SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51504; File No. SR-NASD-2004-033)

April 7, 2005

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto by the National Association of Securities Dealers, Inc. Seeking to Modify the Nasdaq Market Center Execution Service to Add an Optional Routing Feature

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on February 25, 2004, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. On July 15, 2004, Nasdaq submitted Amendment No. 1 to the proposed rule change.[3] On February 23, 2005, Nasdaq submitted Amendment No. 2 to the proposed rule change.[4] On April 7, 2005, Nasdaq submitted Amendment No. 3 to the proposed rule change.[5] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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[1]   15 U.S.C. 78s(b)(1).

[2]   17 CFR 240.19b-4.

[3]   Amendment No. 1 replaced and superseded the originally filed proposed rule change.

[4]   Amendment No. 2 replaced and superseded the originally filed proposed rule change, as amended.

[5]   Amendment No. 3 replaced and superseded the originally filed proposed rule change, as amended.

I.   Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

Nasdaq proposes to modify the Nasdaq Market Center execution service (formerly known as SuperMontage or the Nasdaq National Market Execution System) to provide an optional routing feature that will route orders in Nasdaq-listed securities to other markets accessible by the router when these markets are displaying quotes at prices that are superior to those available on Nasdaq. Pending Commission approval, Nasdaq is scheduled to implement the routing feature on or about May 9, 2005. Below is the text of the proposed rule change, as amended. Proposed new language is italicized; proposed deletions are in [brackets].

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4700. NASDAQ MARKET CENTER - EXECUTION SERVICES

4701. Definitions

Unless stated otherwise, the terms described below shall have the following meaning:

(a) The term "active Nasdaq Market Center securities" shall mean those Nasdaq Market Center eligible securities in which at least one Nasdaq Market Maker or ITS/CAES Market Maker is currently active in the Nasdaq Market Center, or at least one exchange or the Association's Alternative Display Facility is actively quoting the security and Nasdaq has access to the quotes of these markets under Rule 4714. A security will not be considered an "active Nasdaq Market Center security" when trading on Nasdaq has been halted pursuant to Rule 4120 and the interpretations thereunder.

(b) – (z) No change

(aa) The term "Preferenced Order" shall mean an order that is entered into the Non-Directed Order Process and is designated to be delivered to or executed against a particular

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Quoting Market Participant's Attributable Quote/Order if the Quoting Market Participant is at the best bid/best offer when the Preferenced Order is the next in line to be executed or delivered. Preferenced Orders shall be executed subject to the conditions set out in Rule 4710(b). Preferenced Orders shall not be eligible for routing as set out in Rule 4714.

(bb) – (jj) No change

(kk) The term "Auto-Ex" shall mean, for orders in Nasdaq listed securities so designated, an order that (except when it is displayed or interacts with a displayed Discretionary Order at a price in its discretionary price range) will execute solely against the Quotes/Orders of Nasdaq Market Center Participants that participate in the automatic execution functionality of the Nasdaq Market Center and that do not charge a separate quote access fee to Nasdaq Market Center Participants accessing their Quotes/Orders through the Nasdaq Market Center. An Auto-Ex Order may be designated as "Immediate or Cancel" (an "IOC Auto-Ex Order") or "Day" or "GTC" (a "Postable Auto-Ex Order"). A party entering a Postable Auto-Ex Order may (but is not required to) specify that the order will utilize the functionality associated with Discretionary Orders. Auto –Ex orders shall not be eligible for routing as set out in Rule 4714.

(ll) The term "Fill or Return" shall mean for orders in ITS Securities so designated, an order that is to be delivered to or executed by Nasdaq Market Center Participants without delivering the order to an ITS Exchange and without trading through the quotations of ITS Exchanges. Fill or Return orders shall not be eligible for routing as set out in Rule 4714.

