

September 18, 2008

**Via Email and Overnight Mail**

Ms. Florence E. Harmon  
Acting Secretary  
United States Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

**Re: SR-NASDAQ-2008-016: Response to Comment Letter**

Dear Ms. Harmon:

On August 7, 2008, the Securities Industry and Financial Markets Association (“SIFMA”) submitted a comment letter concerning the above-captioned rule filing (the “Filing”),<sup>1</sup> which proposes an innovative proprietary data product to assist investors. The NASDAQ Stock Market LLC (“Nasdaq”) appreciates the opportunity to explain that SIFMA’s comment letter opposing this innovation is factually inaccurate, unsupported by statute or rule, and asks the Securities and Exchange Commission (the “Commission”) to act in a manner that is arbitrary and capricious and contrary to public policy.

SIFMA’s comment letter concerns a July 11, 2008, rule change to create Nasdaq Rule 7044 to establish fees (the “Fees”) to make the Nasdaq Market Pathfinders service (the “Pathfinders Service”) available via either a web-based data product or via a data feed that would provide aggregated market data activity of certain market participants, referred to as “Pathfinders.” A 30-day free trial period accompanies the purely voluntary new service to allow potential subscribers to assess the business use and value of the new service prior to making a decision whether or not to purchase the product for a longer period at the applicable rate thereafter. Nasdaq filed this proposal pursuant to Section 19(b)(2)<sup>2</sup> of the Securities Exchange Act of 1934 (the “Exchange Act”).<sup>3</sup>

First, SIFMA inaccurately claims that Nasdaq collects data in its capacity as a regulatory body and then uses it for commercial purposes. To support their contention, SIFMA mistakenly cites the concerns over the use by Nasdaq of OATS information

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<sup>1</sup> See Securities Exchange Act Release No. 58145 (July 11, 2008), 73 FR 41143 (July 17, 2008).

<sup>2</sup> 15 U.S.C. 78s(b)(2).

<sup>3</sup> 15 U.S.C. 78s(b)(1).

mentioned in the order approving Nasdaq's exchange application.<sup>4</sup> The Pathfinders Service *does not* use OATS information. Period. Rather, the Pathfinders Service relies upon trade information sent directly and only from the NASDAQ Matching Engine. Simply put, SIFMA has gotten its facts wrong.

Second, SIFMA raises several product specific questions in its comment letter regarding the operation of the Pathfinders Service. SIFMA questions whether the Pathfinders Service would provide information in a manner that permits the user to distinguish between short and long sales. The answer is no, the user would not be able to distinguish between short and long sales. Nasdaq does not know the overall net position of the market participants and the Pathfinders Service does not use short selling flags added to orders.

SIFMA questions whether the Pathfinders Service could "compromise the confidentiality of the transacting party's trading strategies, or provide misinformation as to a transacting party."<sup>5</sup> This is not a valid concern. There are numerous filters in place that individual trades must first pass through prior to being included in the data. Specifically, the trade data is aggregated at a security level prior to dissemination to ensure market participants are not inadvertently revealed.

As detailed in the Filing, a minimum of three Pathfinders must exist, as well as an economically relevant position. An "economically relevant position" means that a market participant must trade a minimum amount of each security to be included in the data. For example, to be included in the one-minute snapshot the security must trade a minimum of \$5,000, for the five-minute snapshot the security must trade a minimum of \$25,000 and for the one-hour snapshot the security must trade a minimum of \$300,000. Market participant identifiers ("MPIDs") for market participants are never sent out as part of this feed. This coupled with the filtering of the data means there is no plausible way to reverse engineer the process to determine which market participants volume is included in the data.

Therefore, there is no merit to SIFMA's claim that the Pathfinder Service "will provide a means to reverse engineer the algorithms and strategies Nasdaq members have created, or whether the impact on such algorithms and strategies will be such as to render them useless."<sup>6</sup> As stated above, once the data passes through the various filters there would be no way to reverse engineer the Pathfinders Services' algorithm to determine market participation information. In turn, without the market participant information there is no credible way to reverse engineer individual market participant strategies and algorithms.

The information provided by the Pathfinders Service is essentially a sentiment

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<sup>4</sup> Letter from Ira D. Hammerman, Senior Managing Director and General Counsel, SIFMA, to Florence Harmon, Acting Secretary, Commission (August 7, 2008). We incorporate that letter by reference herein.

