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VIA ELECTRONIC MAIL

January 27, 2022

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: Securities Exchange Act Release No. 93883 (December 30, 2021), 87 FR 523
(January 5, 2022) (SR-IEX-2021-14).

Dear Ms. Countryman:

The Nasdaq Stock Market LLC (“Nasdaq”) is submitting this comment letter with respect to the proposed rule change by Investor Exchange LLC (“IEX”) to amend its fee schedule for market data fees. While Nasdaq appreciates the opportunity to comment on the decision of the Division of Trading and Markets (the “Division”) of the Securities and Exchange Commission (the “Commission”)¹ to temporarily suspend IEX’s proposed rule change and institute proceedings to determine whether to approve or disapprove it, Nasdaq strongly believes that the rule change should have been permitted to take effect in accordance with Section 19(b)(3)(A) of the Securities Exchange Act of 1934 (the “Act”). Thus, if the Division deems it possible from a procedural standpoint, Nasdaq recommends that the Division withdraw its order dated December 30, 2021, for the reasons discussed below. Alternatively, if the Division does not believe that to be possible, it should approve IEX’s proposed rule change promptly.

As discussed in detail below, IEX’s assertions regarding competition in the market for exchange data are not supported by the evidence, and Nasdaq would like to correct the record in this regard. These errors should not impact the IEX filing, however. While IEX may not believe that its market data fees are constrained by competition, they are in fact constrained, and the filing should be permitted to take effect on that basis.

¹ Nasdaq notes that the Order was issued by the Division of Trading and Markets pursuant to delegated authority, and therefore does not necessarily reflect the views of the Commission.

I. IEX’s Assertion That Charges For Proprietary Market Data Are Not Subject to Competitive Forces Is Incorrect.

IEX claims that “each exchange has a natural monopoly over its market data (specifically depth of book and direct access to top of book),”² and that an exchange must show that “it is not taking unfair advantage of its unique position as the sole provider of its own proprietary market data.”³ The data set forth below, however, supports the opposite conclusion—competition among exchanges and non-exchange platforms constrains market data fees.

IEX’s flawed argument rests on three fundamental errors.

First, IEX misunderstands the nature of market power. Market power is the ability to restrict output and raise prices. IEX does not—and cannot—point to any such restriction in output in the sale of market data, and therefore fails to prove the existence of market power.

Second, IEX misunderstands the relationship between market data and competition. Market data is part of the overall competition for exchange services. A key factor, among several, in that overall competition is order flow, which helps determine the quality of market data—the more order flow, the better the quotes and trades will reflect the state of the market as a whole, and the more valuable the market data. No exchange can afford to overprice the total cost of its services without potentially losing order flow, and damaging its overall ability to compete.

Third, IEX implicitly assumes that all market data is of equal value and utility. However, all market data is not of equal value or utility and a variety of factors, including, but not limited to, liquidity, reliability, ease of access, and management of risk all impact the value and utility of data within the market. Indeed, the data summarized below shows that the value of market data is strongly correlated to the amount of liquidity available on the exchange. Buyers are willing to pay more to exchanges with greater liquidity (i.e., greater order flow), but not as much to exchanges with less liquidity (and less order flow).

Because there is competition among exchanges in the sale of market data, the fees proposed by IEX should be approved. If IEX has incorrectly overpriced its data, customers will move order flow, reduce their purchases of market data, or otherwise reduce their purchases from IEX. Notwithstanding IEX’s unfounded belief that it has market power, its prices are in fact constrained by competition, just like the fees of its competitor exchanges.

Market Power Is the Ability To Raise Prices Profitably By Restricting Output.

As the Supreme Court has observed, “[m]arket power is the ability to raise price profitably by restricting output.”⁴ Absent a restriction on output, a price increase (or a price

² Securities Exchange Act Release No. 93557 (November 10, 2021), 86 Fed. Reg. 64268, 64269 (November 17, 2021) (SR-IEX-2021-14).

³ 86 Fed. Reg. 64,268, 64,269 (“IEX does not believe that exchange market data fees are constrained by competitive market forces . . .”).

⁴ *Ohio v. Am. Express*, 138 S.Ct. 2274, 2288 (2018).

above other competitors' prices) may simply reflect increases in the value of services, recovery of costs (including fixed costs), or an appropriate return on investment.⁵

There are no restrictions in the output of market data.⁶ On the contrary, output has expanded as new exchanges enter the market, often offering their market data for free.

IEX claims that the “extreme differences between IEX’s aggregate cost to produce market data . . . and the prices charged by other exchanges for similar products and services clearly suggests that the pricing for market data is not constrained by competition.”⁷ This conclusion is not supported by the evidence. The Supreme Court has explained that “[i]t is always treacherous to try to infer monopoly power from a high rate of return [because] measured rates of return reflect accounting conventions more than they do real profits.”⁸ IEX falls into this error. Moreover, as discussed below, IEX’s cost analysis is inherently arbitrary and unrealistic, as it attributes an extremely small portion of the fixed costs associated with operating a market platform to market data, even though it cannot create market data without incurring those costs.

IEX also contends that its supposed market power arises from its “unique position as the sole provider of its own proprietary market data.”⁹ Notwithstanding IEX’s assertion, a firm may be the sole supplier of a good or service and yet not have market power. Courts examine whether there are other aspects of the relationship that provide a check on the supplier’s power under such circumstances.

In one such case, Domino’s Pizza franchisees claimed that Domino’s Pizza was a monopolist in the sale of pizza ingredients because they were contractually required to purchase ingredients solely from Domino’s. The court examined the entire economic relationship between Domino’s and the franchisees, and rejected the monopolization claim because “[t]he franchise transaction between Domino’s Pizza and plaintiffs was subjected to competition at the pre-contract stage.”¹⁰ IEX’s fees are subject to the competition for order flow and market data sales among 16 exchanges, as well as competition for order flow among non-exchange venues. As such, IEX has no market power notwithstanding its position as “sole provider of its own proprietary market data” because order flow providers determine the value of that data.¹¹

⁵ *Id.*

⁶ An example of an output restriction would be limiting the number of exchange memberships so that customers bid against one another to obtain an artificially scarce input. There are no current examples of such a limitation.

