Nasdaq

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Nasdaq.com

November 21, 2016

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: SR-MIAX-2016-38

Dear Mr. Fields:

The NASDAQ Stock Market LLC ("NOM"), Nasdaq PHLX LLC ("Phlx"), Nasdaq BX, Inc., International Securities Exchange, LLC ("ISE"), ISE Gemini, LLC ("ISE Gemini"), and ISE Mercury, LLC ("ISE Mercury") options markets (collectively "Nasdaq") respectfully submit this comment letter requesting transparent guidance from the Securities and Exchange Commission ("Commission") regarding staff-imposed pricing limitations for certain Penny Pilot Options. Nasdaq requests that the Commission provide transparency in the form of written rather than oral guidance to ensure equal knowledge and treatment among competitors operating options markets. Specifically, the Exchange requests the Commission adopt a rule, an interpretation, or otherwise provide written guidance with respect to any pricing limits applicable to all options exchanges.

Written guidance would promote uniform treatment among options exchange, particularly in such a competitive space as pricing. Written guidance would also benefit investors by clearly articulating the pricing to which they are entitled under the staff's interpretation of the Exchange Act and SEC rules. Written guidance would also assist the numerous members of SEC staff that review pricing proposals by reducing the time spent answering inquiries from fourteen options exchanges. On the other hand, oral guidance leads to uncertainty, ambiguity, and the potential for arbitrary treatment that hinders pricing competition at options exchanges. Oral guidance leads to delayed and uneven application and adherence to new restrictions, resulting in unnecessary competitive conflict and regulatory intervention. Nasdaq would request a more formal process be implemented to provide a transparent forum to communicate pricing limitations.

**Background**

The Commission staff has been issuing oral guidance on options pricing for a year. The below are examples of oral communications between Commission staff and Nasdaq.

- In November 2015, Nasdaq was notified orally that the Commission staff had determined to restrict Penny Pilot Options pricing to a $0.50 per contract limit ("$0.50 limit"). Specifically, Nasdaq was informed the $0.50 limit applies to Penny Pilot Options pricing NOM was requested orally by the Commission staff to refile its rule change to reduce an options fee to coincide with the $0.50 limit.[1]

- In July 2016, Phlx was orally informed that auction pricing, in the aggregate was also subject to the $0.50 limit. In other words, a transaction fee, when combined with any other fee applicable to the transaction, should not exceed $0.50 per contract. Phlx was orally requested by the Commission staff to reduce its auction pricing, which in the aggregate exceeded the $0.50 limit.[2] Nasdaq complied with the staff's requests in order to avoid suspension of its NOM pricing proposal and to avoid the termination of its Price Improvement Auction (PIXL) pilot on Phlx, which was being renewed for another 6 months at the time.[3] Commission staff also assured Nasdaq that it was communicating the same pricing limitations to all other options exchanges, acknowledging the competitive nature of the options markets and the impact of competition of a pricing limit.

Nasdaq believes that the communications have not been consistent among options markets. Below are some reasons the communications appear to be unclear.

- It is unclear when the Commission staff communicated pricing restrictions to other exchanges. For example, as of August 2016 Miami International Securities Exchange LLC ("MIAX") continued to assess a Penny Pilot Options transaction, when combined with a Posted Liquidity Marketing Fee, that exceeded the $0.50 limit in the aggregate in a number of Penny Pilot Options symbols.[4] MIAX retained its pricing in a subset of its symbols (EEM, GLD, IWM, QQQ, and SPY) through November 1, 2016.
- The Commission staff has never contacted ISE, ISE Gemini and ISE Mercury with respect to the $0.50 limit, presumably because those exchanges charged no fees in excess of that informal limit.

Finally, confusion continues to exist as to the limits that are being imposed today on options markets with respect to the $0.50 limit. Below is an example of unclear guidance.

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1 See Securities Exchange Release Act No. 76344 (November 10, 2015), 80 FR 69755 (November 4, 2015) (SR-NASDAQ-2015-115).

2 See Securities Exchange Release Act No. 76344 (July 28, 2016), 81 FR 49709 (July 22, 2016) (SR-Phlx-2016-77).

3 See Securities Exchange Release Act No. 78301 (July 18, 2016), 81 FR 46731 (July 12, 2016) (SR-Phlx-2016-75).

4 The transaction fee plus the Posted Liquidity Marketing Fee had been assessed on MIAX for some time and, it appears, the Commission only addressed the fees in August 2016 because a proposed rule change sought to expand the number of applicable symbols.

