

**JOAN CONLEY**  
SENIOR VICE PRESIDENT  
& CORPORATE SECRETARY  
805 KING FARM BLVD  
ROCKVILLE, MD 20850  
**P:** +1 301 978 8735  
**E:** [joan.conley@nasdaqomx.com](mailto:joan.conley@nasdaqomx.com)

February 24, 2012

Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549

File No: ***SR-NASDAQ-2011-010 and SR-CBOE-2012-008***

Dear Ms. Murphy,

The NASDAQ OMX Group, Inc. (“NASDAQ”) is the largest global operator of free markets, including two U.S. options markets that compete directly with the Chicago Board Options Exchange (“CBOE”).<sup>1</sup> As such, NASDAQ adheres to the free market principle that prices are better set by market forces than by the government. Consistent with that principle, NASDAQ is commenting on SR-CBOE-2012-008 (“CBOE Pricing Proposal”)<sup>2</sup> not to oppose or disrupt CBOE’s pricing but to highlight the potential inconsistency with the government’s disapproval of SR-NASDAQ-2011-010 a proposal of The NASDAQ Stock Market LLC, NASDAQ’s largest U.S. equity market.<sup>3</sup>

NASDAQ Platform Pricing offers a member discounts from previously filed fees for purchasing a substantial volume of market data for non-professional (retail) users, and also directing substantial liquidity to the exchange. The Division of Trading and Markets issued an order suspending Platform Pricing<sup>4</sup> and a second order disapproving it.<sup>5</sup> The

---

<sup>1</sup> NASDAQ operates The NASDAQ Options Market LLC (“NOM”) and NASDAQ OMX PHLX, Inc. (“PHLX”).

<sup>2</sup> See Securities Exchange Act Release No. 34-66277 (Jan. 30, 2012) (“CBOE Pricing Proposal”).

<sup>3</sup> See Securities Exchange Act Release No. 34-63745, 76 Fed. Reg. 4970 (Jan. 27, 2011); (“NASDAQ Platform Pricing”).

<sup>4</sup> See Securities Exchange Act Release No. 34-63796, 76 Fed. Reg. 6,165 (Feb. 3, 2011) (SR-NASDAQ-2011-010) (Suspension of and Order Instituting Proceedings to Determine Whether to

*continued*

Disapproval Order concluded that the "linking of market data fees to execution volume, and the linking of transaction credits to market data purchases, will...negatively impact the competition that exists today in these two markets." NASDAQ timely filed a Petition for Review of the Disapproval Order, which remains pending.<sup>6</sup>

NASDAQ is struggling to reconcile the anti-linking statements contained in the Disapproval Order with a similar pricing link contained in the CBOE Pricing Proposal. Specifically, the CBOE Proprietary Product Sliding Scale allows certain CBOE members to pay reduced execution fees for trading single-listed CBOE proprietary products if they reach set volume thresholds in trading multiple-listed options. Like NASDAQ Platform Pricing, CBOE's Proprietary Products Sliding Scale offers members discounts from previously filed prices if they purchase substantial quantities of two linked products. Unlike, NASDAQ Platform Pricing, CBOE filed no empirical evidence showing that the markets for the linked products are competitive.

Without empirical evidence, it is difficult or impossible for the Commission or market participants meaningfully to analyze the CBOE Pricing Proposal. The Disapproval Order was devoid of empirical support for its conclusions, and it ignored NASDAQ's empirical evidence showing that the markets for data and execution services are robust, and that a voluntary incentive to purchase both services in large quantities therefore cannot be an anti-competitive "tying" arrangement. This is precisely the type of "reasoned" evidence of "competitive forces" that the D.C. Circuit has invited exchanges to submit in support of proposed market data fees. *NetCoalition v. SEC*, 615 F.3d 525, 544 (D.C. Cir. 2010); *see also Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011); *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 167-68 (D.C. Cir. 2010); *Chamber of Commerce v. SEC*, 412 F.3d 133, 136 (D.C. Cir. 2005).