⁷ 86 Fed. Reg. 64,268, 64,274.

⁸ *Blue Cross & Blue Shield of Wisc. v. Marshfield Clinic*, 65 F.3d 1406, 1412 (7th Cir. 1995).

⁹ 86 Fed. Reg. 64,268, 64,269.

¹⁰ *Queen City Pizza v. Domino’s Pizza*, 124 F.3d 430 (3d Cir. 1997).

¹¹ It is appropriate to use antitrust cases to interpret the competition requirements of the Exchange Act because the Exchange Act’s requirement for “equitable allocation” of fees mirrors the antitrust laws. *Compare N. Pac. Railway v. U.S.*, 356 U.S. 1, 4 (1958) (“The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress.”), *with* H.R. Rep. No. 94-229 at 92 (1975) (“[I]t is the intent of

Market data is inseparable from order flow.

One of the key qualities of market data is determined by order flow—the more order flow, and the more diverse the order flow, the more accurately quotes and trades reflect the state of the market as a whole, and the more valuable the market data. Because “competition for order flow is ‘fierce,’”¹² no exchange can afford to overprice the total cost of its services without potentially losing order flow, and damaging its overall ability to compete. Thus, the exchange operates as a typical unified platform in which an alteration to the platform’s input (order flow) changes the value of the platform and demand for its outputs (both data and trading services), and vice versa.

The interdependent relationship between market data and order flow can be demonstrated empirically. Data shows that customers choose whether to buy market data—and often decide not to.¹³ IEX asserts that it “is not aware of and does not believe that there is any evidentiary support for the proposition that competition at the ‘platform level’ constrains market data fees of the type proposed in this filing.”¹⁴ If IEX were correct—and it is not—all exchanges would be able to charge whatever they want for data, with no relationship to underlying data value.¹⁵ The data, in fact, shows the opposite. Prices of direct feeds fall as their value falls, and even then, some customers opt out of specific feeds.

Chart 1 compares current charges for professional depth of book feeds against a measure of market volume (in this case, the square root weighted average of dollar volume market share is used as a proxy).¹⁶

the [Exchange Act] conferees that the national market system evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed.”).

¹² *NetCoalition v. SEC*, 615 F.3d 525, 539 (D.C. Cir. 2010) (quoting Securities Exchange Act Release No. 59039 (December 2, 2008), 73 Fed. Reg. 74770, 74782-83 (December 9, 2008) (SR-NYSEArca-2006-21)) (“no exchange can afford to take its market share percentages for granted’ because ‘no exchange possesses a monopoly, regulatory or otherwise, in the execution of order flow from broker dealers’....”). The level of competition and contestability in the market is evident in the numerous alternative venues that compete for order flow, including sixteen SRO markets, as well as internalizing broker-dealers and various forms of alternative trading systems (“ATSs”), including dark pools and electronic communication networks (“ECNs”), as well as the continuing entrance of new market participants.

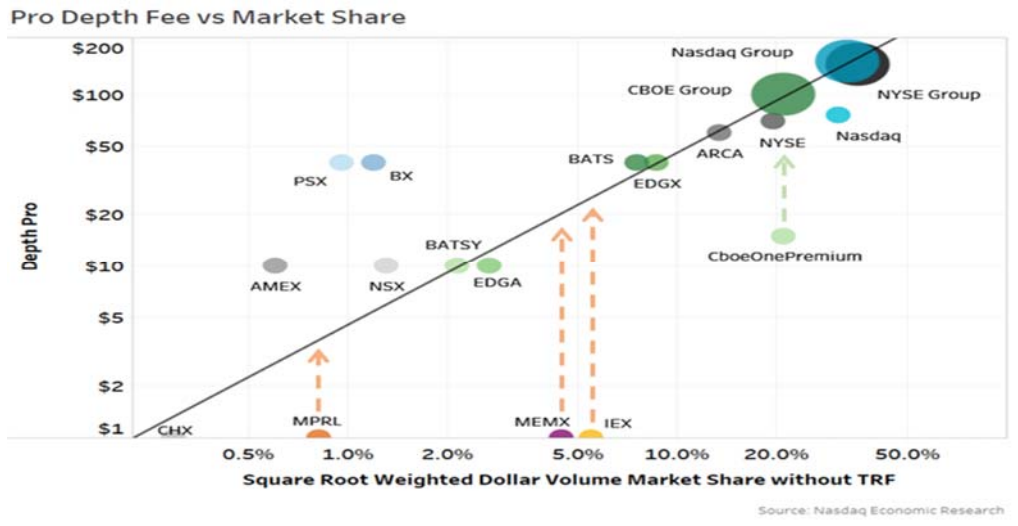
¹³ As shown in Chart 5, discussed below, an analysis of SEC’s form ATS-N data shows that a number of ATSs substitute SIP feeds for IEX, NSX and CHX, despite the fact that those exchanges offered free proprietary data.

¹⁴ 86 Fed. Reg. 64,268, 64,274. Although IEX claims not to operate in a competitive market, it contradicts itself in other passages of the proposal, as in the following examples: “Competing equities exchanges are free to adopt comparable fee structures subject to the SEC rule filing process;” 86 Fed. Reg. 64,268, 64,276, “IEX also believes that the proposed fees are reasonable because they are significantly less than the fees charged by competing equities exchanges . . .”; 86 Fed. Reg. 64268 at 64275; “actual revenue will be determined by decisions made by each Data Subscriber based on the meaningful choices IEX proposes to offer for the receipt of market data.” 86 Fed. Reg. 64,268, 64,273.

¹⁵ See Phil Mackintosh, “Dispelling the Complementary Product Theory for Market Data,” (August 20, 2020), available at <https://www.nasdaq.com/articles/dispelling-the-complementary-product-theory-for-market-data-2020-08-20>.

