

Nasdaq IR Update: SEC Market Structure Proposal

February 18, 2020

SEC's market structure proposal has implications that span most aspects of U.S. equity markets

- Reshapes equity trading under Reg NMS by re-defining which orders will be displayed in the market (under NMS Rule 604), how many shares will be required for orders to be “protected” from trade-throughs (under NMS Rule 611) and when markets can be locked or crossed (under NMS Rule 610).
- Reshapes regulation of U.S. markets:
 - Shifts regulation of brokers/dealers that handle investors' orders by adding further ambiguity to the Duty of Best Execution owed to customers, and the calculations and disclosures of order handling (under NMS Rule 605 and Rule 606).
 - Shifts regulation of exchanges by changing the operation of short selling regulation (under Reg SHO Rule 201), Limit Up/Limit Down and MarketWide Circuit Breakers, and creating new categories of “Regulatory” and “Administrative” data under NMS Rule 600.
- Reshapes the collection, consolidation and dissemination of market data to investors, including what data is collected from brokers and exchanges, and how that data will be consolidated and distributed.
 - Expand the scope of consolidated “SIP” data to include five levels of depth-of-book data and exchange auction data, including changes to NMS Rules 600, 603, and 608.
 - Creates a system of competing consolidators that would be authorized to buy and distribute all consolidated data from all exchanges. A competing consolidator would be required to make all consolidated data available to those that wished to purchase it.
 - Allows “self-aggregators” to buy and consolidate data for their own use, subject to few regulatory standards.
- Establish a new system of registration for a new class of market participants — “competing consolidators” and subjecting them to registration and to provisions of Regulation SCI. (under NMS Rule 613 and 614).
- Links:
 - SEC press release: <https://www.sec.gov/news/press-release/2020-34>
 - SEC proposal: <https://www.sec.gov/rules/proposed/2020/34-88216.pdf>

Complexities with More Questions than Answers

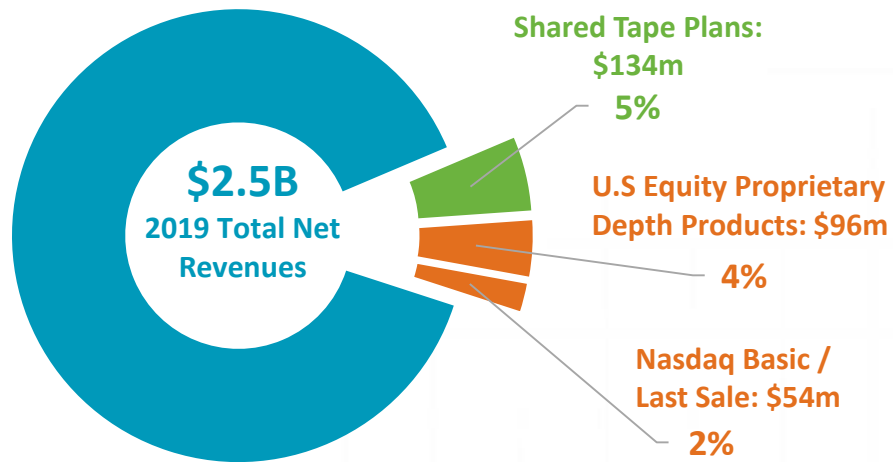
- Proposal is complex:
 - >600 pages long, and in combination with January proposal on governance/consolidation of tape plans, approaches 700 pages (Reg. NMS was about half that length).
 - Request for comment includes 300 questions SEC would like industry to answer.
- Critical questions regarding market structure will need to be carefully examined:
 - National Best Bid and Offer: The proposal abandons the single, unified NBBO in favor of a decentralized, splintered NBBO calculated by dozens of different participants. Investors will have no “North Star” for determining the quality of their trades.
 - Locked and Crossed Markets: The proposal partially rescinds the rule against locking or crossing the markets, allowing some orders to lock or cross the market depending on the price of the stock, the size of the order, and the state of the NBBO.
 - Displayed Orders Not Always Protected: A bifurcated system of round lots and protected quotes would exist, with orders below 100 shares not being protected even though they are redefined as round lots and will be displayed in the exchange data feed. Therefore, displayed retail orders will not be protected against trade-throughs.
 - Duty of Best Execution: The SEC proposes to de-couple the definition of core data and the Duty of Best Execution, creating a grey space where brokers have access to a wide swath of required core data but may, or may not, be obligated to use that data to benefit customers.
- Numerous issues with respect to pricing and product design of market data:
 - The proposal is silent on critical elements of market data products, pricing and production. Unknown are the products that will be offered, the prices of these products, the allocation of quote and trade revenue, the collection of revenue from newly-registered competing SIPs and self-aggregators.
 - Creates several conflicts of interest amongst clients and competitors, and a dramatic expansion of the role of government and interested parties in rate-setting within competitive industries.
 - Due to added complexity, particularly with competing consolidators and self-aggregators, audits will increase and create more administrative burden.
 - Multiple NBBOs and the other proposals above will make it harder to surveil market activity to protect investors.

