

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-79662; File No. SR-NASDAQ-2016-169]

### Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1 Thereto, To Permit The Nasdaq Options Market LLC To Accept Inbound Options Orders Routed by Nasdaq Execution Services LLC

December 22, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 9, 2016, The NASDAQ Stock Market LLC (“Nasdaq” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change. On December 20, 2016, the Exchange filed Amendment No. 1 to the proposed rule change, which amended and replaced the original filing in its entirety. The proposed rule change, as modified by Amendment No. 1, is 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, as modified by Amendment No. 1 thereto, 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 LLC (“NOM”) to accept inbound options orders routed by Nasdaq Execution Services LLC (“NES”) from the International Securities Exchange, LLC (“ISE”) ISE Gemini, LLC (“ISE Gemini”) and ISE Mercury, LLC (“ISE Mercury”) (collectively “ISE Exchanges”).

#### 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 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 the Statutory Basis for, the Proposed Rule Change

##### 1. Purpose

In conjunction with the ISE Exchanges seeking approval to provide outbound routing services to all options markets using an affiliated routing broker, NES,<sup>3</sup> NOM proposes that NES be permitted to route orders from the ISE Exchanges to NOM, subject to certain limitations and conditions, as described below.

NES is a broker-dealer and member of Nasdaq Phlx LLC (“Phlx”), Nasdaq BX, Inc. and NOM (collectively “Nasdaq Exchanges”). NES provides all routing functions for the Nasdaq Exchanges. The Nasdaq Exchanges and NES are permitted affiliates.<sup>4</sup> Accordingly, the affiliate relationship between NOM and NES, 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.<sup>5</sup>

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.<sup>6</sup> The Nasdaq Exchanges received approval from the Commission to permit NES to become a member of these three markets subject to certain limitations and conditions in order to perform certain routing and other functions, respectively.<sup>7</sup> Also

<sup>3</sup> See SR-ISE-2016-27, SR-ISEGemini-2016-16 and SR-ISE-Mercury-2016-22 (not yet published).

<sup>4</sup> See Phlx Rule 985, Nasdaq Rule 2160 and BX Rule 2140.

<sup>5</sup> 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).

<sup>6</sup> Securities Exchange Act Release Nos. 71416 (January 28, 2014), 79 FR 6244 (February 3, 2014) (SR-Phlx-2014-05); 71419 (January 28, 2014), 79 FR 6247 (February 3, 2014) (SR-NASDAQ-2014-007); and 714121 (January 28, 2014), 79 FR 6264 (February 3, 2014) (SR-BX-2014-003).

<sup>7</sup> See Securities Exchange Act Release Nos. 59721 (April 7, 2009), 74 FR 17245 (April 14, 2009) (SR-Phlx-2009-32); 59779 (April 16, 2009) 74 FR 18600 (April 23, 2009) (SR-Phlx-2009-32, Amendment No. 1) notice of filing of proposed rule change

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 Nasdaq Exchanges previously proposed, and the Commission approved,<sup>8</sup> NES’s affiliation with the Nasdaq Exchanges to permit the Exchange to accept inbound orders that NES routes in its capacity as a facility from other Nasdaq Exchanges, subject to the certain limitations and conditions. Nasdaq now proposes to permit NOM to accept inbound options orders that NES routes in its capacity as a facility of the ISE Exchanges, subject to the following limitations and conditions:<sup>9</sup>

- First, the Exchange and FINRA maintain a Regulatory Services Agreement (“RSA”), as well as an agreement pursuant to Rule 17d-2 under the Act (“17d-2 Agreement”).<sup>10</sup> Pursuant to the RSA and the 17d-2 Agreement, FINRA is allocated regulatory responsibilities to review NES’s compliance with certain

relating to enhanced electronic trading platform for options); 61667 (March 5, 2010), 75 FR 11964 (March 12, 2010) (SR-Phlx-2010-36) (notice of filing and immediate effectiveness of proposed rule changes to establish procedures to prevent information advantages resulting from the affiliation between Phlx and NES); and 71416 (January 28, 2014), 79 FR 6244 (February 3, 2014) (SR-Phlx-2014-05) (notice of filing and immediate effectiveness of proposed rule change to inbound routing of options orders). Nasdaq Options Services was the affiliated broker-dealer prior to a rule change to utilize NES, another affiliated broker-dealer of Nasdaq. See also Securities Exchange Act Release Nos. 63769 (January 25, 2011), 76 FR 5423 (January 31, 2011) (SR-BX-2011-003); 63859 (February 7, 2011), 76 FR 8391 (February 14, 2011) (SR-BX-2011-007) (notice of filing of proposed rule change relating to permanent approval of the BX and NES inbound routing relationship); 71420 (January 28, 2014), 79 FR 6256 (February 3, 2014) (SR-BX-2014-004) (notice of filing and immediate effectiveness of proposed rule change to inbound routing). See also Securities Exchange Act Release Nos. 65554 (October 13, 2011), 76 FR 65311 (October 20, 2011) (SR-NASDAQ-2011-142); 71418 (January 28, 2014), 79 FR 6262 (February 3, 2014) (SR-NASDAQ-2014-008) (notice of filing and immediate effectiveness of proposed rule change to inbound routing).