(mm) The term "Pegged" shall mean, for priced limit orders so designated, that after entry into the Nasdaq Market Center, the price of the order is automatically adjusted by the Nasdaq Market Center in response to changes in the Nasdaq Market Center inside bid or offer, as appropriate. The Nasdaq Market Center Participant entering a Pegged Order may specify that the

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price of the order will either equal the inside quote on the same side of the market (a "Regular

Pegged Order") or equal a price that deviates from the inside quote on the contra side of the

market by $0.01 (i.e., $0.01 less than the inside offer or $0.01 more than the inside bid) (a

"Reverse Pegged Order"). The market participant entering a Pegged Order may (but is not

required to) specify a cap price, to define a price at which pegging of the order will stop and the

order will be permanently converted into an unpegged limit order. Pegged Orders shall not be

available for ITS Securities. Pegged orders shall not be eligible for routing as set out in Rule

4714.

       (nn) The term "Discretionary" shall mean,

       (1) for priced limit orders in Nasdaq listed securities so designated, an order that

when entered into the Nasdaq Market Center has both a displayed bid or offer price, as well as a

non-displayed discretionary price range in which the participant is also willing to buy or sell, if

necessary. The displayed price may be fixed or may be pegged to equal the inside quote on the

same side of the market. The pegging of the Discretionary Order may be capped in the same

manner as that of a Pegged Order. The discretionary price range of a Discretionary Order that is

pegged will be adjusted to follow the pegged displayed price. Discretionary Orders for Nasdaq

listed securities shall be eligible for routing as set out in Rule 4714.

       (2) for orders in ITS Securities so designated, an order that when entered

into the Nasdaq Market Center has both a displayed bid or offer price, as well as a non-

displayed discretionary price range in which the participant is also willing to buy or sell,

if necessary. The display price must be fixed. A Discretionary Order in an ITS Security

may not result in a quote that locks or crosses the national best bid and offer and shall

not be executed at a price that trades through the quotation of an ITS Exchange unless it

is designated as a Sweep Order. <u>Discretionary Orders for ITS Securities shall not be eligible for routing as set out in Rule 4714.</u>

(oo) The term "Summary" shall mean, for priced limit orders so designated, that if an order is marketable upon receipt by the Nasdaq Market Center, it shall be rejected and returned to the entering party. Summary Orders may only be entered by Nasdaq Order-Delivery ECNs. <u>Summary orders shall not be eligible for routing as set out in Rule 4714.</u>

(pp) – (qq) No change

(rr) The term "Sweep Order" shall mean, for orders in ITS Securities so designated, an order that may be delivered to or executed by Nasdaq Market Center Participants at multiple price levels. <u>Sweep Orders shall not be eligible for routing as set out in Rule 4714.</u>

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4706. Order Entry Parameters

(a) Non-Directed Orders--

(1) General. The following requirements shall apply to Non-Directed Orders Entered by Nasdaq Market Center Participants:

(A) A Nasdaq Market Center Participant may enter into the Nasdaq Market Center a Non-Directed Order in order to access the best bid/best offer as displayed in Nasdaq <u>and other markets as set out in Rule 4714</u>.

(B) A Non-Directed Order must be a market or limit order, must indicate whether it <u>should be not routed to another market in accordance with Rule 4714, whether it</u> is a buy, short sale, short-sale exempt, or long sale, and may be designated as "Immediate or Cancel", "Day", "Good-till-Cancelled", "Auto-Ex", "Fill or Return", "Pegged", "Discretionary",

"Sweep", "Total Day", "Total Good till Cancelled", or "Total Immediate or Cancel," or "Summary."

(i) - (xiii) No change

(C) The system will not process a Non-Directed Order to sell short if the execution of such order would violate [NASD Rule 3350 or, in the case of ITS Securities,] SEC Rule 10a-1, in the case of ITS Securities. Non-Directed Orders to sell short shall not be executed in the Nasdaq Market Center if the execution of such order would violate NASD Rule 3350. Non-Directed Orders to sell short that cannot be executed in the Nasdaq Market Center and that have elected to be routed to other markets as set out in Rule 4714 shall be routed to another market and processed in accordance with the short sale restrictions in effect at the destination market.

(D) – (F) No change

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4707. Entry and Display of Quotes/Orders

(a) Entry of Quotes/Orders--Nasdaq Quoting Market Participants may enter Quotes/Orders into the Nasdaq Market Center, and Order Entry Firms may enter Non-Attributable Orders into the Nasdaq Market Center, subject to the following requirements and conditions:

(1) No change

(2) Upon entry of a Quote/Order into the system, the Nasdaq Market Center shall time-stamp it, which time-stamp shall determine the ranking of the Quote/Order for purposes of processing Non-Directed Orders as described in Rules 4710(b) and 4714. For each subsequent size increase received for an existing quote at a given price, the system will maintain the original

time-stamp for the original quantity of the quote and assign a separate time-stamp to that size increase. When a Pegged Order (including a Discretionary Order that is pegged) is displayed as a Quote/Order, its time-stamp will be updated whenever its price is adjusted.

