NASDAQ OMX Regulatory

NASDAQ OMX REGWATCH

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INTRODUCTION

The NASDAQ OMX REGWATCH newsletter is designed to give our members a brief snapshot of what has been happening in the world of Market Structure and Regulation, including any recent key filings, news summaries, upcoming dates and links to initiatives to help you stay on top of this ever-changing global environment. We hope you find it helpful and always appreciate any feedback.

REGULATORY INITIATIVES

For more information, please visit the Regulatory Initiatives page located on nasdaqomxtrader.com.

Market Access Rule	Single Stock Circuit Breakers
Limit Up/Limit Down	Clearly Erroneous Improvements
CFTC-SEC Advisory Committee	Market Structure Concept Release
Amendments to Reg SHO	Market Wide Circuit Breakers
Consolidated Audit Trail	Excessive Messaging Policy
Large Trade Reporting	Market Stability Initiatives
Market Maker Obligations	

UPCOMING REGULATORY DATES

- **October 21, 2013:** SEC adopts amendments to Financial Responsibility Rule for Broker-Dealers. See SEC release here.
- **November 1, 2013:** Compliance date for broker-dealers to maintain records, report and monitor large trader activities pursuant to Rule 13h-1.
- **November 4, 2013:** FINRA to require firms to report OTC Transactions in Equity Securities no later than 10 seconds.
- **November 11, 2013:** NASDAQ technology refresh phase one. Phase one includes the customer migration of Drop ports only. See ETA.
- **December 1, 2013:** Deadline for Exchanges and FINRA to submit CAT Plan.
- **December 8, 2013:** Deadline for LULD Phase 2(b) full roll out date.

- **December 9, 2013:** FINRA to disseminate odd lot transactions for OTC equity securities to TDDS. See release.

REGULATORY NEWS WRAP

EXCHANGES

August 14, 2013 – NASDAQ seeks to reclaim market watchdog role. *WSJ* reported that NASDAQ has submitted a plan to the SEC to allow the Exchange to take over some of its market surveillance and oversight, currently being performed by FINRA. The SEC generally relies on exchanges and FINRA to police day-to-day market activity and examine brokers' operations. NASDAQ proposes to take over surveillance for market manipulation attempts focused on things such as the opening and closing of its stock market, according to the filing. Using the SMARTS system would let NASDAQ to refer to a broader array of suspicious trading to FINRA for review, the Exchange officials wrote in the filing.

August 16, 2013 – Exchanges battle hackers in a new war. *WSJ* reported that Cyberattacks are estimated to have cost exchanges around $1 million each over the past year, according to a July research paper from the International Organization of Securities Commissions and the World Federation of Exchanges. But the largest exchanges now spend millions a year on information security, in anticipation of more ambitious, more coordinated attacks. A simulated attack held in July, organized by the Securities Industry and Financial Markets Association and involving more than 500 people from about 50 firms and government agencies, marked the biggest effort by the U.S. securities industry to ward off a coordinated assault on the computer systems that underlie the financial markets. Exchanges and the financial community are common targets and the number of attacks have recently increased. This exercise underscored one of the greatest fears that exchange executives and some policy makers can envision: that a well-funded terrorist organization or a rogue nation could pierce the financial system's defenses and mount an attack that unleashes waves of trading losses, compromises sensitive financial data or even forces the U.S. stock market to shut down. Exchanges are constantly preparing for these events and enhancing their defeneses to ward off percieved attacks.

August 27, 2013 – BATS and Direct Edge to merge. *The NY Times* reported that BATS Global Markets and Direct Edge Holding s will merge making them the second largest stock exchange operator. In an all-stock deal the two exchange operators will continue to operate their current four exchanges. The merged company will be based at BATS' headquarters in Lenexa, KS, near Kansas City, MO., and will have offices in New York and London as well as Jersey City, NJ., where Direct Edge is headquartered.

DARK POOLS

August 12, 2013 – Dark pool trading soars to record highs in Europe. *The Financial Times* reported that off exchange trading in venues known as 'dark pools' reached the highest level in July than ever before. About 10.3% of all European equities trading last month took place on these venues, according to data from Thomson Reuters. It is the first time the proportion of activity executed in dark pools has breached double figures, and exceeds the previous high of 9.1% in January. European regulators are attempting to curb dark pool trading as part of new rules in the second version of the Markets in Financial Instruments Directive. The rules, which are being debated among European regulators, could limit the proportion of stock trading done on some types of dark MTFs and could also place restrictions on broker-run dark pools.

