



SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-71418; File No. SR-NASDAQ-2014-008]

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Inbound Routing of Options Orders

January 28, 2014.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹, and Rule 19b-4 thereunder,² notice is hereby given that on January 15, 2014, The NASDAQ Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to permit the NASDAQ Options Market (“NOM”) to receive inbound orders in options routed through Nasdaq Execution Services, LLC (“NES”) from affiliated exchanges, as described in detail below.

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The purpose of the filing is to permit the receipt of inbound orders routed from affiliated exchanges in options through NES. The Exchange filed a proposed rule change to use NES rather than Nasdaq Options Services LLC ("NOS") for the outbound routing of options orders and the Exchange also updated its equities and options rules to reflect the use of a third party unaffiliated routing broker.³

Now, the Exchange proposes to continue to receive orders from its affiliated exchanges. Specifically, the Exchange proposes to receive options orders, through NES directly from the options market of NASDAQ OMX PHLX LLC ("PHLX")⁴ as well as from NASDAQ OMX BX, Inc. ("BX"),⁵ under the same terms and conditions as NOS currently does. BX and PHLX have filed to use NES for outbound routing,⁶ as well as to receive options orders routed from

³ See SR-NASDAQ-2014-007.

⁴ Securities Exchange Act Release No. 58135 (July 10, 2008), 73 FR 40898 (July 16, 2008) (SR-NASDAQ-2008-061).

⁵ Securities Exchange Act Release No. 67256 (June 26, 2012), 77 FR 39277 (July 2, 2012) (SR-BX-2012-030).

⁶ See SR-BX-2014-003 and SR-Phlx-2014-004.

PHLX through NES.⁷

NOS and NES are broker-dealers and members of NASDAQ, PHLX and BX. Currently, NOS provides all options routing functions for BX Options, PHLX, and NOM. BX, NASDAQ, NOM, PHLX, NES and NOS are affiliates.⁸ Accordingly, the affiliate relationship between NASDAQ and NOS, its member, raises the issue of an exchange's affiliation with a member of such exchange. Specifically, in connection with prior filings, the Commission has expressed concern that the affiliation of an exchange with one of its members raises the potential for unfair competitive advantage and potential conflicts of interest between an exchange's self-regulatory obligations and its commercial interests.⁹ Similarly, under this proposal, the affiliate relationship between NASDAQ and NES raises this issue.

Recognizing that the Commission has previously expressed concern regarding the potential for conflicts of interest in instances where a member firm is affiliated with an exchange of which it is a member, the Exchange previously proposed, and the Commission approved, limitations and conditions on NOS's affiliation with the Exchange. Also recognizing that the Commission has expressed concern regarding the potential for conflicts of interest in instances where a member firm is affiliated with an exchange to which it is routing orders, the Exchange

⁷ See SR-BX-2014-004 and SR-Phlx-2014-005.

⁸ See Securities Exchange Act Release Nos. 58324 (August 7, 2008), 73 FR 46936 (August 12, 2008) (SR-BSE-2008-02; SR-BSE-2008-23; SR-BSE-2008-25; SR-BSECC-2008-01) (order approving NASDAQ OMX's acquisition of BX); and 58179 (July 17, 2008), 73 FR 42874 (July 23, 2008) (order approving NASDAQ OMX's acquisition of PHLX).

⁹ See Securities Exchange Act Release Nos. 59153 (December 23, 2008), 73 FR 80485 (December 31, 2008) (SR-NASDAQ-2008-098); and 62736 (August 17, 2010), 75 FR 51861 (August 23, 2010) (SR-NASDAQ-2010-100). See also Securities Exchange Act Release No. 58135 (July 10, 2008), 73 FR 40898 (July 16, 2008) (SR-NASDAQ-2008-061) (Permitting NOS to be affiliated with PHLX).

previously proposed, and the Commission approved,¹⁰ NOS's affiliation with the Exchange to permit the Exchange to accept inbound orders that NOS routes in its capacity as a facility of PHLX and BX, subject to certain limitations and conditions. The Exchange now proposes to permit NOM to accept inbound options orders that NES (rather than NOS) routes in its capacity as a facility of PHLX and BX, subject to the same limitations that currently apply to NOM accepting inbound orders from PHLX and BX through NOS, as follows:

