

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60186; File No. SR-NASDAQ-2009-056)

June 29, 2009

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of a Proposed Rule Change to Adopt rules to Implement the Options Order Protection and Locked/Crossed Market Plan

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 June 23, 2009, The NASDAQ Stock Market LLC (“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. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to adopt rules to implement the Options Order Protection and Locked/Crossed Market Plan (the “Plan”), and to delete provisions which will no longer be applicable following adoption of the Plan. The text of the proposed rule change is available at <http://nasdaqomx.cchwallstreet.com/>, at NASDAQ’s principal office, and at the Commission’s Public Reference Room.

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 and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

On May 7, 2008, NASDAQ filed an executed copy of the Options Order Protection and Locked/Crossed Market Plan (“Plan”), joining all other approved options markets in proposing the Plan. The Plan requires each options exchange to adopt rules implementing various requirements specified in the Plan. This proposal is designed to fulfill that obligation.

Background

The Plan will replace the current Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (“Linkage Plan”). That plan requires its participant exchanges to operate a stand-alone system or “Linkage” for sending order-flow between exchanges to limit trade-throughs. The Options Clearing Corporation (“OCC [sic]) operates the Linkage system (the “System”). The Linkage rules provide for unique types of Linkage orders, with a complicated set of requirements as to who may send such orders and under what conditions. Before a market maker can trade through another exchange's quote, it first must send a Linkage order and then wait three seconds for a response.

While the Linkage largely has operated satisfactorily, it is under significant strain. When the Commission approved the Linkage Plan in 2000, average daily volume (“ADV”) in the options market was approximately 2.6 million contracts across all exchanges. Now the ADV has increased four-fold to more than 10.8 million contracts, putting added strain on the ability of market makers to comply with the complex Linkage rules. At the same time, the options markets have been moving towards quoting in pennies. This greatly increases the number of price

changes in an option, giving rise to greater chances of trade-throughs and missing markets as market makers send Linkage orders and have to wait three seconds for a response.

Based upon experience in the equities markets following the adoption of Regulation NMS in 2005, the options exchanges have determined to replace the System with the Plan providing for a set of rules and procedures designed to avoid trade throughs and locked markets. The key to Regulation NMS's price-protection provisions is the Intermarket Sweep Order, or ISO. Each equity exchange must adopt rules "reasonably designed to prevent trade-throughs." Exempted from trade-through liability is an ISO, which is an order a member sends to an exchange displaying a price inferior to the national best bid and offer ("NBBO"), while simultaneously sending orders to trade against the full size of any other exchange that is displaying the NBBO. A simple prohibition against most trade-throughs, coupled with the ISO mechanism, has given the equities markets a straight-forward system to provide customers with price protection in a fast-moving, high-volume market that is quoted in pennies.

The Proposed New Definitions. The proposed Plan incorporates a number of defined terms, some identical to definitions from the existing Linkage Plan and others that have been developed along with the proposed Plan itself. Accordingly, NASDAQ is proposing to adopt new Chapter XII, Section 1 which sets forth the defined terms for use under the proposed Plan.

The Proposed Trade Through Rule The Plan essentially would apply the Regulation NMS price-protection provisions to the options markets. Similar to Regulation NMS, the Plan would require participants to adopt rules "reasonably designed to prevent Trade-Throughs," while exempting ISOs from that prohibition.

Accordingly, Nasdaq is proposing to adopt new Chapter XII, Section 2 which codifies the requirement that Nasdaq and other Plan participants avoid trading through superior prices on

other markets. Nasdaq is also proposing to add an ISO order in Chapter VI, Section 1(e)(7) based upon the ISO order that Nasdaq currently uses for compliance with Regulation NMS when trading equities. The ISO order will be exempt from the prohibition against trading throughs. In addition, Nasdaq proposes to add several additional exceptions to the trade-through prohibition that track the exceptions under Regulation NMS or correspond to unique aspects of the options market,” [sic] or both. Specifically:

- System Issues: Section 2(b)(1) of the NOM Rules tracks Section 5(b)(i) of the Plan which corresponds to the system-failure exception in Regulation NMS³ for equity securities and permits trading through an Eligible Exchange that is experiencing system problems.
- Trading Rotations: Section 2(b)(2) of the NOM Rules tracks Section 5(b)(ii) of the Plan which carries forward the current Trade-Through exception in the Old Plan⁴ and is the options equivalent to the single price opening exception in Regulation NMS for equity securities.⁵ Some Options exchanges (other than NOM) use a trading rotation to open an option for trading, or to reopen an option after a trading halt. The rotation is effectively a single price auction to price the option and there are no practical means to include prices on other exchanges in that auction.
- Crossed Markets: Section 2(b)(3) of the NOM Rules tracks Section 5(b)(iii) of the Plan which corresponds to the crossed quote exception in Regulation NMS for equity securities.⁶ If a Protected Bid is higher than a Protected Offer, it indicates that there is some form of market

³ See Rule 611(b)(1) under the Exchange Act.

⁴ See Linkage Plan Section 8(c)(iii)(E).

⁵ See Rule 611(b)(3) under the Exchange Act.

⁶ See Rule 611(b)(4) under the Exchange Act.

dislocation or inaccurate quoting. Permitting transactions to be executed without regard to Trade-Throughs in a Crossed Market will allow the market quickly return to equilibrium.

- Intermarket Sweep Orders (“ISOs”): These two exceptions correspond to the ISO exceptions in Regulation NMS for equity securities.⁷ Section 2(b)(4) of the NOM Rules tracks Section 5(b)(iv) of the Plan which permits a Participant to execute orders it receives from other Participants or members that are marked as ISO even when it is not at the NBBO. Section 2(b)(5) of the NOM Rules tracks Section 5(b)(v) of the Plan which allows a Participant to execute inbound orders when it is not at the NBBO, provided it simultaneously “sweeps” all better-priced interest displayed by Eligible Exchanges.
- Quote Flickering: Section 2(b)(6) of the NOM Rules tracks Section 5(b)(vi) of the Plan which corresponds to the flickering quote exception in Regulation NMS for equity securities.⁸ Options quotations change as rapidly, if not more rapidly, than equity quotations. Indeed, they track the price of the underlying security and thus change when the price of the underlying security changes. This exception provides a form of “safe harbor” to market participants to allow them to trade through prices that have changed within a second of the transaction causing a nominal Trade-Through.
- Non-Firm Quotes: Section 2(b)(7) of the NOM Rules tracks Section 5(b)(vii) of the Plan which carries forward the current non-firm quote Trade-Through exception in the Old Plan.⁹ By definition, an Eligible Exchange’s quotations may not be firm for automatic execution during this trading state and thus should not be protected from Trade-Throughs. In effect, these quotations are akin to “manual quotations” under Regulation NMS.

⁷ See Rule 611(b)(5) and (6) under the Exchange Act.

⁸ See Rule 611(b)(8) under the Exchange Act.

⁹ See Linkage Plan Section 8(c)(iii)(C).

- Complex Trades: Section 2(b)(8) of the NOM Rules tracks Section 5(b)(viii) of the Plan which carries forward the current complex trade exception in the Old Plan¹⁰ and will be implemented through rules adopted by the Participants and approved by the Commission. Complex trades consist of multiple transactions (“legs”) effected at a net price, and it is not practical to price each leg at a price that does not constitute a Trade-Through. Narrowly-crafted implementing rules will ensure that this exception does not undercut Trade-Through protections.
- Customer Stopped Orders: Section 2(b)(9) of the NOM Rules tracks Section 5(b)(ix) of the Plan which corresponds to the customer stopped order exception in Regulation NMS for equity securities.¹¹ It permits broker dealers to execute large orders over time at a price agreed upon by a customer, even though the price of the option may change before the order is executed in its entirety.¹²
- Stopped Orders and Price Improvement: Section 2(b)(10) of the NOM Rules tracks Section 5(b)(xi) of the Plan which would apply if an order is stopped at price that did not constitute a Trade-Through at the time of the stop. In this case, an exchange could seek price improvement for that order, even if the market moves in the interim, and the transaction ultimately is effected at a price that would trade through the then currently-displayed market.
- Benchmark Trades: Section 2(b)(11) of the NOM Rules tracks Section 5(b)(xii) of the Plan which would cover trades executed at a price not tied to the price of an option at the time of execution, and for which the material terms were not reasonably determinable at the time of the commitment to make the trade. An example would be a volume-weighted average price trade,

¹⁰ See Linkage Plan Section 8(c)(iii)(G).

