The NASDAQ Stock Market "Single Book" Proposal
Good for Investors. Good for Competition.
April 6, 2006

NASDAQ has filed with the Commission a rule proposal to integrate Nasdaq's three separate execution systems – NASDAQ, INET, and Brut - into a single execution system drawing on a single pool of liquidity in strict price/time priority.

The Single Book will:

- ***benefit investors*** by offering a faster, fairer, more efficient and more transparent system that executes trades in strict price/time priority;
- ***promote competition*** by allowing NASDAQ to increase efficiency, decrease costs, and provide better service to market participants;
- ***comply with Regulation NMS*** Access and Order Protection Rules to prevent locked and crossed markets and trade throughs and fulfill Nasdaq's obligations in handling sub-penny trading as well; and
- ***advance NASDAQ's exchange registration*** by enabling NASDAQ to participate in the national market system as a national securities exchange.

The Single Book will be built on the industry-leading INET technology that Nasdaq purchased for $1 billion in 2005. The operating rules of the proposed Single Book will draw from those that the SEC has approved for use in the NASDAQ, INET, and Brut systems.

- The Single Book will use functionality from INET for order entry, display, processing, and routing of orders (modified to comply with Reg NMS).
- The NASDAQ system will contribute existing functionality for the Opening and Closing Crosses which provides market participants with a liquid, transparent process for setting a reliable price at two critical points in the day.
- The Single Book will produce market data currently offered by both the NASDAQ and INET systems but, because NASDAQ is combining three liquidity pools into one, the data will represent a greater percentage of trading activity and will be more useful to investors.

The Single Book, like the INET system it is built upon, will not offer order delivery functionality. This is a necessary step in the evolution of the NASDAQ Stock Market because order delivery denigrates the overall quality of the NASDAQ market, imposes high costs on users of the market, and harms NASDAQ's ability to compete. More specifically:

- ***The elimination of order delivery functionality is consistent with the Exchange Act.*** No other SRO market has been required to or chosen to offer order delivery to its participants. To force NASDAQ to continue to offer order delivery functionality without imposing the same requirement on the NYSE's Hybrid System and the systems of the American, Boston, Chicago, National and Pacific Stock Exchanges would violate the Exchange Act goal of equal regulation and would be arbitrary and capricious under the Administrative Procedures Act of 1946 (5 U.S.C. 706).

- ***Order delivery harms market quality and investors.*** It is a legacy execution mechanism that results in slower executions, lower fill rates, and worse prices for investors that involuntarily interact with order delivery firms. These dangers are acute at the critical opening and closing of the market. For one week in March 2006:
    - 100 percent of automatic execution orders that Nasdaq attempted to execute actually executed.
    - 14 percent of total orders that Nasdaq delivered to ECNs failed to execute; for one ECN the overall failure rate exceeded 25%.
    - 55.6 percent of orders delivered to ECNs between 9:30:00 and 9:30:15 failed to execute.
    - 27.9 percent of orders delivered to ECNs between 9:30:15 and 9:30:30 failed to execute.
    - Between 9:30:00 and 9:30:15, three ECNs have mean response times of over four, nine, and twenty seconds per order.

- ***Order delivery makes NASDAQ less competitive.*** It is costly to NASDAQ as it demands disproportionate system capacity and unique specifications, requirements, and programming not available to or needed by automatic execution participants, the vast majority of NASDAQ participants. No other SRO market incurs these costs.

- ***Order delivery is contrary to Regulation NMS.*** Providing order delivery would risk making NASDAQ a “slow” market and, when an order delivery participant experienced technical problems, would permit other trading centers to declare “self-help” and stop routing orders to NASDAQ. Offering order delivery functionality will impair Nasdaq’s ability to continuously provide “a response to incoming orders that does not significantly vary between orders handled entirely within the SRO trading facility and orders delivered to an ECN” as required under Reg NMS.

- ***Order Delivery Participants have alternatives.*** Firms that currently use order delivery can still participate in NASDAQ via automatic execution. Alternatively, such firms that wish to avoid automatic execution systems have already begun negotiating to report trades through other SRO markets’ facilities in return for market data revenue. NASDAQ notes, however, that those participants that currently utilize order delivery functionality within NASDAQ’s current system do not offer order delivery within their own systems; they demand automatic executions from their own subscribers within their own systems.