(3) – (4) No change

(b) Display of Quotes/Orders in Nasdaq — The Nasdaq Market Center will display [a Nasdaq] Quotes/Orders submitted to the system as follows:

(1) – (2) No change

(3) Exceptions--The following exceptions shall apply to the display parameters set forth in paragraphs (1) and (2) above:

(A) – (C) No change

(D) Non-Directed Orders and Routing – Non-Directed Orders marked for routing as set out in Rule 4714 shall not be displayed in the Nasdaq Market Center while outside the Nasdaq Market Center. Non-Directed Orders marked for routing shall be displayed in the Nasdaq Market Center as set out in Rules 4701 and 4707 while such orders are in the Nasdaq Market Center.

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4710. Participant Obligations in the Nasdaq Market Center

(a) No change

(b) Non-Directed Orders

(1) General Provisions--A Quoting Market Participant in a Nasdaq Market Center eligible security, as well as Order Entry Firms, shall be subject to the following requirements for Non-Directed Orders:

(A) No change

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(B) Processing of Non-Directed Orders — Upon entry of a Non-Directed Order into the system, the Nasdaq Market Center will ascertain who the next Quoting Market Participant or Order Entry Firm in queue to receive an order is and shall deliver an execution to Quoting Market Participants or Order Entry Firms that participate in the automatic-execution functionality of the system, or shall deliver a Liability Order to Quoting Market Participants that participate in the order-delivery functionality of the system. Non-Directed Orders entered into the Nasdaq Market Center system shall be delivered to or automatically executed against Quoting Market Participants' or Order Entry Firms' Displayed Quotes/Orders and Reserve Size, in strict price/time priority, as described in the algorithm contained in subparagraph (b)(B)(i) of this rule. The individual time priority of each Quote/Order submitted to the Nasdaq Market Center shall be assigned by the system based on the date and time such Quote/Order was received. Remainders of Quote/Orders reduced by execution, if retained by the system, shall retain the time priority of their original entry. For purposes of the execution algorithms described in paragraphs (i), (ii) and (iii) below, "Displayed Quotes/Orders" shall also include any odd-lot, odd-lot portion of a mixed-lot, or any odd-lot remainder of a round-lot(s) reduced by execution, share amounts that while not displayed in the quotation montage of the Nasdaq Market Center, remain in system and available for execution.

(i) Execution Algorithm — Price/Time — The system will default to a strict price/time priority within Nasdaq, and will attempt to access interest in the system in the following priority and order:

a. Displayed Quotes/Orders of Nasdaq Market Makers, ITS/CAES Market Makers, and Nasdaq ECNs, displayed Non-Attributable Quotes/Orders of Order Entry Firms, and displayed non-attributable agency Quotes/Orders of UTP Exchanges (as

permitted by subparagraph (f) of this rule), in time priority between such participants' Quotes/Orders;

b. Reserve Size of Nasdaq Quoting Market Participants and Order Entry Firms, in time priority between such participants' Quotes/Orders; and

c. Principal Quotes/Orders of UTP Exchanges, in time priority between such participants' Quotes/Orders.

(ii) Exceptions — The following exceptions shall apply to the above execution parameters:

a. If a Nasdaq Quoting Market Participant or Order Entry Firm enters a Non-Directed Order into the system, before sending such Non-Directed Order to the next Quoting Market Participants in queue, the Nasdaq Market Center will first attempt to match off the order against the Nasdaq Quoting Market Participant's or Order Entry Firm's own Quote/Order if the participant is at the best bid/best offer in Nasdaq. Nasdaq Quoting Market Participants and Order Entry Firms may avoid any attempted automatic system matching permitted by this paragraph through the use of an anti-internalization qualifier (AIQ) quote/order flag containing the following values: "Y" or "I", subject to the following restrictions:

Y — if the Y value is selected, the system will execute the flagged quote/order solely against attributable and non-attributable quotes/orders (displayed and reserve) of Quoting Market Participants and Order Entry Firms other than the party entering the AIQ "Y" flagged quote/order. If the only available trading interest is that of the same party that entered the AIQ "Y" flagged quote/order, the system will not execute at an inferior price level, and will instead return the latest entered of those interacting quote/orders (or unexecuted portions thereof) to the entering party or route the quote/order to another market as

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set out in Rule 4714 if the quote/order is marked for routing; provided, however, that in the case of a Discretionary Order interacting with a bid/offer entered by the system pursuant to Rule 4710(b)(5), the Discretionary Order (or unexecuted portions thereof) will be returned.

I — if the I value is selected, the system will execute against all available trading interest, including the quote/orders of the Order Entry Firm or Nasdaq Quoting Market Participant that entered the AIQ "I" flagged order, based on the price/time execution algorithm

b. No change

c. No change

d. No change

e. If a Nasdaq Market Center Participant enters a Discretionary Order, the Discretionary Order shall first be executed against (or delivered in an amount equal to) the Quotes/Orders and Reserve Size of Nasdaq Market Center Participants (including displayed Discretionary Orders at their displayed prices) in conformity with this rule and subject to any applicable exceptions. If the full size of the incoming Discretionary Order cannot be executed at its displayed price, the order may also be executed against (or delivered in an amount equal to) the Quotes/Orders and Reserve Size of Nasdaq Market Center Participants within the incoming Discretionary Order's discretionary price range (including displayed Discretionary Orders at their displayed prices), in conformity with this rule and subject to any applicable exception. If the full size of the incoming Discretionary Order cannot be executed in this manner, the order may also be executed by (or receive delivery of) displayed Discretionary Orders with discretionary price ranges that overlap with the incoming Discretionary Order's discretionary price range, in conformity with this rule and subject to any applicable exception.

The unexecuted portion of a Discretionary Order will then be retained by the Nasdaq Market Center for potential display in conformity with Rule 4707(b). To the extent a Discretionary Order designated for routing is not executed in full in accordance with the procedures described above upon submission to the Nasdaq Market Center the order shall be routed as set out in Rule 4714.

When a Discretionary Order is displayed as a Quote/Order, Non-Directed Orders or Quotes/Orders entered at the displayed price (including incoming Discretionary Orders with a displayed or discretionary price equal to the displayed Discretionary Order's displayed price) may be executed against (or delivered to) the displayed Discretionary Order, and market orders may be executed against (or delivered to) the displayed Discretionary Order when its displayed price is at the inside. Non-Directed Orders or Quotes/Orders (other than Discretionary Orders) entered at a price within the displayed Discretionary Order's discretionary price range may be executed by (or receive delivery of) the displayed Discretionary Order at the price of the incoming Non-Directed Order or Quote/Order if there are no displayed Quotes/Orders at that price or better. Incoming Discretionary Orders with a discretionary price range that overlaps with the displayed Discretionary Order's discretionary price range may be executed by (or receive delivery of) the displayed Discretionary Order at the overlapping price most favorable to the displayed Discretionary Order. A displayed Discretionary Order that may be executed at a price in its discretionary price range will execute against Non-Directed Orders and Quotes/Orders entered by Nasdaq Market Center Participants in the automatic execution functionality of the Nasdaq Market Center, and will be delivered to Non-Directed Orders and Quotes/Orders entered by Nasdaq Order-Delivery ECNs.

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For purposes of determining execution priority, the price priority of a displayed Discretionary Order will be based on its displayed price when it may be executed at its displayed price. When displayed Discretionary Orders may be executed at prices within their discretionary price ranges, their price priority vis-à-vis one another will be based on their most aggressive discretionary prices, and their price priority vis-à-vis Quotes/Orders that are not Discretionary Orders will be based upon the price at which they are executable.

f. No change

g. Non-Directed Orders marked for routing shall be processed in accordance with Rule 4714.