- First, the Exchange and FINRA maintain a Regulatory Contract, as well as an agreement pursuant to Rule 17d-2 under the Act ("17d-2 Agreement").¹¹

Pursuant to the Regulatory Contract and the 17d-2 Agreement, FINRA will be allocated regulatory responsibilities to review NES's compliance with certain Exchange rules.¹² Pursuant to the Regulatory Contract, however, NASDAQ retains ultimate responsibility for enforcing its rules with respect to NES.
- Second, FINRA will monitor NES for compliance with the Exchange's trading rules, and will collect and maintain certain related information.¹³

¹⁰ See Securities Exchange Act Release Nos. 58135 (July 10, 2008), 73 FR 40898 (July 16, 2008)(SR-NASDAQ-2008-061); and 69755 (June 13, 2013), 78 FR 36800 (June 19, 2013) (SR-NASDAQ-2013-070).

¹¹ 17 CFR 240.17d-2.

¹² NES is also subject to independent oversight by FINRA, its designated examining authority, for compliance with financial responsibility requirements.

¹³ Pursuant to the Regulatory Contract, both FINRA and the Exchange will collect and maintain all alerts, complaints, investigations and enforcement actions in which NES (in its capacity as a facility of PHLX and BX routing orders to NOM) is identified as a participant that has potentially violated applicable Commission or Exchange rules. The Exchange and FINRA will retain these records in an easily accessible manner in order to facilitate any potential review conducted by the Commission's Office of Compliance Inspections and Examinations.

- Third, FINRA will provide a report to the Exchange's chief regulatory officer ("CRO"), on a quarterly basis, that: (i) Quantifies all alerts (of which FINRA is aware) that identify NES as a participant that has potentially violated Commission or Exchange rules, and (ii) lists all investigations that identify NES as a participant that has potentially violated Commission or Exchange rules.
- Fourth, the Exchange has in place NASDAQ 2140(c) which requires The NASDAQ OMX Group, Inc., as the holding company owning both the Exchange and NES, to establish and maintain procedures and internal controls reasonably designed to ensure that NES does not develop or implement changes to its system, based on non-public information obtained regarding planned changes to the Exchange's systems as a result of its affiliation with the Exchange, until such information is available generally to similarly situated Exchange members, in connection with the provision of inbound order routing to the Exchange.

By meeting the above conditions, the Exchange will have set up mechanisms that protect the independence of the Exchange's regulatory responsibility with respect to NES, as well as demonstrate that NES cannot use any information advantage it may have because of its affiliation with the Exchange.

For several weeks, the Exchange has been working with the Financial Regulatory Authority ("FINRA") and The Options Clearing Corporation ("OCC") to secure the necessary approvals for NES to perform these functions. The Exchange has now secured those approvals. The Exchange seeks to complete this process and implement this proposal in January or February.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act¹⁴ in general, and furthers the objectives of Section 6(b)(5) of the Act¹⁵ in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest, because the proposed rule change will allow the Exchange to continue to receive inbound orders from an affiliate (NES rather than NOS), acting in its capacity as a facility of PHLX and BX, in a manner consistent with prior approvals and established protections. The Exchange believes that these conditions establish mechanisms that protect the independence of the Exchange's regulatory responsibility with respect to NES, as well as ensure that NES cannot use any information it may have because of its affiliation with the Exchange to its advantage.

(B) Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Receiving orders through NES rather than NOS does not raise any issues of intra-market competition because it involves inbound routing from an affiliated exchange. Nor does it result in a burden on competition among exchanges, because there are many competing options exchanges that provide routing services, including through an affiliate.

¹⁴ 15 U.S.C. 78f(b).

¹⁵ 15 U.S.C. 78f(b)(5).

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

No written comments were either solicited or received.

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

Because the foregoing proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act¹⁶ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹⁷

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) Necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

IV. Solicitation of Comments

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

¹⁶ 15 U.S.C. 78s(b)(3)(a)(ii).

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

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2014-008 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-2014-008. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer

to File Number SR-NASDAQ-2014-008 and should be submitted on or before [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁸

Kevin M. O'Neill,
Deputy Secretary.

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¹⁸ 17 CFR 200.30-3(a)(12).