

MEMO# 14435

February 7, 2002

NASDAQ PROPOSED RULE CHANGE RELATING TO QUOTATION UPDATE CHARGE AND MECHANISM FOR SHARING MARKET DATA REVENUE

[14435] February 7, 2002 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 6-02 RE: NASDAQ PROPOSED RULE CHANGE RELATING TO QUOTATION UPDATE CHARGE AND MECHANISM FOR SHARING MARKET DATA REVENUE The Securities and Exchange Commission has issued a notice of the filing and immediate effectiveness of a proposed rule change filed by the Nasdaq Stock Market¹ (a copy of which is attached) instituting a quotation update charge and introducing a mechanism for sharing market data revenue with NASD members. The proposed rule change became operative on a pilot basis beginning on February 1, 2002, and currently is scheduled to end on October 31, 2002. Specifically, Nasdaq will charge NASD members \$0.01 for each "quotation update." A "quotation update" includes any change to the price or size of a displayed quotation or reserve size. The Release states that a quotation update fee will not be charged for a change in the displayed quotation or reserve size that is performed automatically by the NNMS when an execution against the quotation occurs. A charge will be imposed, however, for quotation changes made by the "Autoquote Refresh" functionality of the NNMS (which restores a market maker's quotation price and size in accordance with parameters established by the market maker whenever its displayed quotation size and reserve size have been decremented to zero). The Release states that Nasdaq is imposing a quotation update charge because it believes that the absence of any charges for quotation updates has encouraged market participants to quote inefficiently, in turn imposing unnecessary burdens on Nasdaq system capacity. In addition, Nasdaq believes that to the extent that quotations are accessed through non-Nasdaq systems, the firms that post the quotations are currently free riding on the quotation infrastructure provided by Nasdaq. As noted above, the proposed rule change also introduces a mechanism to share with NASD members a portion of the market data revenue that it receives, through the NASD, under the Nasdaq UTP Plan. Specifically, the formula for determining an NASD member's credit (which is delineated in the Release) focuses on the reporting of non-Nasdaq system trades, such as internalized trades, because, according to the Release, Nasdaq expects that members will have increasingly greater options to report such trades to UTP Exchanges in the future. ¹ Securities Exchange Act Release No. 45342 (January 28, 2002), 67 FR 5019 (February 1, 2002) ("Release"). Comments on the proposed rule change are due to the SEC no later than February 22, 2002. ² Therefore, in order to continue to provide an "attractive environment" for the reporting of these trades, Nasdaq believes that it is appropriate to share a portion of the data revenue associated with these trades with members that report

them to Nasdaq. Ari Burstein Associate Counsel Attachment Attachment (in .pdf format)

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