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(e) UTP Exchanges – Direct Participation in Nasdaq Market Center

Direct [P]participation in the Nasdaq Market Center by UTP Exchanges is voluntary. If a UTP Exchange does not participate directly in the Nasdaq Market Center, the UTP Exchange's quotes may nevertheless be accessible in accordance with Rule 4714 [will not be accessed through the Nasdaq Market Center, and the Nasdaq Market Center will not include the UTP Exchange's quotation for order processing and execution purposes].

A UTP Exchange may voluntarily participate in the Nasdaq Market Center directly if it executes a Nasdaq Workstation Subscriber Agreement, as amended, for UTP Exchanges, and complies with the terms of this subparagraph [(e)] (f) of this rule. The terms and conditions of such access and participation, including available functionality and applicable rules and fees, shall be set forth in and governed by the Nasdaq Workstation Subscriber Agreement, as amended for UTP Exchanges. The Nasdaq Workstation Subscriber Agreement, as amended for UTP Exchanges may expand but shall not contract the rights and obligations set forth in these

rules. Access to UTP Exchanges may be made available on terms that differ from the terms applicable to members but may not unreasonably discriminate among similarly situated UTP Exchanges. The following provisions shall apply to UTP Exchanges that choose to participate in the Nasdaq Market Center.

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4714. Routing – Nasdaq-Listed Securities

If a Non-Directed Order for a Nasdaq-listed security is not executed in its entirety in the Nasdaq Market Center and such order is designated for routing, the order (or the unfilled portion thereof – referred to hereinafter as an "order") shall be processed as follows:

(a) The order shall be routed to those markets accessible through the Nasdaq Market Center router that are displaying quotes priced better than the Quotes/Orders available in the Nasdaq Market Center as a limit order. Routed orders shall be executed pursuant to the rules and regulations of the destination market.

(b) In the event an order routed from the Nasdaq Market Center to another market is not executed in its entirety, the remaining portion of the order shall be returned to the Nasdaq Market Center and shall be eligible for execution, or re-routing, if marketable. A market order that is converted to a limit order for routing will become a market order again upon return to the Nasdaq Market Center.

(c) In the event an order becomes non-marketable while it is in the execution queue, or the order is not marketable upon return to Nasdaq, the order shall be included in the Nasdaq Market Center book (if consistent with the order's time in force condition) in accordance with the time priority established by the time-stamp assigned to the order when it was initially

submitted to the Nasdaq Market Center. Once an order is placed in the Nasdaq Market Center book it shall not be routed outside the Nasdaq Market Center.

(d) An order that has been routed to another market shall have no time standing in the Nasdaq Market Center execution queue relative to other orders in the Nasdaq Market Center. A request from a Nasdaq Market Center Participant to cancel an order while it is outside the Nasdaq Market Center shall be processed subject to the applicable rules of the market to which the order has been routed.

(e) Orders shall not be routed to other markets during the Nasdaq Market Center Opening and Closing Crosses, as described in Rules 4704 and 4709.

(f) Orders shall not be routed to other markets at prices that exceed the execution price governors described in Rule 4710(b)(1)(B)(ii)(c).

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II.   Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq included statements concerning the purpose of, and basis for, the proposed rule change, as amended, and discussed any comments it received on the proposed rule change, as amended. The text of these statements may be examined at the places specified in Item IV below. Nasdaq has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A.   Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1.   Purpose

Nasdaq is proposing to modify the Nasdaq Market Center execution service to create an optional routing feature that will route orders in Nasdaq-listed securities to other markets when

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those markets are displaying quotes at prices that are superior to those displayed in Nasdaq and

that are accessible through the router.[6] Under the proposal, Nasdaq Market Center Participants

will be able to choose on an order-by-order basis whether they want an order routed outside the

Nasdaq Market Center.[7] Routed orders would be executed pursuant to the rules and regulations

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[6]   Nasdaq states that the routing feature will be optional; members can continue to use other routers to reach other markets. In general, Non-Directed market orders and limit orders will be eligible for routing. In addition, Discretionary Non-Directed Orders will be eligible for routing. Members also will be able to use the following time in force conditions on Non-Directed Orders eligible for routing: Immediate or Cancel, Day, Good-till-Cancelled, Total Day, Total Good till Cancelled, Total Immediate or Cancel, and End of Day. Other unique Non-Directed Order types, such as Pegged orders, are not eligible for routing. Finally, routing will not be available for Directed Orders and Preferred Orders.