August 13, 2013 – ASIC gets tough on dark activity. *The Financial Review* reported that the Austrialian Regulator is getting tougher on dark pools. Under the new rules, Investment banks will be forced to publicly disclose information about their activities in dark pools and report suspicious activity. As part of the new rules, which were flagged earlier this year and finalized recently, investment banks must disclose when they trade within their own crossing systems. In addition , these new regulations state that firms must also allow clients to opt out of having their trades executed in a dark pool and agree not to "unfairly discriminate between users." All suspicious activity within dark pools will have to be reported to ASIC under these new rules. Dark pools account for about 23% of all trading activity in the Australian market. However, the popularity of the alternative trading venues has declined from about 30 percent since May, when ASIC introduced rules that prevent brokers from using them unless they can show they are getting a "meaningful price improvement" for clients on share transactions.

DERIVATIVES

August 7, 2013 – Legal battle over options contracts continue. The *WSJ* reports after a 7 year long legal battle over opening up some options contracts to other exchanges it will continue on even longer according the U.S. Supreme Court. The International Securities Exchange is resuming a legal challenge in an attempt to force their rival CBOE to open up some of their most popular contracts to other exchanges. At issue are options contracts linked to the values of the Standard & Poor's 500-stock index and the Dow Jones Industrial Average, which trade exclusively on markets run by CBOE due to long-standing licensing deals maintained between CBOE and index provider S&P Dow Jones Indices. The ISE, owned by German exchange group Deutsche Börse, now is updating a 2006 legal filing that had sought court approval to launch its own options on the S&P 500 and DJIA. ISE argues that U.S. copyright law allows the ISE to use the published values of the S&P 500 and DJIA to trade options on the indexes, without a license from the index owner.

August 13, 2013 – SEC issues short selling rule avoidance warning. *The Trade* reported that the SEC, through OCIE, has issued a risk alert to investors about trading strategies designed to falsely meet the ‘close out’ requirement for short sellers. In a statement, the SEC said under Regulation SHO, short sellers who fail to deliver securities after the settlement date are required to close out their position immediately, unless they qualify, as bona fide market makers, for a limited amount of extra time to close-out. The Commission detected a variety of tactics to avoid the ‘close-out’ rule through options trading. The rules were brought in to ensure prompt settlement for short selling trades to reduce settlement failure.The Commission also pointed other techniques some short sellers have employed to avoid Reg SHO. These include trading in securities that are hard to borrow, multiple large trades with the same trader acting as a contra party and continuous failure to deliver positions.

HFT

August 12, 2013 – Russia embraces high-frequency trading. *Financial Times* reported that Russia is making proactive steps to attract more high frequency trading and launching a number of initiatives designed to increase liquidity and open the markert to more participants. Estimates from the Moscow Exchange place high-frequency trading at around 40% of the total but many expect this to soar in the months to come. According to industry observers, there are two main reasons why the HFT debate has yet to filter through to Russia. The first is to do with pre-trade risk controls that prevent erroneous orders hitting the market in the first place. The Moscow Exchange’s systems are designed to identify and prevent orders that members are not able to fund. These pre-trade controls were put in place before regulators in other parts of the world considered similar mechanisms in the wake of the flash crash. Second, the make-up of liquidity is very different in Russia compared with other markets. There is little trading by institutional investors, which typically seek to move large orders.

August 23, 2013 – CFTC looking for tougher oversight of HFT. The *WSJ* reported that the CFTC approved a roadmap for its oversight of high frequency trading indicating its intention to increase controls of computerized markets amid a series of glitches. The 137-page "concept release" on automated trading poses multiple questions to market players about whether the agency should tighten restrictions on futures exchanges and high-speed trading firms. Many of the questions focus on risk controls for trading that is constantly testing the limits of speed and volume that exchanges can handle. The release notes high-frequency trading often is different from automated trades executed on behalf of regular investors, and asks whether such rapid-fire trading activities "should receive different regulatory attention." CFTC Chairman Gary Gensler said in an interview that while the agency has "done a lot already" to grapple with computer trading, it might have to impose tighter controls as firms push for faster trading speeds. "There's a balance of the integrity of the market versus speed," he said. Yet, the CFTC leaves open the possibility of doing nothing, asking for comment on "the extent to which measures already in place may be sufficient to safeguard markets."

DODD-FRANK

August 15, 2013 – CFTC agrees to risk management controls for DCOs. *Financial News* reported that the CFTC aproved new rules governing the risk management standards for derivatives clearing organziations (DCOs). The U.S. Treasury's Financial Stability Oversight Council categorises certain DCOs as systemically important derivatives clearing organisations (SIDCOs) which will be subject to the new CFTC rules under the Dodd-Frank Act. Under the rules, financial resources requirements for SIDCOs involved in activities with more complex risk profiles, or those systemically important in multiple jurisdictions, have been increased. The rules prohibit firms classified as SIDCOs from including their available default resources in assessments and impose enhanced safeguards for business continuity and disaster recovery.