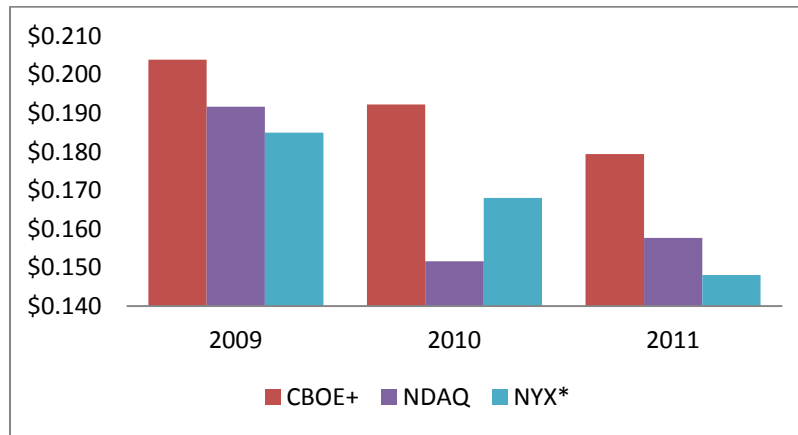
**Background.** Options markets operate in an intensely competitive environment. NASDAQ's and CBOE's ability to attract order flow is driven largely by price competition. NASDAQ OMX's two options exchanges, PHLX and NOM, modify options trading fees monthly or even bi-monthly to attract new order flow, retain existing order flow, and regain order flow lost to competitors' price cuts. In 2011, PHLX and, NOM filed 71 execution fee changes and options exchanges together filed 173 fee changes (excluding market data, connectivity, colocation, and other fees). Fierce competition has lowered options trading costs, benefitting investors and promoting the goals of the Securities Exchange Act of 1934. For example, based on publicly-available data, average revenue per contract has declined for three major options market operators:

---

Approve or Disapprove a Proposed Rule Change to Link Market Data Fees and Transaction Execution Fees) ("Suspension Order").

<sup>5</sup> *See* Securities Exchange Act Release No. 34-63796, 76 Fed. Reg. 59,466 (Sept. 26, 2011) (SR-NASDAQ 2011-010) (Order Disapproving a Proposed Rule Change to Link Market Data Fees and Transaction Execution Fees) ("Disapproval Order").

<sup>6</sup> *See* <http://www.sec.gov/rules/sro/nasdaq/2011/34-65362-petition.pdf> (October 4, 2011.).



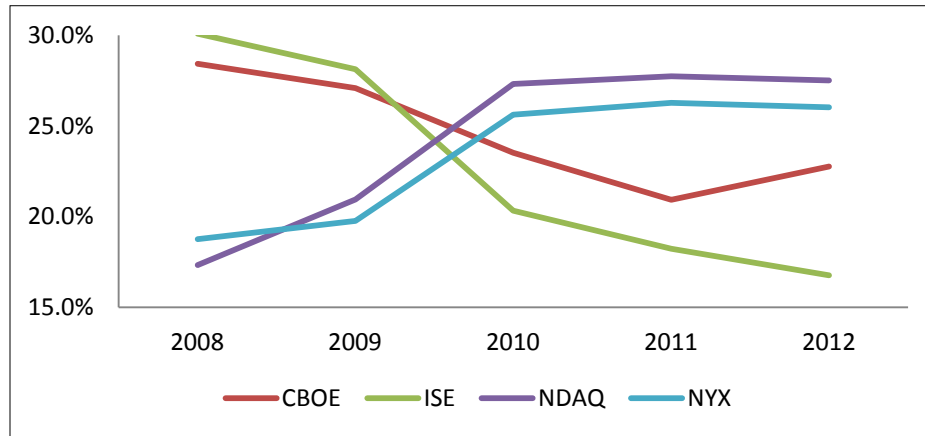
NASDAQ believes the Commission deserves credit for this competition and the resulting price declines; longstanding Commission policies towards trading and market regulation are largely responsible for the strength of current competition.