¹⁶ See Phil Mackintosh, “Accounting for Prices of NMS-II Depth,” (December 9, 2021), available at <https://www.nasdaq.com/articles/accounting-for-prices-of-nms-ii-depth>.

Chart 1



All exchange groups with mature data pricing models sit on a diagonal line.¹⁷ Far from showing evidence of “monopoly rent,” even for the largest exchanges there is a consistent charge *per unit of liquidity* provided by that exchange group (large bubbles). Exchanges toward the right of the graph have more volume, and hence have been relatively successful in competing for order flow. As a result, their data has greater value, and the fees for such data are higher, reflected in a linear progression on the graph. Implicit fees for IEX and other exchanges that do not (currently) explicitly charge fees are shown by the broken lines.

Current IEX data fees (i.e., fees prior to implementation of the proposed fee changes) are implicit because, in purchasing market data, customers have budget constraints that require them to look at all of the costs of interacting with an exchange—not merely the cost to trade, but the entire cost of using the platform, which may include, for example, connectivity fees, market data fees, membership fees, or fees for analytic products. The precise mix depends on the customer and its use case.

While Chart 1 may appear to show that IEX is currently charging fees significantly below the trend line, Chart 2 shows that the cost of trading at IEX is relatively expensive when compared to its competitors Cboe, Nasdaq and NYSE, when all-in costs are considered.

¹⁷ Nasdaq notes that exchanges assess fees both above and below the trend line, but the line shows a remarkable overall correlation between market share (i.e., value) and price.

Chart 2

Estimated All-in-Cost to Trade

Note: Cboe estimates based on annual 10k. Equinex cost represents an estimate for colocation/connectivity. NYSE total cost/trade less SIP based on 2018 blog. NYSE segments based on Nasdaq cost/trade allocations. IEX based on annual Form 1A. Nasdaq 'SIP' cost includes both SIP Trading & Quoting tape revenues plus revenue attributable to Nasdaq Basic/Last Sale. Mills are defined as cost in cents per 100 shares traded. Total cost/trade is one-sided.

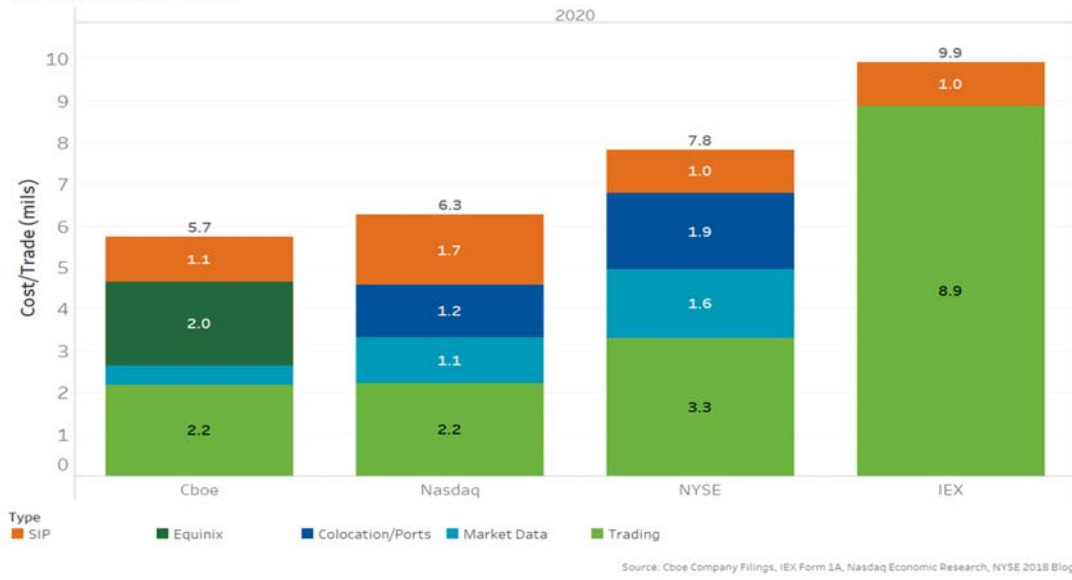
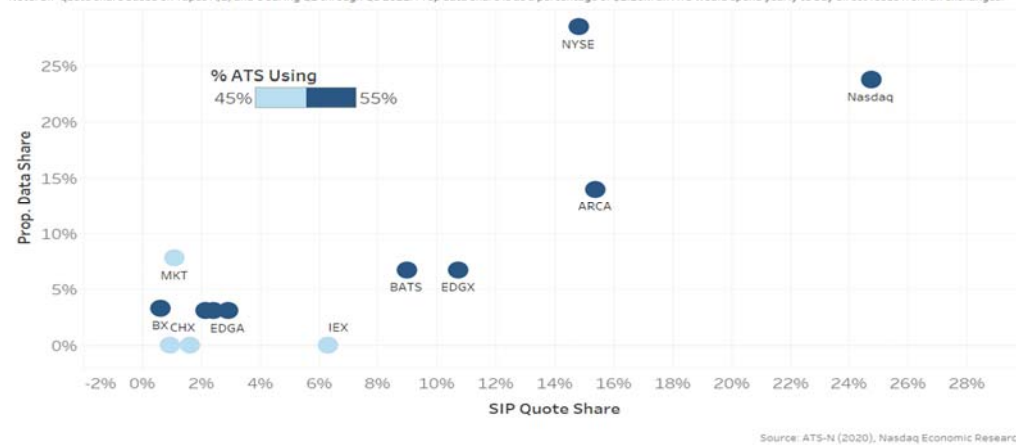


Chart 3 compares the quality of quotes issued by an exchange, as measured by SIP Quote Revenue Share,¹⁸ against each exchange’s market share in proprietary data feeds.

Chart 3

SIP Quoting Share vs. Prop Data Feed Share

Note: SIP quote share based on Tapes A, B, and C during Q1 through Q3 2021. Prop data share is as a percentage of \$1.16M an ATS would spend yearly to buy direct feeds from all exchanges.