September 03, 2013 – New rules for uncleared swap pose regulatory arbitrage risk. The *Financial Times* reported that after the long-awaited guidelines from international regulators that require market participants to back exotic swap trades with collateral, market participants warn that proposals risk regulatory arbitrage for banks that also need to adhere to separate capital charges. Both Basel III and the non-cleared margin framework will be interpreted and applied by each national regulator, posing the risk of regulatory arbitrage between different countries if both sets of rules are not aligned. A lot of responsibility is being delegated to national regulators in terms of which firms should be covered and what constitutes high quality collateral. This makes it difficult to create a level playing field, especially as exposures will be calculated on a consolidated level globally. From a bank's perspective, this means that there is a practical challenge of knowing in real time the market and counterparty risks of all of its global subsidiaries and branches.

September 17, 2013 – Regulatory complexity stifling OTC shake up. *Financial Times* reported that haphazard rulemaking could be detrimenetal to the OTC derivatives markets. According to FT, experts described new rules that require swap trades to be passed through clearing houses and reported to trade repositories as confusing for investors in some areas, while also doubting whether the reforms would protect investors in stressed market conditions. The focus on costs by market participants could spark a race to the bottom in clearing houses' risk management standards potentially negating the impact of the rule.

CLEARING

August 7, 2013 – Bloomberg and LCH Team up to ease collateral. *Financial Times* reported that LCH Clearnet has entered into a partnership with Bloomberg to better control the rising collateral costs of swaps. LCH's SwapClear Margin Approximation Risk tool helps market participants determine how much it will cost to fund derivatives trades that will become more expensive to transact under new regulations. The new rules require privately held contracts to be transacted on electronic platforms and pass through clearing houses to limit systematic risk. The resulting new requirements for collateral, or margin, has led to this tool that will help traders calculate and manage how large price moves and changes in market conditions will influence collateral requirements before entering into a trade.

MARKET STABILITY & VOLATILITY CONTROLS

August 22, 2013 – Goldman Options Error. The *WSJ* reported that in many ways Goldman won on Thursday when NYSE Euronext's Amex options exchange cancelled nearly all of the errant options trades that caused waves throughout the markets. Just after U.S. markets opened August 20th, a faulty system at Goldman mistakenly issued waves of orders to trade stock-options contracts, in some cases at prices that were far off the prevailing market rate, with many at $1. Goldman traced the false orders to changes made Monday to an internal software program that helps determine the prices at which the firm would buy or sell options from clients, said people familiar with the matter. It was thought that had the trades stood, Goldman could have been liable for multiple millions of dollars. Options exchanges finalized their decisions the next day on whether or not to kill the trades—and the results varied widely. The reason is generally because there is a crazy quilt of rules among the nation's 12 exchanges that is creating uncertainty in the market. The big difference stems from whether an exchange will cancel such trades or merely adjust their prices in certain instances.

August 24, 2013 – NASDAQ's shutdown leads to SEC actions. The 3-hour shutdown of the NASDAQ Stock Market has prompted SEC Chairman White to push harder for stronger technology safeguards. NASDAQ said its failure this week stemmed from "a connectivity issue between an exchange participant" and the network, called a securities information processor, that provides data about quotes and prices. Such systems, or SIPs, are owned by the two major exchange operators -- the NASDAQ OMX Group Inc. and NYSE Euronext. The SEC's recent rule proposal, known as Regulation SCI, would require exchanges, SIPs and clearing firms to adopt policies to prevent failures, stress test their systems to ensure trading continues through a disruption, such as a software glitch or natural disaster, and report the disruptions to the SEC. However, there is still much to be debated and finalized as part of Regulation SCI.

August 29, 2013 – Exchange moves to revamp volatility curbs on lightly traded ETFs. U.S. exchanges asked the Securities and Exchange Commission to exclude a handful of lightly traded exchange-traded funds from new market-volatility curbs following a string of halts in ETFs that scarcely trade according to Dow Jones. The Exchanges and FINRA proposed a higher volume threshold for the first wave of ETFs to fall under the limit-up/limit-down pilot program, according to a document submitted to the SEC dated Tuesday. The proposal would remove limit-up/limit down rules for certain ETFs that trade less than 2 million in shares each day, on average and place them into another tier of limit up limit down protections more suitable for more thinly traded ETFs. A NYSE spokeswoman said the exchange "will temporarily remove these securities from the LULD Pilot to ensure the pilot operates as intended and address the potential adverse impact of these types of trading halts."