Given this highly competitive environment for options trading and the attendant benefits to investors, NASDAQ suggests the Commission should curtail its review of pricing-related rule changes that result from and increase competition. Empirical evidence demonstrates that no exchange has market power sufficient to raise prices for competitively-traded options in an unreasonable or unfairly discriminatory manner in violation of the Exchange Act. In actuality, it is *member firms* that control the order flow that options markets compete to attract.<sup>7</sup> Only by attracting members' orders can options exchanges display bids and offers that are the *sine qua non* of trade executions. This "second-order" competition –where competition is driven by customers rather than sellers of a product – is reflected both in the large number of pricing-related rule changes and also in rapid shifts of market share among multiple effective competitors seen on the chart of equity options market share below.

---

<sup>7</sup> Michael Porter, *How Competitive Forces Shape Strategy* (Harvard Business Review, 2009).

*Market Share Changes for Competitively Traded Equity Options*



**CBOE’s Pricing Proposal.** Although the CBOE Pricing Proposal is 88 pages and changes the CBOE fee schedule in several dozen places, NASDAQ’s comment is focused solely on the CBOE Proprietary Product Sliding Scale.<sup>8</sup> The CBOE Proprietary Product

<sup>8</sup> See SR-CBOE-2-012-008 at page 82. The relevant provision (as marked in SR-CBOE-2012-008) states:

**CBOE PROPRIETARY PRODUCTS SLIDING SCALE:** Clearing Trading Permit Holder Proprietary transaction fees and transaction fees for Non-Trading Permit Holder Affiliates (as defined in footnote 11) in OEX, XEO, SPX and volatility indexes (“CBOE Proprietary Products”) in a month will be reduced provided a Clearing Trading Permit Holder reaches certain volume thresholds in multiply-listed options on the Exchange in a month as described below.

The standard Clearing Trading Permit Holder Proprietary transaction fee and transaction fees for Non-Trading Permit Holder Affiliates (as defined in footnote 11) in CBOE Proprietary Products will be reduced to the fees shown in the following table for Clearing Trading Permit Holders that execute at least 375,000 contracts but less than 1,500,000 contracts in multiply-listed options on the Exchange in a month[, excluding contracts executed in AIM that incurred the AIM Execution Fee]:

CBOE Proprietary Contracts

<u>Tiers</u>	<u>Per Month</u>	<u>Rate</u>
First	First 750,000	18 cents
Second	Next 250,000	5 cents
Third	Above 1,000,000	2 cents

The standard Clearing Trading Permit Holder Proprietary transaction fee and transaction fees for Non-Trading Permit Holder Affiliates (as defined in footnote 11) in CBOE Proprietary Products will be further reduced to the fees shown in the following table for Clearing Trading Permit Holders that execute 1,500,000 or more contracts in multiply-listed options on the Exchange in a month[, excluding contracts executed in AIM that incurred the AIM Execution Fee]:

*continued*

Sliding Scale allows CBOE Clearing Trading Permit Holders and their non-trading affiliates to pay reduced execution fees for trading single-listed CBOE proprietary products as they reach certain volume thresholds in trading multiply-listed options. The CBOE proprietary products – OEX, XEO, SPX and Volatility Indexes – are single-listed on CBOE, meaning they are not traded on any competing options exchange.

NASDAQ supports the development of single-listed proprietary products and the ability of exchanges to charge higher fees for trading proprietary products than they charge for trading multiple-listed products. In fact PHLX has single-listed proprietary products (including PHLX Sector Index Options and PHLX World Currency Options) for which it charges increased execution fees. As CBOE persuasively explains in support of its proposed rule change, exchanges invest heavily in developing, promoting, and protecting proprietary products. The right of intellectual property holders to recover the costs of developing unique products is well established and applies with equal force to securities products as to commercial products generally.