¹⁸ The SIPs allocate revenue to exchanges, in part, based on the amount of time an exchange publishes a price at the National Best Bid and Offer (“NBBO”) in order to reward the best quality data. Time at the NBBO is partly determined by the amount of liquidity on the exchange, as highly liquid exchanges are more likely to have securities at the NBBO.

Exchanges that spend the most time at the NBBO and therefore have the best quality data also have the largest market share for proprietary data feeds. Customers reward exchanges that are the best at attracting diverse order flow and provide the best market quality.

SIP revenues also help IEX subsidize its purportedly “free” market data. All exchanges that publish quotes and trades earn revenues from the SIP, and this revenue can be a substitute for proprietary data fees. After approval of IEX’s D-Limit order type, a significant portion of IEX revenues originate with revenue sharing from the SIP, an increase of over \$16m a year, despite a relatively insignificant increase in trades, as IEX contribution to liquidity remains almost unchanged.

Chart 4

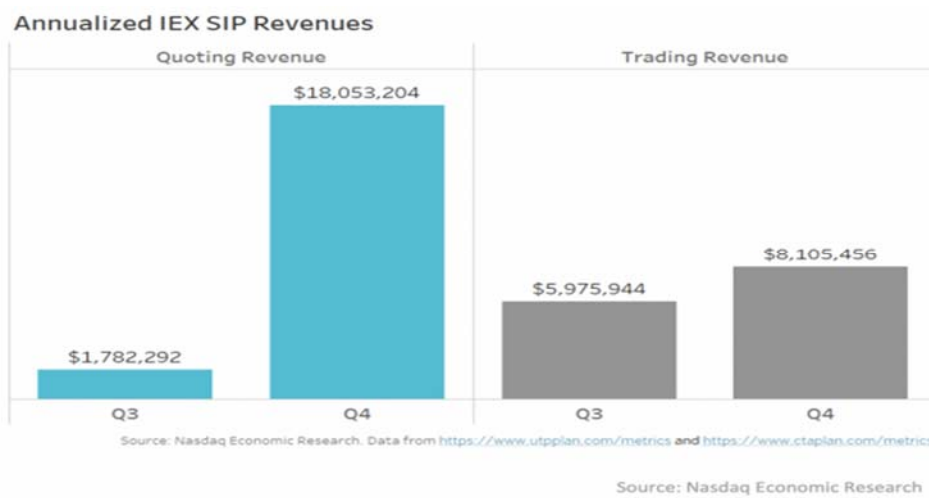


Chart 5 compares direct feed fees to contributions to NBBO quality.

Chart 5

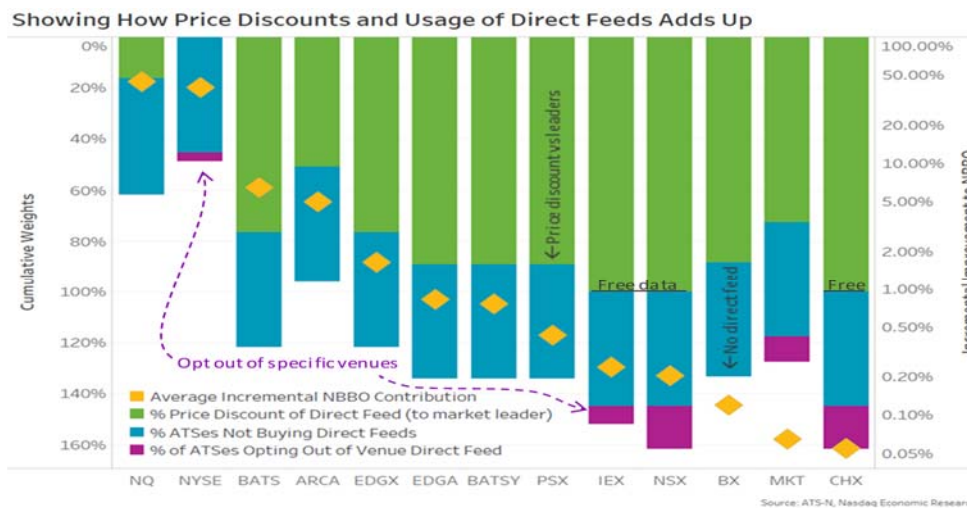


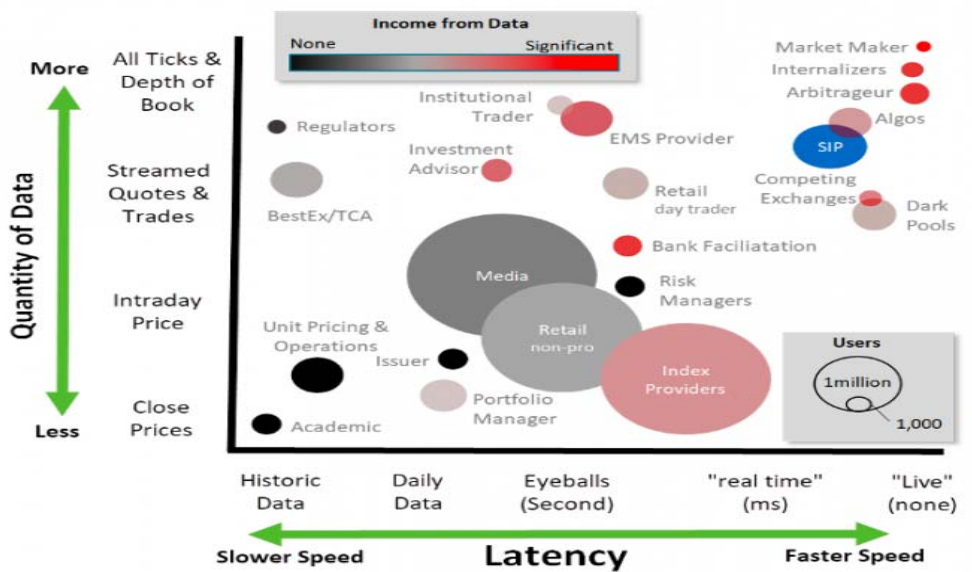
Chart 5 ranks exchanges from highest contribution (Nasdaq) to lowest contribution (NYSE Chicago) to NBBO quality. The green portion of the bar shows the fee discount for data relative to the market leader. Exchanges that are the furthest from the NBBO (i.e., have the lowest data quality) offer the largest discounts; in some instances, their data is free. The data shows:

- Exchanges charge less for less valuable data.
- The majority of dark pools do not buy all direct feeds.
- Some traders opt out of specific direct feeds on a venue-by-venue basis (purple bars).
- Some customers do not take free data (purple bars with free data). *Even when data is nominally free, the costs of processing data sometimes outweigh its value.*

IEX's lack of market power is evident in the fact that some market participants choose not to consume it even though it is free.

