SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Approving a Proposed Rule Change To Amend Rule 4758

December 21, 2015.

I. Introduction

On September 21, 2015, The NASDAQ Stock Market LLC (“NASDAQ” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) \(^1\) and Rule 19b–4 thereunder, \(^2\) a proposed rule change to adopt a new routing option, the Retail Order Process (“RTFY”). The proposed rule change was published for comment in the Federal Register on October 1, 2015. \(^3\) The Commission received two comment letters on the proposed rule change \(^4\) and a response letter from NASDAQ. \(^5\) On November 3, 2015, the Commission extended the time period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change, to December 30, 2015. \(^6\) NASDAQ subsequently submitted a second response letter. \(^7\) This order approves the proposed rule change.

II. Description of the Proposal

NASDAQ is proposing to amend Rule 4758 to add a new order routing option—RTFY—for Designated Retail Orders (“DROs”). \(^8\) NASDAQ states that retail order firms \(^9\) often send non-marketable order flow to post and display on exchanges. However, some orders that have been deemed to be non-marketable by the entering firm become marketable by the time the exchange receives them. \(^10\) NASDAQ notes that these orders ultimately remove liquidity from the NASDAQ order book even though the firm entering the order did not intend them to remove liquidity. \(^11\)

Under the proposal, a DRO that is marketable upon receipt by NASDAQ and that elects to follow the RTFY routing option will be routed to destinations in the System routing table instead of immediately removing liquidity from the Exchange order book—unless explicitly instructed by the entering party to check the Exchange order book first. \(^12\) RTFY orders may remove liquidity from the Exchange book after routing to other destinations. \(^13\) All non-marketable RTFY orders will post on the Exchange book. \(^14\)

According to NASDAQ, the destinations in the System routing table for RTFY will include OTC market makers, \(^15\) which may also be registered NASDAQ market makers. \(^16\) NASDAQ believes these market makers will likely provide the greatest opportunity for price improvement for the DROs, and the RTFY routing option will benefit DROs by providing additional price improvement opportunities for retail investors. \(^17\) NASDAQ anticipates that the RTFY routing option will route to trading centers in the System routing table that have experience executing and providing price improvement to DROs. \(^18\)

As proposed, an order using the RTFY routing option will be sent to the primary listing exchange for opening, reopening, and closing auctions. \(^19\) Orders received in NASDAQ-listed securities prior to market open that are not eligible for the pre-market session will be submitted to the primary listing market for inclusion in that market’s opening process. \(^20\) Orders received in NASDAQ-listed securities prior to market open that are not eligible for the pre-market session will follow normal pre-market processing. \(^21\) Orders received prior to the market open that are eligible for the pre-market session will be posted—and routed if

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\(^{2}\) See letter from Jonathan F. Cayne, Senior Associate General Counsel, NASDAQ to Brent J. Fields, Secretary, Commission, dated October 6, 2015 (“NASDAQ Response”).

\(^{3}\) See letter from Jonathan F. Cayne, Senior Associate General Counsel, NASDAQ to Brent J. Fields, Secretary, Commission, dated October 22, 2015 (“NASDAQ Letter”).


\(^{9}\) See letter from Jonathan F. Cayne, Senior Associate General Counsel, NASDAQ to Brent J. Fields, Secretary, Commission, dated October 22, 2015 (“NASDAQ Response”).
marketable—for potential execution. Approximately two minutes prior to market open, active pre-market session orders in the Exchange’s possession will be routed to the primary listing exchange. When a security that is listed on an exchange other than NASDAQ is halted, RTFY orders—including RTFY orders received during the halt—will be sent to the primary listing exchange for inclusion in that exchange’s reopening process. All RTFY orders will be sent to the primary listing exchange approximately two minutes prior to that exchange’s closing process.

In its proposal, NASDAQ notes that the RTFY routing option is similar to the existing TFTY routing option. NASDAQ specifically notes that orders using the TFTY routing option do not check the NASDAQ book—unless so instructed by the entering firm—for available shares, and instead route to the TFTY destinations on the System routing table with the goal of executing with lower transaction fees. NASDAQ states that the RTFY routing option differs from TFTY in three ways: (i) RTFY is only available to DROs; (ii) RTFY uses a separate and distinct routing table; and (iii) RTFY orders will be sent to the primary listing exchange for opening, reopening, and closing auctions.

NASDAQ notes that there are several alternatives to using an Exchange routing strategy. NASDAQ also notes that it offers multiple routing options, that each routing option has its own set of strengths and trade-offs, and that these varying routing strategies are designed to meet varying market participants’ needs. NASDAQ believes the RTFY routing option will meet the needs of the retail order firms that opt to use it based on their routing technology, business model, or level of retail order flow.

NASDAQ states that the RTFY routing table will be monitored and approved by a best execution committee (“Committee”). NASDAQ states that the Committee determines how to organize the System routing table and which trading destinations are included in the routing table by reviewing various parameters, such as price improvement, fill rate, latency, interaction rate, experience of the execution venue operator, and the volume the execution venue handles on a daily basis. NASDAQ notes that the parameters considered by the Committee evolve over time; often resulting in new parameters being considered.

