applicability of the fee to market makers and/or the requirements of Rule 4613 as needed to promote efficient quotation practices by market makers.

<sup>8</sup> NASDAQ believes that this exclusion is reasonable because an MPID with an extremely low volume of entered orders has only a *de minimis* impact on the market.

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

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

<sup>3</sup> See generally Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010, Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues, at 11 (February 18, 2011) (“The SEC and CFTC should also consider addressing the disproportionate impact that [high frequency trading] has on Exchange message traffic and market surveillance costs \* \* \*. The Committee recognizes that there are valid reasons for algorithmic strategies to drive high cancellation rates, but we believe that this is an area that deserves further study. At a minimum, we believe that the participants of those strategies should properly absorb the externalized costs of their activity.”).

<sup>4</sup> See, e.g., FINRA Sanctions Trillium Brokerage Services, LLC, Director of Trading, Chief Compliance Officer, and Nine Traders \$2.26 Million for Illicit Equities Trading Strategy (September 13, 2010) (available at <http://www.finra.org/Newsroom/NewsReleases/2010/P121951>). The fee proposed in this filing will not in any way substitute for, or result in a diminution of, NASDAQ’s surveillance program for market manipulation.

The following example illustrates the calculation of the Order Entry Ratio:

- A member enters 35,000,000 displayed, liquidity-providing orders:
  - o The member is registered as a market maker with respect to 20,000,000 of the orders. These orders are excluded from the calculation.
  - o 10,000,000 orders are entered at the NBBO. The Weighting Factor for these orders is 0x.
  - o 5,000,000 orders are entered at a price that is 1.50% away from the NBBO. The Weighting Factor for these orders is 2x.

- Of the 15,000,000 orders included in the calculation, 90,000 are executed.
- The Weighted Order Total is  $(10,000,000 \times 0) + (5,000,000 \times 2) = 10,000,000$ . The Order Entry Ratio is  $10,000,000/90,000 = 111$

If an MPID has an Order Entry Ratio of more than 100, the amount of the Order Entry Fee will be calculated by determining the MPID's "Excess Weighted Orders." Excess Weighted Orders are calculated by subtracting (i) the Weighted Order Total that would result in the MPID having an Order Entry Ratio of 100 from (ii) the MPID's actual Weighted Order Total. In the example above, the Weighted Order Total that would result in an Order Entry Ratio of 100 is 9,000,000, since  $9,000,000/90,000 = 100$ . Accordingly, the Excess Weighted Orders would be  $10,000,000 - 9,000,000 = 1,000,000$ .

The Excess Order Fee charged to the member will then be determined by multiplying the "Applicable Rate" by the number of Excess Weighted Orders. The Applicable Rate is determined based on the MPID's Order Entry Ratio:

Order entry ratio	Applicable rate
101–1,000 .....	\$0.005
More than 1,000 .....	0.01

In the example above, the Applicable Rate would be \$0.005, based on the MPID's Order Entry Ratio of 111. Accordingly, the monthly Excess Order Fee would be  $1,000,000 \times \$0.005 = \$5,000$ .

## 2. Statutory Basis

NASDAQ believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>9</sup> in general, and with Sections 6(b)(4) and 6(b)(5) of the Act,<sup>10</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, is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

NASDAQ believes that the Order Entry Fee is reasonable because it is designed to achieve improvements in the quality of displayed liquidity and market data that will benefit all market participants. In addition, although the level of the fee may theoretically be very high, the fee is reasonable because market participants may readily avoid the fee by making improvements in their order entry practices that reduce the number of orders they enter, bring the prices of their orders closer to the NBBO, and/or increase the percentage of their orders that execute. For similar reasons, the fee is consistent with an equitable allocation of fees, because although the fee may apply to only a small number of market participants, the fee would be applied to them in order to encourage better order entry practices that will benefit all market participants. Ideally, the fee will be applied to no one, because market participants will adjust their behavior in order to avoid the fee. Finally, NASDAQ believes that the fee is not unfairly discriminatory. Although the fee may apply to only a small number of market participants, it will be imposed because of the negative externalities that such market participants impose on others through inefficient order entry practices. Accordingly, NASDAQ believes that it is fair to impose the fee on these market participants in order to incentivize them to modify their behavior and thereby benefit the market.

Finally, NASDAQ believes that the fee will help to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest, because the fee is designed to reduce the extent of non-actionable orders in the market, thereby promoting greater order interaction, increasing the quality of market data, and inhibiting potentially abusive trading practices.