To understand how this market discipline works, it is worthwhile examining at a high level the many different types of market participants that purchase market data.

Chart 6



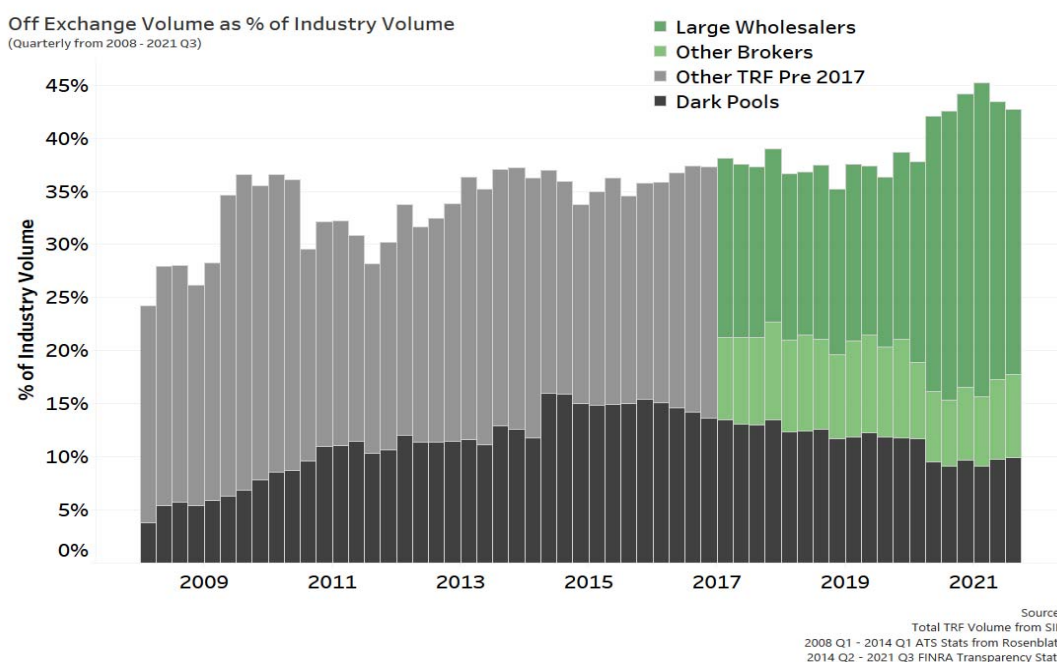
Illustrative purposes only. Size of dots reflects approximate # of users of data (larger = more, smaller = less) Source: Nasdaq Economic Research

Chart 6 compares market data purchasers according to their data needs (number of different types of products purchased), and how fast they need the data (latency). The size of each bubble indicates the number of users of such data. Examination of the chart shows that many data customers can easily substitute among market data products. Media and non-professional retail users, for example, have no need for low-latency data, and do not need a great variety of different types of data; last sale prices would be sufficient for most of their needs.

The charts thus far have focused on competition among exchanges for the sale of market data. Exchanges also face competition for order flow with non-exchange venues. In reviewing this aspect of competition, it is important to note the qualitative differences between exchange and non-exchange venues on market quality. By publishing prices, exchanges create competition to be the best buyer or seller. That creates tighter spreads¹⁹ that not only reduce transaction costs²⁰ but also form prices that everyone can use for portfolio valuation and to find new assets to buy or sell, among other benefits.²¹ Less transparent trading platforms—those that do not publish bids and offers—do not have the same salutary impact on market quality.

Chart 7 shows that order flow to less transparent trading venues has grown over time.

Chart 7



The latest data shows that over 43% of all shares are traded off-exchange. That means just over 50% of shares trade on the 16 exchanges in the U.S.²² Given the positive impact that published quotes have on the market as a whole, it is important that exchanges be allowed to set prices freely, subject to competitive forces, in order to drive transparency and market quality.

¹⁹ See Phil Mackintosh, “Three Charts That Show the Importance Of A Competitive Bid/Offer NBBO,” (December 4, 2018), available at <https://www.nasdaq.com/articles/three-charts-that-show-the-importance-of-a-competitive-bid-offer-nbbo-2018-12-04>.

²⁰ See Phil Mackintosh, “V is for Volume, and Its Implications for the Access Fee Pilot,” (April 4, 2019), available at <https://www.nasdaq.com/articles/v-volume-and-its-implications-access-fee-pilot-2019-04-04>.

²¹ The beneficiaries of transparent prices include, among others, ATSS, derivatives investors and traders, and other off-exchange platforms that use published prices to set their internal prices.

²² See Phil Mackintosh, “An Intern’s Guide to Trading,” (July 1, 2021), available at <https://www.nasdaq.com/articles/an-interns-guide-to-trading-2021-07-01>.