<sup>8</sup> *Id.*

<sup>9</sup> The Exchange notes that similar filings are proposed for the Phlx and BX markets. See SR-Phlx-2016-120 and SR-BX-2016-068 (not published).

<sup>10</sup> 17 CFR 240.17d-2. FINRA reviews NES’ compliance for certain common rules. The RSA with FINRA specifies the types of business activities that NES may undertake and it also indicates the obligations to which NES is subject under the RSA. Among other things, NES must maintain a certain amount of net capital pursuant to SEC Rule 15c3-1(a)(1)(ii) and operate pursuant to SEC Rule 15c3-3(k)(2)(ii). NES is permitted to route orders in options to the appropriate market center for execution in accordance with member order and requirements.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Exchange rules.<sup>11</sup> Pursuant to the RSA, however, NOM retains ultimate responsibility for enforcing its rules with respect to NES.

- Second, FINRA monitors NES for compliance with the Exchange's trading rules, and collects and maintains certain related information.<sup>12</sup>

- Third, FINRA provides a report to the Exchange's chief regulatory officer ("CRO"), on a quarterly basis, that: (i) Quantifies all alerts (of which the Exchange or 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, NOM has in place NOM Rule 2160(c), which requires Nasdaq, 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.<sup>13</sup>

The Exchange has met all the above-listed conditions in connection with NES routing in its capacity as a facility of BX and Phlx. By meeting the above conditions, the Exchange has 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. Because the Exchange has

<sup>11</sup> NES is also subject to independent oversight by FINRA, its designated examining authority, for compliance with financial responsibility requirements.

<sup>12</sup> Pursuant to the RSA, both FINRA and NOM 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 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. Pursuant to the RSA, the Exchange and FINRA would be required to perform these activities with respect to NES acting in its capacity as a facility of each of the affiliated entities routing orders to NOM.

<sup>13</sup> See Securities Exchange Act Release Nos. 65554 (October 13, 2011), 76 FR 65311 (October 20, 2011) (SR-NASDAQ-2011-142); 71418 (January 28, 2014), 79 FR 6262 (February 3, 2014) (SR-NASDAQ-2014-008) (notice of filing and immediate effectiveness of proposed rule change to inbound routing).

met all the above-listed conditions, it now seeks to permit an inbound routing relationship with the ISE Exchanges pursuant to the same conditions. The Exchange will continue to comply with the four conditions stated above.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>14</sup> in general, and with Sections 6(b)(5) of the Act,<sup>15</sup> in particular, in that the proposal is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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 NES, acting in its capacity as a facility of Phlx and BX, in a manner consistent with prior approvals and established protections and will further be permitted to receive inbound orders from the ISE Exchanges, for which NES will also act in its capacity as a facility of those markets. The Exchange believes that the proposed 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, or affiliation with other Nasdaq Exchanges or ISE Exchanges, to its advantage.

## B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. Permitting NOM to receive inbound orders from the ISE Exchanges does not create any issues of intra-market competition because it involves inbound routing from affiliated markets. 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.

<sup>14</sup> 15 U.S.C. 78f.

<sup>15</sup> 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

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) By order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be 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, as modified by Amendment No. 1, is consistent with the Act. Comments may be submitted by any of the following methods:

### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2016-169 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2016-169. This file number should be included on the subject line if email 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 Web site 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 such 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-2016-169, and should be submitted on or before January 19, 2017.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>16</sup>

**Eduardo A. Aleman,**  
Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-79663; File No. SR-ISEMercury-2016-22]

### Self-Regulatory Organizations; ISE Mercury, LLC; Notice of Filing of Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, To Permit Nasdaq Execution Services, LLC To Become an Affiliated Member of the Exchange To Perform Certain Routing and Other Functions

December 22, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 9, 2016, ISE Mercury, LLC ("ISE Mercury" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change. On December 20, 2016, the Exchange filed Amendment No. 1 to the proposed rule change, which amended and replaced the Form 19b-4, and Exhibit 1 thereto, in their entirety. On December 20, 2016, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>3</sup> The proposed rule change, as

modified by Amendment Nos. 1 and 2, is 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, as modified by Amendment Nos. 1 and 2, from interested persons.