Non-Directed orders will not be routed outside the Nasdaq Market Center during Nasdaq's Opening and Closing Crosses, which are described in NASD Rules 4704 and 4709. Nasdaq believes that routing orders outside Nasdaq during the opening and closing crosses would be inconsistent with the purpose of these auctions, which is to arrive at a single price that is based on the maximum number of shares that can be executed on Nasdaq.

Nasdaq states that it also will not route orders at prices that exceed the execution price governors that limit the prices at which orders can execute in the Nasdaq Market Center (NASD Rule 4710(b)(1)(B)(ii)(c)). The governors prevent large market orders and marketable limit orders priced significantly away from the inside, which in many instances are entered in error, from executing through numerous price levels automatically without any restraint and thus establishing a new inside market and potentially a new historic high or low price for a security that is not truly reflective of current market trading. Nasdaq adopted the governors to balance the goals of rapid execution and price discovery against the need to protect investors from excessive volatility and market confusion that can result from these orders. For these very same reasons, Nasdaq believes it should not route orders to other markets at prices that exceed these price limitations.

[7]   By default, eligible Non-Directed Orders will be marked for routing. Members, however, will be able to override the default by indicating that an order should not be routed.

While Nasdaq initially expects to access through its router those quotes that would qualify as "automated quotations" as under Regulation NMS, Nasdaq may route to non-automated quotations as appropriate. Nasdaq will access the quotes of exchanges through its broker-dealer subsidiary, Brut, which may not be a member of all exchanges (Brut's quotes are displayed in the Nasdaq Market Center, thus the liquidity in the Brut

of the destination market. Nasdaq states that there will be no change in the processing of orders

not marked for routing; these orders will continue to be processed through the normal Nasdaq

Market Center execution service execution algorithm.

According to Nasdaq, the processing of an order marked for routing will differ depending

ECN will be accessible as part of the liquidity in the Nasdaq Market Center). Routing
done by Brut for the Nasdaq Market Center is conducted separately from routing the Brut
Facility performs for its subscribers. Nasdaq also will route orders to exchanges in which
Brut is not a member, to the extent Brut has access to the market participants displaying
quotes in these other markets. For example, one national securities exchange's quotes
can be accessed indirectly by routing orders to the ECN that is the predominant, if not
sole, market participant displaying quotes on that exchange. In addition, Nasdaq also
may route orders to market centers that display their quotes through the NASD's
Alternative Display Facility ("ADF") and market centers that do not display their quotes
through exchanges or the ADF.

on whether there are quotes on other markets at prices superior to those displayed on Nasdaq and such quotes are accessible by Nasdaq. For each order flagged for routing, the Nasdaq Market Center will determine whether Nasdaq is at the best price vis-à-vis other markets that are accessible through Nasdaq's router. If Nasdaq is displaying the best prices, the order will be executed in full or up to the maximum amount of shares available in Nasdaq at the price levels that are superior to the prices at these other markets. Nasdaq would route any unfilled portion of the order to one of the other markets that are displaying superior quotes and that is accessible by the Nasdaq router. If more than one market is at a price level that is superior to Nasdaq's displayed price, the computer algorithm of the Nasdaq Market Center router will determine the market, or markets, to which the order will be sent, based on several factors including the number of shares being displayed, response time, likelihood of undisplayed trading interest, and the cost of accessing the market.

If other markets accessible through the router have prices superior to those on Nasdaq when an order is next in line to be processed, the order will by-pass the Nasdaq Market Center execution algorithm and will be routed to a market or markets displaying the superior priced quotes.[8] If an order (or a portion of the order) remains unfilled after being routed, it will be returned to Nasdaq where, if the order is marketable, it will be returned to the Non-Directed Order processing queue, where it can be executed in Nasdaq, or routed again, if Nasdaq is not at

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[8]   Nasdaq states that when a member submits a market order to the Nasdaq Market Center and has chosen to have the order routed, if routed, the market order will be routed to another market as a limit order. An order that has been routed to another market shall have no time standing in the Nasdaq Market Center execution queue relative to other orders in the Nasdaq Market Center.

the best price when the order is next in line in the processing queue.[9] Once a routed limit order

is no longer marketable, whether it becomes non-marketable upon return to Nasdaq or while in

the execution queue, it will be placed on the Nasdaq Market Center book, if consistent with the

order's time in force condition.[10] Once on the book, however, an order will not be routed out of

the Nasdaq Market Center, even if it becomes marketable against the quotes of another market.