Congress directed the Commission to “rely on ‘competition, whenever possible, in meeting its regulatory responsibilities for overseeing the SROs and the national market system.’”²³ As a result, the Commission has historically relied on competitive forces to determine whether a fee proposal is equitable, fair, reasonable, and not unreasonably or unfairly discriminatory. “If competitive forces are operative, the self-interest of the exchanges themselves will work powerfully to constrain unreasonable or unfair behavior.”²⁴ Accordingly, “the existence of significant competition provides a substantial basis for finding that the terms of an exchange’s fee proposal are equitable, fair, reasonable, and not unreasonably or unfairly discriminatory.”²⁵ In its 2019 guidance on fee proposals, Commission staff indicated that they would look at factors beyond the competitive environment, such as cost, only if a “proposal lacks persuasive evidence that the proposed fee is constrained by significant competitive forces.”²⁶

IEX market data fees are subject to competition from other exchanges and non-exchange venues, which provides a substantial basis for showing that the proposed IEX fees are equitable, fair, reasonable, and not unreasonably or unfairly discriminatory.

II. Congress Intended Exchange Fees, Including Market Data Fees, To Be Immediately Effective.

Prior to the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010,²⁷ Section 19(b)(3)(A) of the Securities Exchange Act of 1934²⁸ (the “Act”) provided that although fees, dues, and other charges of exchanges and other self-regulatory organizations (“SROs”) must be filed as proposed rule changes with the Commission, the SRO may appropriately designate them as immediately effective. The Commission, however, adopted language in its own Rule 19b-4²⁹ that purported to limit the authority of SROs to designate fees as immediately effective if the fees were charged to persons other than members of an SRO. This limitation was clearly at odds with the plain meaning of the Act but was never subjected to judicial review. Rather, in 2010, Congress explicitly rejected the gloss that the Commission had put on Section 19(b)(3)(A) by amending the statute to provide for the immediate effectiveness of fees imposed “on any person, whether or not the person is a member of the self-regulatory organization.”

²³ See *NetCoalition v. SEC*, 615 F.3d 525, 534-35 (D.C. Cir. 2010); see also H.R. Rep. No. 94-229 at 92 (1975) (“[I]t is the intent of the conferees that the national market system evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed.”).

²⁴ See Securities Exchange Act Release No. 59039 (December 2, 2008), 73 Fed. Reg. 74,770 (December 9, 2008) (SR-NYSEArca-2006-21).

²⁵ *Id.*

²⁶ See U.S. Securities and Exchange Commission, “Staff Guidance on SRO Rule filings Relating to Fees” (May 21, 2019), available at <https://www.sec.gov/tm/staff-guidance-sro-rule-filings-fees>.

²⁷ Pub. L. 111-203, 124 Stat. 1376 (2010).

²⁸ 15 U.S.C. 78s(b)(3)(A).

²⁹ 17 CFR 240.19b-4. The rule has never been amended to conform to the statute but of course the statutory language is controlling.

While it is true that Congress also reserved to the Commission the authority to suspend an immediately effective proposed rule change and institute proceedings to determine whether it should be approved or disapproved, the routine invocation of this authority with respect to fees that may be charged to non-members (such as market data fees) is at odds with Congress's intent that such fees should generally be permitted to take effect immediately.³⁰

The holding of *Susquehanna Int'l Group, LLP v. SEC*³¹—which the Commission cites frequently as the basis for disapproving proposed rule changes, as well as the basis for suspending IEX's proposed fee filing in this instance—does not dictate otherwise. That case was construing what *the Commission* must do when reviewing the proposed rule change of a registered clearing agency that is *not* immediately effective. The statutory language construed by the court in *Susquehanna* simply does not exist in the provisions of the Act governing the decision of the Commission to suspend or not to suspend immediately effective filings.

Moreover, with respect to proposed rule changes that must be approved by the Commission—both those filed under Section 19(b)(2) and those that have been suspended under Section 19(b)(3)(A)—*Susquehanna* does not hold that the SRO has a “burden” to prove anything. Rather, it provides that the Commission itself must do the work required to determine the consistency of the change with the Act. “[T]he SEC’s unquestioning reliance on [an SRO’s] defense of its own actions is not enough to justify approving [a rule]. Instead, the SEC should have *critically reviewed [the SRO’s] analysis or performed its own.*” (emphasis added).

In this case, however, no such critical review is required. Rather, it should be readily apparent to the Division that it should not analyze the “market for IEX data” as an economically meaningful market, since numerous market participants are able to participate actively in the securities markets without taking IEX's free data. Rather, as discussed above, the relevant market is the market to provide exchange services. The argument that IEX has a “monopoly over its own data” is not, in and of itself, a valid premise under economic theory – otherwise every seller of a product in any market would have a monopoly of that product. Setting aside the inherent issues with that premise, the supposed monopoly does not provide IEX with the ability to dictate how or where market participants choose to execute their orders, nor does it allow IEX to mandate that firms routing orders to it also choose to buy its data. Rather, as with other exchanges, IEX will succeed or fail based on the overall value its services provide to market participants, as a function of the efficiency of its market operations, the information content of its data, and the overall cost of doing business with it. To date, IEX has commanded a great deal of press attention but only marginal market share. If it believes that increasing its already high all-in costs will help its competitive standing, there is no need for the Commission to stand in its way.³² The market is perfectly capable of choosing winners and losers.

³⁰ See *NetCoalition v. SEC*, 715 F.3d 342 (D.C. Cir. 2013) (“*NetCoalition IP*”) (finding the suggestion that the SEC should institute proceedings with respect to every proposed rule change would “confound[] the Congress’s express intent that a rule become effective ‘upon filing with the Commission.’”).

³¹ 866 F.3d 442 (D.C. Cir. 2017).

³² The fact that no market participants opted to comment on IEX’s proposal when it was first published is ample evidence that IEX’s data fees are not a matter of significant concern to market participants.

III. There Is No Statutory Authority for the Commission to Conduct Rate-Making Proceedings

The Division uncritically accepts IEX's assertion that it enjoys a monopoly over a relevant market and therefore must justify its fees based on costs. The Division then poses a remarkable barrage of questions that seem to suggest it is considering imposing a permanent regime of cost-plus ratemaking over IEX's data fees. Before the Commission embarks on such a path, Nasdaq believes that it should first consider whether the Act provides it with that authority.