## 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. Specifically, NASDAQ believes that the fee will constrain market participants from pursuing certain inefficient and potentially abusive trading strategies. To the extent that this change may be construed as a burden on competition, NASDAQ believes that it is appropriate in order to further the purposes of Section 6(b)(5) of the Act.<sup>11</sup>

## 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>12</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–2012–055 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–2012–055. This file number should be included on the subject line if email is used.

<sup>9</sup> 15 U.S.C. 78f.

<sup>10</sup> 15 U.S.C. 78f(b)(4) and (5).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

<sup>12</sup> 15 U.S.C. 78s(b)(3)(a)(ii) [sic].

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 on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal offices 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-2012-055, and should be submitted on or before June 5, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

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

[FR Doc. 2012-11699 Filed 5-14-12; 8:45 am]

BILLING CODE 8011-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-66950; File No. SR-EDGA-2012-17]

### Self-Regulatory Organizations; EDGA Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Amending Certain Sections of Its Current Bylaws

May 9, 2012.

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 April 25, 2012, EDGA Exchange, Inc. (the "Exchange" or "EDGA") 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

The Exchange proposes to amend certain sections of the Amended and Restated Bylaws of EDGA Exchange, Inc. (the "Current Bylaws") to conform with the Exchange's current corporate governance practices. The text of the proposed rule change is attached as Exhibit 5 and is available on the Exchange's Web site at [www.directedge.com](http://www.directedge.com), at the Exchange's principal office, and at the Public Reference Room of the Commission.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in Sections A, B and C below, of the most significant aspects of such statements.

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

###### 1. Purpose

The Exchange proposes to amend certain sections of the Current Bylaws to conform with the Exchange's current corporate governance practices. In addition, the Exchange proposes to address other non-substantive revisions to reflect changes since the Securities and Exchange Commission (the "SEC" or the "Commission") granted the Exchange's registration as a national securities exchange in March 2010.<sup>3</sup>

###### Board of Directors

Article III, Section 5 of the Current Bylaws state that the Chief Executive Officer shall also be the Chairman of the Board of Directors (the "Board"). The Exchange proposes to revise this provision in the New Bylaws to state, "[t]he Directors shall choose among themselves who will be the Chairman of the Board (the "Chairman"), who may

also be the Chief Executive Officer," because the Exchange believes separating the two roles is a good corporate governance practice and provides the Board additional flexibility when determining the Chairman. In addition, the Exchange proposes to add clarifying language that states that if the Chief Executive Officer or other member of management of the Exchange is the Chairman, then he or she shall not participate in executive sessions of the Board. The Exchange believes this amendment helps to preserve the purpose of the executive session, which is for the Board to meet without the Exchange's management present. Similarly, the Exchange proposes to make a conforming amendment to Article VII, Section 6, to provide that the Chief Executive Officer may be the Chairman of the Board.

###### Committees of the Board

The Exchange's Board consists of an Appeals Committee, an Audit Committee, a Compensation Committee, an Executive Committee and a Regulatory Oversight Committee (collectively, the "Board Committees"). In Article V, the Exchange proposes to amend the Current Bylaws to more fully describe the responsibilities of the Board Committees and to be consistent with the provisions of the Board Committees' charters.

In Article V, Section 5(a), the Exchange proposes to amend the Current Bylaws to state that the Compensation Committee is also responsible for assisting the Board in fulfilling its responsibilities to ensure the structures of compensation systems of the Exchange do not interfere with the Exchange's ability to fulfill its responsibilities as a Self Regulatory Organization ("SRO").

In Article V, Section 5(b) (proposed to be re-numbered as Section 5(b)(i)-(vii)), the Exchange proposes to amend the Current Bylaws to state that the Audit Committee is also responsible for assisting the Board in fulfilling its responsibilities to oversee the financial soundness and compliance resources and the effectiveness of financial and compliance control processes related to the operation of the Exchange; taking appropriate actions to oversee overall corporate policy for quality activities and reporting of a SRO, sound business risk management practices and ethical behavior; overseeing all activities of the Exchange's internal audit function, including management's responsiveness to internal audit recommendations and selecting and replacing and determining the compensation of the head of the Internal Audit Department (or if such

<sup>13</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.

<sup>3</sup> See Securities and Exchange Act Release No. 61698 (March 12, 2010), 75 FR 13151 (March 18, 2010).