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

The Exchange proposes to (1) permit the Exchange to receive inbound orders in options routed through Nasdaq Execution Services, LLC ("NES") from certain affiliated exchanges, as described in detail below, by establishing procedures designed to prevent potential informational advantages resulting from the affiliation with NES; and (2) grant the Exchange an exemption to permit NES, an affiliate of the Exchange, to become a Member of the Exchange in order to perform certain routing an [sic] other functions on behalf of the Exchange.

#### 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 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 the Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

The purpose of the filing is to permit ISE Mercury to receive inbound orders in options routed through Nasdaq Execution Services, LLC ("NES") from certain affiliated exchanges, as described herein and establish procedures designed to prevent potential informational advantages resulting from the affiliation between ISE Mercury and NES. The Exchange requests approval to permit NES, an affiliate of the Exchange, to become a Member of the Exchange in order to perform inbound routing on behalf of the Exchange. The Exchange is also filing to permit ISE Gemini [sic] to route

outbound orders through NES either directly or indirectly through a third party routing broker-dealer<sup>4</sup> to other market centers and perform other functions regarding the cancellation of orders and the maintenance of a NES error account.<sup>5</sup>

#### Restriction on Affiliation

NES is a broker-dealer owned and operated by Nasdaq, Inc. NES is affiliated with International Securities Exchange, LLC ("ISE"), ISE Gemini, ISE Mercury LLC,<sup>6</sup> NASDAQ PHLX LLC ("Phlx"), The NASDAQ Options Market LLC ("NOM") and NASDAQ BX, Inc. ("BX"). For purposes of this filing the term "Affiliated Entities" shall refer to ISE, ISE Gemini, Phlx, NOM and BX (collectively "Affiliated Entities"). Currently, NES is a member of Phlx, NOM and BX (collectively "Nasdaq Exchanges") and provides all options routing functions for Phlx, NOM and BX.<sup>7</sup>

Today, Phlx Rule 985 (Affiliation and Ownership Restrictions), The NASDAQ Stock Market LLC ("Nasdaq") Rule 2160 (Restrictions on Affiliation)<sup>8</sup> and BX Rule 2140 (Restrictions on Affiliation) currently prohibit the Nasdaq Exchanges or any entity with which it is affiliated from, directly or indirectly, acquiring or maintaining an ownership interest in, or engaging in a business venture with, a Nasdaq Exchange member or an affiliate of a Nasdaq Exchange member in the absence of an effective filing under 19(b) of the Act. 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.<sup>9</sup> NES performs

<sup>4</sup> The ability to route orders to other exchanges using either the Exchange's affiliated broker-dealer (NES) or a third party unaffiliated broker-dealer, which the Exchange may choose to use, is for efficiency and potential cost savings.

<sup>5</sup> The ability to route orders to other exchanges using either the Exchange's affiliated broker-dealer (NES) or a third party unaffiliated broker-dealer, which the Exchange may choose to use, is for efficiency and potential cost savings. See ISE-2016-27 (not published) which amends ISE Chapter 19, Rules 1901, 1903, 1904 and 1905. The ISE rule changes impact ISE Mercury because Chapter 19 is incorporated by reference into the ISE Mercury Rulebook.

<sup>6</sup> ISE, ISE Gemini and ISE Mercury are collectively referred to as "ISE Exchanges."

<sup>7</sup> See Phlx Rule 1080(m) and Nasdaq and BX Rules at Chapter VI, Section 11.

<sup>8</sup> NOM is a facility of Nasdaq.

<sup>9</sup> Securities Exchange Act Release Nos. 71416 (January 28, 2014), 79 FR 6244 (February 3, 2014) (SR-Phlx-2014-05); 71419 (January 28, 2014), 79

<sup>16</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 2 amended the description of one of the inbound routing conditions that would apply. Specifically, the Exchange modified the third condition to specify that the report that FINRA will provided to the Exchange's chief regulatory officer on a quarterly basis will quantify all alerts, of which the Exchange or FINRA (rather than solely FINRA) are aware, that identify Nasdaq Execution Services,

LLC as a participant that has potentially violated Commission or Exchange rules.