- It is unclear from oral guidance whether the $0.50 pricing limit applies to Complex Orders. The current MIAX[5] proposal does not apply to Complex Options in Penny Pilot symbols. Presently, the Chicago Board Options Exchange Incorporated ("CBOE")[6] also has Complex Order Penny Pilot Options pricing that exceeds the $0.50 limit.
- It is also unclear whether or not the Commission is seeking to limit Penny Pilot Options pricing for Complex Orders in auctions.

Today, after a year of developments, there is still no written guidance available and it is unclear whether similar oral guidance was provided to all options markets.

**Competition**

Nasdaq operates in a highly competitive market in which market participants can easily and readily direct order flow to competing venues if they deem fee levels at a particular venue to be excessive or rebates to be inadequate.[7] Accordingly, in order to remain competitive in its efforts to attract order flow, the Exchange must offer market participants an attractive trading platform, in addition to competitive fees and liquidity rebates. Price competition is a central component of the competition for order flow. As part of this competition, Nasdaq has modified 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. Empirical evidence also 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.

As recently as April 2010, the Commission proposed a pricing cap on access fees for options that

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5 MIAX's Complex Order Market Maker Penny Pilot Options transaction fees in Tier 1 ($0.25) and Tier 2 ($0.19), when combined with the $0.25 marketing fee and the $0.08 Surcharge for Removing Liquidity, exceed the $0.50 per contract limit. Also, with respect to non-Market Makers, the $0.08 per contract surcharge, when added to the $0.47 per contract transaction fee in Penny Pilot Options exceeds the $0.50 per contract limit. See MIAX's Fee Schedule.

6 CBOE's Complex Order Market-Maker/DPM/LMM Liquidity Provider Sliding Scale transaction pricing at Tier 1 ($0.23) and Tier 2 ($0.17), when combined with the $0.25 marketing fee and the $0.08 Complex Taker Fee, exceeds the $0.50 per contract limit. Also, with respect to non-Market-Makers/DPMs/LLMs the $0.08 taker fee, when added to the $0.45 per contract transaction fee in Penny Pilot Options, exceeds the $0.50 per contract limit. See CBOE's Fees Schedule.

7 "No one disputes that competition for order flow is 'fierce.' … As the SEC explained, '[i]n the U.S. national market system, buyers and sellers of securities, and the broker-dealers that act as their order-routing agents, have a wide range of choices of where to route orders for execution'; [and] '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'…." *NetCoalition I*, 615 F.3d at 539 (quoting_ArcaBook Order, 73 FR at 74782-74783). Although the Court and the SEC were discussing the cash equities markets, NASDAQ believes that, as discussed above, these views apply with equal force to the options markets.

mirrored the cap adopted for equities under Regulation NMS.[8] The Commission abandoned the access fee proposal and there is still no formal rule capping fees in options markets. The Commission was unable to establish a clear record for the imposition of pricing limitations and never moved forward with a fee cap. Nonetheless, the staff is informally imposing fee and revenue caps without the benefit of a public record of any kind.

Nasdaq notes that where the Commission sets limits on pricing and communicates those limits verbally to certain impacted options exchanges there exists a possibility of creating a pricing distortion in this highly competitive environment. If Nasdaq is constraining itself, for example in its pricing of Penny Pilot Options for Complex Orders, to abide by a limit that others are either not privy to or have a different understanding about, the limit serves to distort the manner in which the various competitors are pricing their services. This results in a market which is not truly competitive. The Commission should avoid any inferences that it is impacting the setting of options prices in a distorted fashion by disseminating information concerning its policy on pricing in the form of written guidance.

**Recommendation**

Nasdaq respectfully requests a formal process and written guidance on options pricing limits. Nasdaq requests a forum for the options exchanges to discuss with the Commission staff, holistically, the market structure issues that are driving the $0.50 limit. We thank the Commission for the opportunity to comment on this proposed rule filing. If you have any additional questions, or if we can be of further assistance in this matter, please do not hesitate to contact us.

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8 See Securities Exchange Act Release No. 61902 (April 14, 2010), 75 FR 20738 (April 20, 2010) (S7-09-10) ("access fee proposal"). The articulated reason for this proposed rule change was the potential for uncapped fees to interfere with access to displayed quotes.

Respectfully,

Joan Conley

cc: Stephen Luparello, Director, SEC Division of Trading and Markets
Gary Goldsholle, Deputy Director, SEC Division of Trading and Markets
David Shillman, Associate Director, SEC Division of Trading and Markets
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