Unlike PHLX, CBOE has extended this principle by linking execution fees for single-listed proprietary products to trading volume in multiple-listed products, in effect leveraging its investment in proprietary products to gain market share in trading of multiple-listed options.

Along with ceasing excluding AIM Contra Execution Fees from counting towards the Cap, the Exchange also proposes ceasing excluding contracts executed in AIM that incur the AIM Contra Execution Fee from counting towards the CBOE Proprietary Products Sliding Scale. **Going forward, contracts executed in AIM that incur the AIM Contra Execution Fee will count towards helping a CTPH reach a higher tier in the CBOE Proprietary Products Sliding Scale, and thereby pay lower fees for executions in CBOE proprietary products. The purpose of this change is to improve the Exchange's competitive position. (emphasis added).**<sup>9</sup>

CBOE also notes that the proposed fee change potentially encourages the use of CBOE's price improvement mechanism and brings more liquidity and order interaction to CBOE, two goals that PHLX supports.

---

CBOE Proprietary Contracts

<u>Tiers</u>	<u>Per Month</u>	<u>Rate</u>
First	First 750,000	15 cents
Second	Above 750,000	1 cent

<sup>9</sup> See Securities Exchange Act Release No. 34-66277 (Jan. 30, 2012) at p. 6 (AIM is CBOE's Automated Improvement Mechanism).

NASDAQ has not previously questioned CBOE's authority to link execution fees in single-listed proprietary products to trading volume in multiple-listed products; the CBOE Proprietary Products Sliding Scale has been in effect since March of 2011 without comment from NASDAQ.

***NASDAQ Platform Pricing.*** After CBOE established the Proprietary Products Sliding Scale and before CBOE filed the current Pricing Proposal, the Staff of the Division of Trading and Markets, invoking authority delegated to it by the Commission, issued an order disapproving NASDAQ's proposal to offer members discounts on existing prices for market data and execution services. Under Platform Pricing, members earn discounts by purchasing a substantial volume of market data for non-professional (retail) users, and also directing a substantial amount of liquidity to the exchange. These are discounts off prices for market data and execution services that the Commission *already accepted* as fair and reasonable. The proposal would enable NASDAQ to compete more effectively against exchange competitors and alternative trading systems, which have lower regulatory costs and often attract order flow by providing market data free of charge.

On, January 28, 2011, the Division of Trading and Markets suspending and instituting proceedings regarding NASDAQ's rule proposal.<sup>10</sup> Although the Commission previously accepted the non-discounted prices for NASDAQ's market data products, and although courts and commentators widely agree that discounts are pro-competitive, the Division nevertheless suspended Platform Pricing and instituted proceedings to determine whether NASDAQ's bundled discount was somehow a "tying arrangement [that] may not be consistent with the statutory requirements applicable to a national securities exchange under the [Exchange] Act."

On September 20, 2011, the Division disapproved NASDAQ Platform Pricing.<sup>11</sup> The Disapproval Order contains just six pages of analysis and is devoid of economic data or other empirical support for its sweeping conclusion that the "linking of market data fees to execution volume, and the linking of transaction credits to market data purchases, will . . . negatively impact the competition that exists today in these two markets." Order at 13. Moreover, the Division ignored expert reports and other evidence NASDAQ submitted that showed that the markets for data and execution services are fluid and robust, and that a voluntary incentive to purchase both services in large quantities therefore cannot be an anti-competitive "tying" arrangement. In fact, NASDAQ's evidence showed that the Platform Pricing proposal is but one of many pricing strategies that exchanges use to compete with one another on a "platform" basis to attract order flow and encourage different types of investors to purchase market data. Consistent with the existence of competitive markets, the Platform Pricing Proposal will cut prices, not raised them.

---

<sup>10</sup> See Securities Exchange Act Release No. 34-63796, 76 Fed. Reg. 6,165 (Feb. 3,2011) .