September 04, 2013 – Reg SCI unlikely to prevent recent failures. *The Trade* reported that the use of technology by exchanges is currently the focus of the Securities and Exchange Commission's (SEC) latest rule proposal, Regulation Systems Compliance and Integrity (Reg SCI). However, Larry Tabb (CEO of Tabb Group), doubts that the regulation could lead to any significant change to prevent future failures. Tabb said, that he doesnt think Reg SCI really had the potential to sort out these kind of problems because it's not going to stop faulty technology of exceptional circumstances from causing problems. While firms failing to comply with Reg SCI could be fined, the SEC is already able to fine exchanges and participants for technology problems. Tabb added that exchanges should ensure they have better throttling measures in place to ensure they don't suffer similar issues, as effective management of message flow into technology systems would prevent vital systems from falling over.

September 16, 2013 – Market disruptions seen sign of the times. *Bloomberg* reported that the recent disruptions will never be completely preventable. While U.S. Securities and Exchange Commission Chairman Mary Jo White urged efforts to strengthen markets following the NASDAQ mishap, 35% of those surveyed say regulators shouldn't try to enforce zero-fault tolerance in equity markets, eight percentage points more than those who say they should, according to the global poll of investors, analysts and traders who are Bloomberg subscribers. "Market participants need to understand, as do the regulators, that nothing is perfect and there will occasionally be problems, but that's part of the evolution of the capital market," respondent Kevin Divney, chief investment officer at Beaconcrest Capital Management LLC in Boston, said in a phone interview. "If the regulators put too high a penalty on the market structure, they could impede innovations." In the latest attempt to strengthen the fragmented U.S. equity market, White held private talks with exchange executives yesterday to discuss improvements in systems for distributing price data.

September 16, 2013 – Data glitch halts options trading. The problem occurred in the so-called OPRA system, or Options Price Reporting Authority, which disseminates options price quotes, last-sale reports and other trading information to all of the nation's exchanges that trade options. OPRA's operations and technology are managed by SIAC, a unit of NYSE Euronext. The glitch also impacted the other nine exchanges that use OPRA, which include the NYSE's electronic exchange ARCA, NASDAQ and BATS. Today's closure is the latest setback for American exchanges, which have faced criticism that the complexity of their electronic infrastructure leaves it vulnerable to breakdowns.

September 25, 2013 – NASDAQ consider cooperating to address glitches. *WSJ* reported that even though they are longtime rivals NYSE and NASDAQ are discussing plans in which each company would run a backup for the other's benchmark stock-pricing data, according to people involved in the discussions. If one exchange group's feed went down, traders could turn to its competitor for data while the problem was being fixed. The impetus is a run of recent breakdowns—two for NASDAQ and one at NYSE. The Securities and Exchange Commission this month set a deadline for exchanges to strengthen their technology, and exchange executives have since brainstormed ways to build better backup systems. Exchange officials, including the chief executives of NYSE and NASDAQ, agreed at a September 12th meeting called by the SEC to work together to outline ways to strengthen the system. The approach has challenges, however, currently, NYSE's and NASDAQ'sdata feeds use different methods to communicate with traders and exchanges—essentially speaking different languages. Creating dual backups raises the question of whether communications would need to be standardized, which would take time, the people familiar with the discussions said.

TRANSACTION TAX

September 02, 2013 – Italy imposed financial tax on HFT. Italy implemented a new tax on high-frequency trading according to Agence France Presse, becoming the first country to impose a levy on an opaque and little-regulated market. The 0.02-percent levy applies to derivatives deals lasting less than half a second and is the second part of new financial transaction taxes being imposed in Italy. Ten other European countries are preparing to introduce similar taxes on financial transactions, a prospect that has concerned experts worried about a possible wider impact on the economy.

September 03, 2013 – Liquidity dries up in FTT countries. Liquidity in French and Italian markets has dried up since the countries introduced financial transaction taxes (FTTs), despite a broader recovery in Europe, according to research from TABB Group. French market share has fallen to almost half its 2011 peak of 23% so far in 2013 and TABB estimates the market will represent just 12.8% of European equity turnover by year-end. In contrast to the situation in the French and Italian markets, the UK and Germany now both have around 21% of market share, up from 19% and 18% respectively in 2011. The research found that a growing number of asset managers are now executing a large proportion of their trades in the dark, with 25% of asset managers claiming they trade more than 30% of flow off-exchange. Just 6% of asset managers do no dark trading, showing the trend toward making greater use of dark pools has stretched to virtually all parts of the market.