> 2.   Statutory Basis

Nasdaq believes that the proposed rule change, as amended, is consistent with

Section 15A of the Act,[11] in general, and furthers the objectives of Section 15A(b)(6),[12] in

particular, in that Section 15A(b)(6) requires the NASD's rules to be designed, among other

things, to protect investors and the public interest. In addition, Nasdaq believes its proposal is

consistent with Section 11A(a)(1)(C)(ii) of the Act,[13] which states that it is in the public interest

and appropriate for the protection of investors and the maintenance of fair and orderly markets to

assure, among other things, fair competition among brokers and dealers, among exchange

markets, and between exchange markets and markets other than exchange markets. Finally,

Nasdaq believes its proposal is consistent with the Commission's Regulation NMS, which

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[9]   Nasdaq states that a market order that is converted to a limit order when it is routed to another market will become a market order again upon return to Nasdaq. However, if after being placed back in the order execution queue the order is routed yet again, it will be re-converted to a limit order.

[10]   Nasdaq states that orders returned to Nasdaq will be placed on the Nasdaq Market Center book on the basis of the time-stamp assigned to the order when it was originally submitted to the Nasdaq Market Center.

[11]   15 U.S.C. 78o-3.

[12]   15 U.S.C. 78o-3(b)(6).

[13]   15 U.S.C. 78k-1(a)(1)(C)(ii).

supports the concept of self-regulatory organizations ("SROs") accessing the quotes of other

SROs through broker-dealers.[14]

Nasdaq believes this proposal is consistent with the NASD's obligations under Section

15A of the Act because it would enable members to use the Nasdaq Market Center to access

other markets that are displaying prices superior to those available on Nasdaq. In addition,

Nasdaq also believes that the proposal is consistent with Section 11A because it should allow

Nasdaq to compete with a national securities exchange that offers a similar routing feature

through its broker-dealer subsidiary. Further, Nasdaq believes that the proposal would allow

Nasdaq to implement the method envisioned by the Commission in Regulation NMS for

accessing other SROs' quotes.

B.   Self-Regulatory Organization's Statement on Burden on Competition

Nasdaq does not believe that the proposed rule change, as amended, will impose any burden

on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C.   Self-Regulatory Organization's Statement on Comments on the Proposed Rule
         Change Received from Members, Participants, or Others

No written comments were either solicited or received.

III.   Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action
         Within 35 days of the date of publication of this notice in the Federal Register or within

such longer period (i) as the Commission may designate up to 90 days of such date if it finds

such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which

Nasdaq consents, the Commission will:

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[14]   Securities Exchange Act Release Nos. 49325 (Feb. 26, 2004), 69 FR 11126 (Mar. 9,
         2004); 49749 (May 20, 2004), 69 FR 30142 (May 26, 2004); 50870 (Dec. 16, 2004),
         69 FR 77424 (Dec. 27, 2004).

(A)   by order approve such proposed rule change, as amended; or

(B)   institute proceedings to determine whether the proposed rule change should be

disapproved.

IV.   Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning

the foregoing, including whether the proposed rule change, as amended, is consistent with the

Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-
  2004-033 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and
  Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2004-033. This file number should be

included on the subject line if e-mail is used. To help the Commission process and review your

comments more efficiently, please use only one method. The Commission will post all

comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies

of the submission, all subsequent amendments, all written statements with respect to the

proposed rule change that are filed with the Commission, and all written communications

relating to the proposed rule change between the Commission and any person, other than those

that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be

available for inspection and copying in the Commission's Public Reference Room. Copies of

such filing also will be available for inspection and copying at the principal office of Nasdaq.

All comments received will be posted without change; the Commission does not edit personal

identifying information from submissions. You should submit only information that you wish to

make available publicly. All submissions should refer to File Number SR-NASD-2004-033 and

should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated

authority.[15]

Margaret H. McFarland
Deputy Secretary

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[15]   17 CFR 200.30-3(a)(12).