<sup>11</sup> See Securities Exchange Act Release No. 34-63796, 76 Fed. Reg. 59,466 (Sept. 26,2011).

On October 4, 2011, NASDAQ filed a Petition for Review challenging the disapproval of Platform Pricing.<sup>12</sup> NASDAQ specifically challenged the conclusory statements that the linking of market data fees to execution volume could be an anti-competitive tying arrangement and that such arrangement could negatively impact competition that exists in those markets.<sup>13</sup>

***Reconciling NASDAQ Platform Pricing with CBOE's Pricing Proposal.*** In the absence of empirical data and clear Commission guidance, it is difficult to reconcile the Division's disapproval of the supposed "tying arrangement" presented by Platform Pricing with CBOE's proposed link between execution fees for single-listed products with execution volume in multiple-listed products. The fundamental prerequisites for an anti-competitive tying arrangement are market power in a tying product and a foreclosure of competition in the tied product. Neither prerequisite was satisfied in the case of NASDAQ Platform Pricing because the two markets involved – market data and execution services – are both intensely competitive, as demonstrated by un-refuted empirical evidence that NASDAQ placed in the record. Under well-established competition theory, a link involving a single-listed proprietary product (CBOE Pricing Proposal) is more anti-competitive than a link between two competitive products (NASDAQ) Platform Pricing.

On their surface, CBOE's and NASDAQ's pricing proposals may appear distinguishable. On one hand, the CBOE Pricing Proposal involves two options trading products, whereas the NASDAQ Platform Pricing Proposal involves two equities trading products. Alternatively, the CBOE Pricing Proposal involves two execution services products, whereas the NASDAQ Platform Pricing Proposal involves one execution services product and one market data product.

Closer examination reveals, however, that such distinctions are superficial and arbitrary. Neither the statutory language nor the legislative intent of the Exchange Act support this distinction between options and equities trading, or a distinction between execution services and market data, or a distinction between existing and new fees. There is no statutory language addressing the reasonableness or fairness of linking the pricing of two products of any kind, regardless of the degree of similarity or difference between the linked products. Options and equities are listed and traded under the same exchange license. Similarly, execution services and market data are offered under the same exchange license.

---

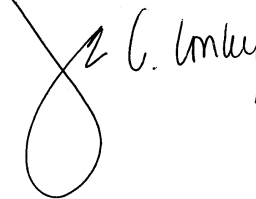
<sup>12</sup> See <http://www.sec.gov/rules/sro/nasdaq/2011/34-65362-petition.pdf>.

<sup>13</sup> The Petition for Review also argued that the Platform Pricing Proposal is deemed approved because the Commission did not issue an order disapproving the rule change within the period prescribed by the Section 19(b)(2)(D) of the Exchange Act. 15 U.S.C. § 78s(b)(2)(D). As stated in the Petition for Review, NASDAQ could offer the proposed discounts without waiting for the Commission to address the Petition for Review.

The distinction, if any, could rest on differences between the products or markets involved in the two proposals. If so, it is difficult to analyze such differences without empirical data about the products or markets. This is precisely the type of “reasoned” evidence of “competitive forces” that the D.C. Circuit has invited exchanges to submit in support of proposed market data fees. *NetCoalition v. SEC*, 615 F.3d 525, 544 (D.C. Cir. 2010). By declining to demand or address empirical evidence, the Division risks failing “once again . . . [to] adequately . . . assess the economic effects of a new rule.” *Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011); *see also Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 167-68 (D.C. Cir. 2010); *Chamber of Commerce v. SEC*, 412 F.3d 133, 136 (D.C. Cir. 2005).

Accordingly, NASDAQ respectfully urges the Commission to address this apparent gap in empirical evidence and analysis either in the context of CBOE’s Pricing Proposal or in response to NASDAQ’s Petition for Review of the order disapproving NASDAQ Platform Pricing.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "G. Linsky". The signature is written in a cursive style with a large loop at the end of the name.