<sup>5</sup> Id. at p.2.

<sup>6</sup> Id. at p.2-3.

indicator that would provide the general public with a better feeling for how a specific type of market participant (those taking a side via buy or sell trades) feel about certain securities and actually serves to level the playing field. This feed serves as Nasdaq's first attempt at providing an idea of what the "smart money" is doing and provides information comparable to what is sometimes referred to as "the word on the street," which is simply another way of saying information gleaned from the large amount of order flow on the trading desks of large broker dealers. As a result, for the first time this type of information will be made available to the public.

Nasdaq is able to aggregate the volume data by issue for specific periods of time and not disclose the MPID, thus allowing Nasdaq to show what such participants are doing without running the risk of revealing the identification of the market participants. It is common sense, as well as common business sense, that Nasdaq would be fundamentally averse to create a product that could potentially cause any harm to its member firms or their ability to trade. Nasdaq always strives to provide as much transparency to the market as feasible and believes that this innovative product accomplishes this in a way that has never been done before. Market forces should determine the fate of this completely voluntary market data product since market participants can quote and trade in any number of other venues.

Third, SIFMA reiterates its tired arguments to extend the two-year moratorium on innovation in market data products. SIFMA's comment letter erroneously contends that the Filing does not provide an adequate rationale for the proposed Fees. On the contrary, the Filing clearly sets forth the necessary reasons for the Fees and fully complies with the statutory standard for such filings. The Filing states, in part, that

[T]he proposal provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system which Nasdaq operates or controls, and it does not unfairly discriminate between customers, issuers, brokers or dealers. Use of the Pathfinders service is voluntary and the subscription fees will be imposed on all purchasers equally based on the professional/non-professional status of issuers and/or the level of service selected. The proposed fees will cover the costs associated with establishing the service, responding to customer requests, configuring Nasdaq's systems, programming to user specifications, and administering the service, among other things.<sup>7</sup>

As the Commission has itself stated, "[u]nder Section 19 of the Exchange Act, the Commission must approve a proposed rule change related to setting fees for market data if it finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules thereunder."<sup>8</sup> The Commission further stated that "competitive forces generally will constrain an exchange in setting fees for non-core data because it should recognize that its own business will suffer if it acts unreasonably or

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<sup>7</sup> See Filing at 41144.

<sup>8</sup> See Securities Exchange Act Release No. 57917 (June 4, 2008), 73 FR 32751 (June 10, 2008).

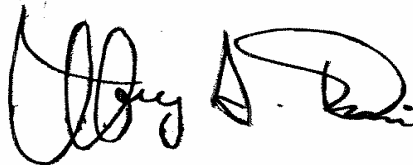
unfairly.”<sup>9</sup> The Pathfinders Service disseminates precisely the type of voluntary non-core data that the Commission is alluding to and Nasdaq is indeed subject “to significant competitive forces in setting the terms of its proposal for non-core data, including the level of any fees.”<sup>10</sup>

As with depth-of-book and other innovative market data products SIFMA has attempted to stifle, the data for this product is gained through intense competition for order flow. In this case, SIFMA’s arguments are particularly weak because it is clear that there is no legal or practical obligation for anyone to purchase the Pathfinders Service. It is unclear whether a market even exists for this product, much less market power to over-price it. It is evident from SIFMA’s reflexive opposition, however, that their goal is to stifle all innovation in the market data sphere.

SIFMA is using the same arguments to delay the Filing that it has used to challenge numerous market data fee proposals filed by various national securities exchanges. It would be inappropriate and arbitrary for the Commission to use the Filing, which clearly complies with the statutory standards of the Exchange Act, as a vehicle to address the broad policy issues raised by SIFMA. The Filing should be permitted to stand.

Please call me at 301-978-8484 if you have any further questions or would like to discuss this comment response letter in greater detail.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeffrey S. Davis". The signature is fluid and cursive, with the first name being the most prominent.

Jeffrey S. Davis  
Deputy General Counsel  
Vice President

cc: Dr. Erik R. Sirri, Director, Division of Trading and Markets  
Robert L.D. Colby, Esq., Deputy Director, Division of Trading and Markets  
Daniel A. Gallagher, Esq., Deputy Director, Division of Trading and Markets  
Katherine A. England, Esq., Assistant Director, Division of Trading and Markets

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<sup>9</sup> Id. at 32752.

<sup>10</sup> Id.