Vague terms like "fair and reasonable," "equitably allocated," and "not unreasonably discriminatory" are not the sort of language that Congress uses when it intends to establish a system of cost-plus ratemaking. By way of comparison, the Natural Gas Act of 1938,³³ which does establish such a system, includes provisions such as the 15 U.S.C. 717e:

(a) Cost of property

The [Federal Energy Regulatory] Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

(b) Inventory of property; statements of costs

Every natural-gas company upon request shall file with the [Federal Energy Regulatory] Commission an inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the [Federal Energy Regulatory] Commission informed regarding the cost of all additions, betterments, extensions, and new construction.

If Congress had intended the Commission to exercise similar authority over market data fees, one would expect to find similar enabling language in its statute. As the DC Circuit noted in *Village of Bergen v. FERC*, 33 F.3d 1385, 1389 (D.C. Cir. 1994), "a dash of rate-related language" has been viewed by Congress as not "sufficient to authorize rate-making activity," when there is an "absence of specific rate-making provisions."

Moreover, Congress did provide a specific grant of ratemaking authority to the Commission with respect to the regulation of commissions charged by *exchange members*, in Section 6(e) of the Exchange Act. Specifically, to the extent that an exchange seeks to regulate its members' fees in this manner, the Commission must find that the fees "are reasonable in relation to the costs of providing the service for which such fees are charged" and must "publish [] the standards employed in adjudging reasonableness."³⁴ The Commission must also conduct proceedings that provide opportunities for oral presentations and cross-examination. Congress's

³³ Pub. L. 75-688, 57 Stat. 821 (1938).

³⁴ 15 U.S.C. 78f(e). *See also* S. Rep. No. 94-75, at 72 (1975) (noting "[t]he absence of articulated standards for ratemaking in the securities industry" and stating that, in the context of potential exchange regulation of broker commissions, this "would be corrected by requiring that if fixed [commission] rates are permitted, the SEC must (1) find that the rates are 'reasonable in relation to the costs of providing the service for which such fees are charged' and (2) publish 'the standards employed in adjudging reasonableness.'")

inclusion of limited ratemaking authority in Section 6(e) but its *omission of similar language* in Sections 6(b)(4) and 11A(c)(1)(C), which govern the review of exchange fees, underscores that the SEC does not have ratemaking authority in the latter setting.³⁵

IV. IEX's Filing and the Commission's Questions About It Underscore the Problems with Rate-Making

Even if the Commission did possess rate-making authority with respect to exchange fees, it would be remarkably arbitrary for the Division to attempt to develop a generally applicable system for cost-plus ratemaking based on a series of ad hoc questions about the submissions of a single SRO. In other words, the choices made by IEX in justifying its fees on a cost-plus basis, and the questions that the Division chooses to ask about IEX's filing, should not be treated as dictating the process to be followed by other SROs when submitting fees. Questions raised in the context of the IEX filing may or may not be representative of other exchanges, and should not be treated as such. There are significant differences across SROs with regard to functionality, technology, rule sets and services, among other things. If the Commission believes it has authority to conduct cost-plus ratemaking, the Administrative Procedure Act³⁶ dictates that it must propose a rule for notice and comment and that its final rule must be prepared to withstand judicial scrutiny.³⁷ Moreover, a careful review of the Division's questions highlights the conundrums that should make the Commission reluctant to travel down the ratemaking path.

1. Cost Allocation

IEX proposes that only the costs that it identifies as "direct costs" should be included in the cost base underlying its proposed fees. If the Division accepts this as the appropriate rate base, does this mean that other SROs will not be permitted to recoup indirect costs through market data fees? It is obvious that market data cannot exist unless an exchange incurs numerous other costs, including, but certainly not limited to, the cost of a trading engine, cybersecurity, regulation, expenditures associated with operating a listings market, and the cost of maintaining the technological infrastructure necessary to operate a sophisticated financial technology business, including resiliency, redundancy, and testing. Does the Division expect that exchanges will cover none of these costs through market data fees? If so, would recouping all of these costs from products other than market data result in an "equitable allocation"? In particular, to the extent that internalizers and dark pools derive substantial value from benchmarking trades for their customers using data about on-exchange trades that they do not execute, is it equitable to expect them to pay none of the costs of trading infrastructure? If it is equitable to assign some of these indirect costs to market data, then what is the appropriate allocation? Similarly, IEX asserts that its direct equipment cost should be depreciated over a

³⁵ See *Russello v. United States*, 464 U.S. 16, 23 (1983) ("'[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion'"); see also S. Rep. No. 94-75, at 12 (1975) (Commission would not "have either the responsibility or the power to operate as an 'economic czar' for the development of a national market system. Quite the contrary, for a fundamental premise of the bill is that the initiative for the development of the facilities of a national market system must come from private interests and will depend upon the vigor of competition within the securities industry as broadly defined.").

³⁶ Pub. L. 79-404, 67 Stat. 237 (1946).

³⁷ Cf. 15 U.S.C. 78f(e) (requiring the Commission to "publish[] the standards employed in adjudging reasonableness" of commissions subject to explicit rate-making authority").

period of three years. Does the Division have any expertise that would enable it to determine whether this is an accurate timeframe, and would it be reasonable for the Division to rely solely on comments to determine whether it is accurate?

IEX reasonably asserts that it is entitled to recoup the costs of product enhancements, but the Division questions whether these costs might vary from year to year. This question, together with the section on “Periodic Reevaluation,” imply that the Division is contemplating a system of recurrent “rate cases,” under which an exchange must return to the Commission periodically to justify its fees. It should be clear, however, that there is even less statutory basis for requiring periodic reevaluation of existing fees than there is for a cost-plus analysis of fees in the first place.³⁸ Questions such as “how often should . . . reevaluation occur, and what metrics and thresholds should be considered?” might be appropriate if the Commission was engaged in a rulemaking authorized by Congress, but are remarkably inappropriate in the context of a fee that Congress authorized to be immediately effective and for which it established no reevaluation mechanism.