¹¹ See Rule 611(b)(9) under the Exchange Act.

¹² For a further discussion on how this exemption operates, see Regulation NMS Adopting Release, Exchange Act Release No. 51808 (June 9, 2005) at notes 322-325.

or “VWAP.” This corresponds to a Trade-Through exemption in Regulation NMS for equity trades.¹³ NOM does not currently permit these types of options trades, and any transaction-type relying on this exemption would require NOM to adopt implementing rules, subject to Commission review and approval.

The Proposed Locked and Crossed Markets Rule. Similar to Regulation NMS, the Plan requires its participants to adopt, maintain and enforce rules requiring members: to avoid displaying locked and crossed markets; to reconcile such markets; and to prohibit members from engaging in a pattern or practice of displaying locked and crossed markets. These provisions are subject to exceptions that are contained in the rules of each participant and that are to be approved by the Commission.

Accordingly, Nasdaq has proposed to adopt Chapter XII, Section 3 of the NOM rules which would set forth the general prohibition against locking/crossing other eligible exchanges as well as several exceptions that the Plan participants approved that permit locked markets in limited circumstances. Specifically, the exceptions to the general prohibition on locking and crossing occur when (1) the locking or crossing quotation was displayed at a time when the Exchange was experiencing a failure, material delay, or malfunction of its systems or equipment; (2) the locking or crossing quotation was displayed at a time when there is a Crossed Market; or (3) the Member simultaneously routed an ISO to execute against the full displayed size of any locked or crossed Protected Bid or Protected Offer.

NOM Routing Arrangements, NASDAQ is proposing to rely upon the order routing arrangements already in place on its market

Proposed Temporary Linkage Rule. NASDAQ also proposes to adopt Chapter XII,

¹³ See Rule 611(b)(7) under the Exchange Act.

Section 4 which provides that the Exchange will continue to accept Principal Acting as Agent (“P/A”) and Principal Orders from options exchanges that continue to use such orders to address trade-throughs. [sic] via the existing linkage for a temporary period. Nasdaq is also proposing to modify Chapter VII, Section 5 to clarify the obligations of market makers to honor all trades routed pursuant to proposed Chapter XII of the NOM rules, regardless of whether it is routed via the Linkage or through a private linkage arrangement.

Miscellaneous. NASDAQ is making several miscellaneous minor changes to its rules in connection with the new Plan. Specifically, NASDAQ is proposing modifications to Chapter IV, Section 5 to remove unnecessary references to the existing Linkage Plan, and also to Chapter 7, Section 5 to remove references to “P/A” orders and also to the existing Linkage Plan.

Fees. The Exchange is proposing no changes to the fees applicable to orders routed by NOM to away markets. The fee is the same whether the order is routed to NOM from an away market via the linkage or via a private routing arrangement. NASDAQ is retaining references to the current Linkage in NASDAQ Rule 7050(1) to assess fees for orders sent to NASDAQ via the Linkage during the temporary period.

Implementation. NASDAQ proposes to implement this proposed rule change upon withdrawal from the current Linkage Plan and effectiveness of the new Plan. Implementation is currently scheduled for August 31, 2009.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,¹⁴ in general, and with Sections 6(b)(5) of the Act,¹⁵ in particular. The proposal is consistent with Section 6(b)(5) in that it is designed to prevent fraudulent and manipulative acts

¹⁴ 15 U.S.C. 78f.

¹⁵ 15 U.S.C. 78f(b)(4), (5).

and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. In particular, the Exchange believes that adopting rules that implement the Plan will facilitate the trading of options in a national market system by establishing more efficient protection against trade-throughs and locked and crossed markets.

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

NASDAQ does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

Written comments were neither solicited nor 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 the self-regulatory organization consents, the Commission will:

A. by order approve such proposed rule change, 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 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-NASDAQ-2009-056 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2009-056. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing will also be available for inspection and copying at the principal office of the self-regulatory organization. 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-NASDAQ-2009-056 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁶

Elizabeth M. Murphy
Secretary

¹⁶ 17 CFR 200.30-3(a)(12).