NASDAQ states that neither the Exchange, nor any of its affiliates, will accept payment for order flow from any OTC market maker to which an RTFY order is sent. If the trading venue pays a standard rebate for DROs to all of its subscribers or another exchange pays a rebate to remove liquidity, NASDAQ will accept and retain those rebates. However, NASDAQ expects that most, if not all, orders routed using the RTFY routing option will be sent to and executed by an OTC market maker that may also be a registered NASDAQ market maker.

III. Comment Summary and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, 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.

The Commission received two comment letters opposing the proposal, as well as a response and a supplemental response from NASDAQ. The commenters express concern that RTFY is designed to allow leakage of order flow information. The Commission notes that, in response, NASDAQ states that this claim is factually incorrect and is speculation. NASDAQ reiterates that RTFY is designed to enhance execution quality and benefit retail investors by providing price improvement opportunities to retail order flow. According to NASDAQ, it will use the Committee to review and determine the structure and destinations of the System routing table, and if the Committee observes that a particular destination is not providing sufficient price improvement, the destination will have to improve or be dropped from the System routing table. NASDAQ also notes that RTFY is a voluntary routing type, and retail orders may not use RTFY if it fails to benefit their clients. Moreover, NASDAQ notes that retail investors have a choice when routing their orders and it is up to them to determine whether they will use a broker-provided router or send their orders directly to a particular destination.

The commenters also express concerns related to best execution. Specifically, one commenter questions whether retail investors will forgo their marketable orders interacting with the NBBO in favor of an “imbalanced” price improvement at OTC market makers. This commenter expresses concern that RTFY could result in a failure to obtain best execution, specifically in situations where NASDAQ was at the NBBO when a marketable retail order that has elected the RTFY routing option was received, NASDAQ routes the marketable retail order away but the order does not execute on the away destinations, and by the time the order comes back to NASDAQ, the NBBO has moved so that the retail order is no longer marketable and posts to the book instead of executing. In addition, both commenters express concerns regarding the transparency of the RTFY routing.
In response, NASDAQ states its belief that providing additional price improvement opportunities for retail investors is a “critical component of its best execution obligations.” In its supplemental response letter, NASDAQ states that, in all routing of orders, when one routing destination is chosen over another, there is always a possibility that an execution will be missed. The Committee notes, however, that NASDAQ believes that any chance of an RTFY order missing a better price at the Exchange is “miniscule.” The Committee notes that, according to NASDAQ, some routing destinations agree to a guaranteed minimum price improvement per share for RTFY orders, some focus more on the average price improvement, and others are unsure of what the level of price improvement will be, but provide assurances that they will compete vigorously with their execution quality. Consequently, NASDAQ believes that the competition for RTFY orders, and thus the resulting execution quality, will be better than what is experienced today.

The Committee notes that, with respect to commenters’ concerns regarding the RTFY routing table and the Committee, NASDAQ states that—as with all other routing options, other than Directed Orders—the RTFY routing table will be monitored and approved by the Committee. According to NASDAQ, the use of a best execution committee is not novel, and such committees are widely-used at many broker-dealers. In addition, the Committee is subject to FINRA oversight, as well as oversight by NASDAQ Inc.’s internal audit group, which reports to the audit committee of the Board of Directors of NASDAQ Inc. According to NASDAQ, the Committee reviews the performance of routing destinations on a regular basis for all routing and the same will be true for RTFY. If the Committee determines that a particular routing destination is underperforming based on the various parameters, such as price improvement, fill rate, and latency, the Committee may either remove that destination altogether or lower its priority within the routing table. According to NASDAQ, this process ensures that these destinations will compete aggressively with each other in order to receive RTFY orders.

Based on the foregoing, the Committee believes that the proposed rule change is consistent with the Act.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR–NASDAQ–2015–112) be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.\n
Brent J. Fields, Secretary.

[FR Doc. 2015–32527 Filed 12–24–15; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations; Miami International Securities Exchange LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend Its Fee Schedule

December 21, 2015.

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)\(^1\) and Rule 19b–4\(^2\)

\(^{1}\) See NASDAQ Supplemental Response, supra note 7, at 2.
\(^{2}\) See id. NASDAQ notes that missed executions often may be due to latency in away destinations systems. See id. at 3. According to NASDAQ, because latency is one of the parameters that the Committee considers in its regular reviews of routing destinations, destinations causing undue latency that may lead to missed executions or inferior execution prices would lose their priority within the routing table or be removed altogether. See id. NASDAQ also notes that, if the Committee determines that a particular routing destination is not providing sufficient price improvement opportunities, then that destination will likely be removed from the RTFY routing table. See NASDAQ Supplemental Response, supra note 7, at 2. NASDAQ states that, in the past, the Committee has moved venues down within the routing table due, in part, to unsatisfactory fill rate, unsatisfactory price improvement, and/or unsatisfactory latency profile. See id.


\(^{6}\) See Exchange Rule 515A(a)(2)(ii). When the Exchange receives a properly designated Agency Order for auction processing, a Request for Responses (“RFR”) detailing the option, side, size, and initiating price will be sent to all subscribers of the Exchange’s data feeds. Members may submit

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