Understanding the SEC's Rulemaking Process

- SEC commission issued the proposed rule February 14, 2020.
- After the proposed rule is published in the Federal Register, a 60 day comment period begins.
- After comment period closes, SEC must review the comments, which can take several months to digest for more ambitious/controversial proposals.
- If the comments compel the SEC to significantly revise its proposal, then it may need to re-propose it, in whole or in part, opening a new comment period and related review of feedback. Such a re-proposal occurred in the case of Reg NMS.
- In sum, while there is considerable uncertainty, the SEC's rulemaking process is likely to take considerable time to complete, and may result in a significantly altered proposal or not result in any final rulemaking.
- After a final rule is approved by the SEC, it could be subject to legal challenges at the DC Circuit.
- If the final SEC rule is approved and moves into implementation phase, it could result in a lengthy delay due to the legal and technological complexities.

Potential Considerations Around Market Data

% of Total Nasdaq 2019 Revenues



Potential Risks and Considerations

- While many unknowns remain, the potential change to Nasdaq's revenues could largely be dependent on the net impact of customers who decide to switch to a new consolidated SIP, away from depth or Nasdaq Basic products.
- While product substitution could occur, Nasdaq would receive compensation from new content and potential additional users of core market data.
- The SEC's rulemaking proposal, if implemented as proposed, would require additional information before impacts can be reasonably assessed. Therefore, we are not making changes at this time to our medium-term outlook of low to mid single digit revenue growth for market data.

What Isn't Changing: Market Data is Valuable and Distribution Remains Subject to SEC Oversight

- Exchange market data is critical to the proper functioning of our marketplaces and helping investors, traders and intermediaries such as banks, brokers and liquidity providers to be effective as they navigate the marketplace.
- While the distribution and components in core data may change, exchanges will continue to be compensated for their contributions to this service.
- There will continue to be full depth data and the proposal envisions new ways for exchanges to distribute portions of the core data to "internal aggregators", which will pay exchanges for this usage.
- All product design, pricing of new SIP data products will be subject to SEC review/approval, and open to public commentary, as it has been in the past.

Disclaimers

Non-GAAP Information

In addition to disclosing results determined in accordance with U.S. GAAP, Nasdaq also discloses certain non-GAAP results of operations, including, but not limited to, net income attributable to Nasdaq, diluted earnings per share, operating income, and operating expenses, that include certain adjustments or exclude certain charges and gains that are described in the reconciliation table of U.S. GAAP to non-GAAP information provided at the end of this release. Management uses this non-GAAP information internally, along with U.S. GAAP information, in evaluating our performance and in making financial and operational decisions. We believe our presentation of these measures provides investors with greater transparency and supplemental data relating to our financial condition and results of operations. In addition, we believe the presentation of these measures is useful to investors for period-to-period comparisons of results as the items described below do not reflect ongoing operating performance.

These measures are not in accordance with, or an alternative to, U.S. GAAP, and may be different from non-GAAP measures used by other companies. In addition, other companies, including companies in our industry, may calculate such measures differently, which reduces their usefulness as a comparative measure. Investors should not rely on any single financial measure when evaluating our business. This information should be considered as supplemental in nature and is not meant as a substitute for our operating results in accordance with U.S. GAAP. We recommend investors review the U.S. GAAP financial measures included in this earnings release. When viewed in conjunction with our U.S. GAAP results and the accompanying reconciliations, we believe these non-GAAP measures provide greater transparency and a more complete understanding of factors affecting our business than U.S. GAAP measures alone.

We understand that analysts and investors regularly rely on non-GAAP financial measures, such as non-GAAP net income attributable to Nasdaq, non-GAAP diluted earnings per share, non-GAAP operating income and non-GAAP operating expenses to assess operating performance. We use these measures because they highlight trends more clearly in our business that may not otherwise be apparent when relying solely on U.S. GAAP financial measures, since these measures eliminate from our results specific financial items, such as those described below, that have less bearing on our ongoing operating performance.

Foreign exchange impact: In countries with currencies other than the U.S. dollar, revenues and expenses are translated using monthly average exchange rates. Certain discussions in this release isolate the impact of year-over-year foreign currency fluctuations to better measure the comparability of operating results between periods. Operating results excluding the impact of foreign currency fluctuations are calculated by translating the current period's results by the prior period's exchange rates.

Disclaimers

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