Finally, in response to IEX’s assignment of 6.15 FTEs to its market data rate base, the Division takes a journey into IEX’s human resources department, seeking to know who these people are, what they do, and whether IEX is entitled to use its fees to recoup all of their compensation. If one were to read the entire Exchange Act, one would find no authority for the Commission to regulate personnel and compensation decisions made by exchanges. Yet the Division appears eager to use fee filings as a basis for doing so.

2. TOPS versus DEEP.

Here, the Division probes the five-to-one ratio between the proposed price of IEX’s depth-of-book product (DEEP) and its top-of-book product (TOPS). As the Division notes, “IEX does not assert in its filing that DEEP is five times more costly to produce than TOPS,” undoubtedly because it is not. Rather, IEX is likely doing what other exchanges do, and pricing based on the relative value of its products. Moreover, because the costs that it has chosen to allocate to these products are, in all likelihood, shared between the two products, any attempt at a cost-based allocation between the two products would be inherently arbitrary. The same could also be said about an attempt to allocate the costs of operating all aspects of an exchange platform among its various products. Thus, IEX’s decision to allocate none of the costs of its trading platform to these products is also arbitrary, and requires it to charge the highest trading costs in the industry to users of the platform. However, Nasdaq agrees with IEX’s assertion that ultimately, fees “are solely determined by the individual Data Subscriber’s business needs.” In other words, market participants will decide whether they need these products, and if IEX’s fees are too high, or if the relative fees for DEEP and TOPS are not consistent with their value, market forces are perfectly capable of sending IEX the signals that will allow it to decide whether to change them.

³⁸ See *Nasdaq v SEC*, No. 18-1324 (D.C. Cir., June 5, 2020) (judgment remanding, with direction to vacate, a Commission order that would have required exchanges to review and justify existing fees).

3. Subscribers.

Here, the Division asks detailed questions about IEX's customer base and its interactions with its customers to understand the basis of its projection about the effect of a price change on demand. In doing so, the Division fails to consider that the information that it believes IEX should provide to commenters may be commercially sensitive. Moreover, it seems to anticipate that IEX can obtain detailed information about how each current (and possibly potential) customer will react to a price change in advance of IEX submitting the filing. This is not, however, how the real world operates. Businesses may survey a few customers about a potential price change but are unlikely to have the time, in the midst of competitive market pressures, to conduct a comprehensive study. Moreover, a price change such as the one IEX proposes may be driven entirely by a need for revenue, and a belief that generating some revenue from a product that currently generates no revenue at all may enhance IEX's financial position. There is nothing problematic with IEX testing the market in this manner: if its expectations are inaccurate, the market will tell it so.

4. Profit margin and rate of return

Even if the Commission had authority to engage in rate of return regulation, the Division's questions in these sections reflect a fundamental misunderstanding of how that process would work. In classic public utility ratemaking, a utility's rate of return is a function of the cost of its capital (i.e., the return it must provide to investors to raise capital), and prices are required to be set in a manner that allows the utility to cover these costs.³⁹ Separate rates of return are not calculated for each category of product, however. A brief consideration of IEX's fees makes it easy to understand why that is the case, and also why rate-making is a disfavored regulatory exercise. Suppose that IEX's projections are entirely accurate, its data revenues exceed its allocated data costs by 25%, and the Commission determines that this is an appropriate "rate of return" on these costs. Suppose that IEX wins new customers, however, but that rather than celebrating its success, it is forced to start a "reevaluation" of whether its returns are now "too high." It could lower its prices, or it could increase its costs, or simply allocate costs shared with other products differently to achieve the desired "rate of return." Thus, unless the Commission establishes exactly how shared costs are to be allocated, any effort to micromanage the "rate of return" on particular products will be illusory, and the results will vary arbitrarily from one SRO to another. An SRO's profit margin could be based on how cleverly it describes its costs to the Commission, rather than on the interplay of market forces. In Nasdaq's view, that would breed significant market inefficiency.

Moreover, even if the Commission had authority to undertake a comprehensive rate-making procedure for all SROs—which it clearly does not—any procedure would potentially suffer from the tendency of such regulation to have the unintended consequence of encouraging the regulated firm to make excessive investments to increase the size of its rate base.

If the Commission and the public truly wish to understand the profitability of exchange platforms, it is very easy for them to examine the audited and readily available financial statements from each exchange. Any effort at a more granular analysis is doomed to failure,

³⁹ Of course, stock exchanges are not "classic" public utilities because they are not monopolies. For all of the reasons stated herein, exchanges are subject to rigorous competition.

however, since there is simply no universal or consistent and coherent way to allocate an exchange's significant shared costs among its different products.

5. Distribution Fee

The same challenges of cost allocation described above also apply to the Division's questions about IEX's proposed Distribution Fee. In this regard, Nasdaq merely notes that the circumvention of validly established fees—both inadvertent and intentional—is a significant challenge for the industry, and supports IEX's right to charge a fee to defray the costs associated with an SRO's obligation to enforce its fee rules.

6. Delayed IEX Data

The Division asks a number of questions about a product that IEX will not sell and from which it will receive no revenue. Nasdaq fails to see why the Division believes it has jurisdiction over such a product, or how the product impacts IEX's right to sell the products that are the subject of its filing.

7. Sharing with Affiliates

The Division suggests that IEX's fee language may not clearly explain its intent with respect to distribution of its products to affiliated equity exchanges. This concern appears to be well founded, and IEX should therefore amend its fee language to make it clear that affiliated exchanges would pay only \$3,000 to receive DEEP and TOPS.

* * * * *

Thank you for the opportunity to comment on this Proposal. Nasdaq relishes the opportunity to compete freely and fairly with exchange and non-exchange market participants and does not believe the Commission should stand in the way of IEX's efforts to do the same.

Sincerely,



Erika Moore
Vice President and Corporate Secretary

cc: Chairman Gary Gensler
Commissioner Hester M. Peirce
Commissioner Allison Herren Lee
Commissioner Caroline A. Crenshaw
Haoxiang Zhu, Director, Division of Trading and Markets