

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-60371; File No. SR-NASDAQ-2009-070)

July 23, 2009

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend NASDAQ Rule 4751 to Provide System Functionality That Will Cancel Any Portion of Most Types of Unpriced Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 20, 2009, The NASDAQ Stock Market LLC (the “NASDAQ Exchange”)<sup>3</sup> filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the NASDAQ Exchange. The NASDAQ Exchange has designated the proposed rule change as constituting a non-controversial rule change under Rule 19b-4(f)(6) under the Act,<sup>4</sup> which renders the proposal effective upon filing with the Commission. 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 the Substance of the Proposed Rule Change

The NASDAQ Exchange is proposing a rule change with the Securities and Exchange Commission [sic] to amend NASDAQ Rule 4751 to provide system functionality that will cancel any portion of most types of unpriced orders (also known as

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> The Commission notes that The NASDAQ Stock Market LLC refers to itself in a variety of ways throughout this notice.

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

market orders) submitted to the Exchange that would execute at a price that is more than \$0.25 or 5 percent worse than the national best bid and offer at the time the order initially reaches the Exchange, whichever is greater. This would apply both to orders executing on NASDAQ and the portion of any order routed to another market center.

(a) The text of the proposed rule change is below. Proposed new language is underlined; deletions are bracketed.[sic]<sup>5</sup>

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**Rule 4751. Definitions**

(a)-(e) No change.

(f)(1)-(11) No change.

(12) “Unpriced Orders” are any order types permitted by the System to buy or sell shares of a security at the national best bid (best offer) (“NBBO”) at the time when the order reaches the System.

(13) “Collared Orders” are all Unpriced Orders except: (1) Market On Open Orders as defined in Rule 4752; (2) Market On Close Orders as defined in Rule 4754; (3) Unpriced Orders included by the System in any Nasdaq Halt Cross or Nasdaq Imbalance Cross, each as defined in Rule 4753; or (4) Unpriced Orders that are Reference Price Cross Orders as defined in Rule 4770. Any portion of a Collared Order that would execute (either on NASDAQ or when routed to another market center) at a price more than \$0.25 or 5 percent worse than the NBBO at the time when the order reaches the System, whichever is greater, will be cancelled.

(g)-(i) No change.

<sup>5</sup> Changes are marked to the rules of The NASDAQ Stock Market LLC found at <http://nasdaqomx.cchwallstreet.com/>.

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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, the NASDAQ Exchange 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 Item IV below. The NASDAQ Exchange 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

The purpose of the proposed rule change is to protect market participants by reducing the risk that unpriced orders, also known as market orders, will execute at prices that are significantly worse than the national best bid and offer ("NBBO") at the time the Exchange receives the order. NASDAQ believes that most market participants expect that their order will be executed at its full size at a price reasonably related to the prevailing market. However, participants may not be aware that there is insufficient liquidity at or near the NBBO to fill the entire order, particularly for more thinly-traded securities. These unpriced orders can disrupt both on [sic] NASDAQ and other markets to which all or a portion of these orders are routed.

NASDAQ is proposing to implement new functionality in its trading and routing systems that would cancel any portion of most unpriced orders that would execute either

on NASDAQ or when routed to another market center at a price that is the greater of \$0.25 or 5 percent worse than the NBBO at the time NASDAQ receives the order.

Unpriced orders that would be subject to this calculation and potential cancellation are defined as “Collared Orders.”

The following example illustrates how the Collared Order process would work. A market participant submits a SCAN Order (routable order) to buy 500 shares.<sup>6</sup> A SCAN order executes within NASDAQ to the extent liquidity is available at the NBBO and then routes to other market centers. The NBBO is \$6.00 bid by \$6.05 offer, with 100 shares available on each side. Both sides of the NBBO are set by another market center (“Away Market”), but NASDAQ has 100 shares available at the \$6.05 to sell at the offer price and also has reserve orders to sell 100 shares at \$6.32 and 400 shares at \$6.40. No other market center is publishing offers to sell the security in between \$6.05 and \$6.40.

In this example, the Collared Order would be executed in the following manner:

- 100 shares would be executed by NASDAQ at the \$6.05;
- 400 shares would be routed to the Away Market as an immediate or cancel order with a price of \$6.05;
- 100 shares executed by the Away Market;<sup>7</sup>
- 300 shares returned to NASDAQ;

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<sup>6</sup> If the order were a NASDAQ-only unpriced order that is not eligible for routing, NASDAQ would execute against the liquidity available on NASDAQ up to the Collared Order thresholds and cancel the remainder of the order, provided, however, that a NASDAQ-only order will never trade through a protected quote on another market center.

<sup>7</sup> This assumes that the Away Market’s offer was still available and that the Away Market had no additional non-displayed orders at this price.

- 100 shares executed by NASDAQ at \$6.32 (more than \$0.25 but less than 5 percent worse than the NBBO); and
- 200 shares, representing the remainder of the Collared Order, would be cancelled because the remaining liquidity available at \$6.40 is more than 5 percent worse than the NBBO.

The following unpriced orders would be excluded from the definition of Collared Orders:

- Market On Open Orders that are included in the NASDAQ Opening Cross;
- Market On Close Orders that are included in the NASDAQ Closing Cross;
- Unpriced orders that are included in NASDAQ Halt and Imbalance Crosses;<sup>8</sup>
- Unpriced Orders that meet the definition of Reference Price Cross Orders for purposes of the NASDAQ Crossing Network.<sup>9</sup>

NASDAQ proposes to exclude these unpriced orders because in each case the crossing mechanism is designed to lessen or eliminate the impact that an individual unpriced order may have on price discovery. For example, the Crossing Network is designed to execute as many shares as can be paired at the midpoint of the NBBO at the time the cross is timed to occur. Therefore, an unpriced order in the Crossing Network, which can never itself impact the NBBO, would not affect the price at which the trades occur. Any portion of the unpriced order that was not executed in the Crossing Network would be cancelled or carried forward to the next Crossing Network if so instructed.

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<sup>8</sup> The Halt Cross is used to resume trading in stocks that have been halted, such as in cases of regulatory halts, and for the release of initial public offerings for trading.

<sup>9</sup> The Crossing Network occurs at four scheduled times during the trading day for orders designated for the network.

With respect to the Opening Crosses, Closing Crosses and Halt Crosses, the crosses are designed to aggregate orders input into the cross and to execute the most orders that can be matched at a single price. In addition, NASDAQ displays to the market both the size of any order imbalances and the likely price at which the cross will execute. This transparency incentivizes firms to enter orders on the opposite side of a large imbalance, causing the execution price to move closer to the prior market price for the security. This process mitigates the impact of a large unpriced order. NASDAQ also notes that orders entered into crosses are not immediately executed, unlike unpriced orders in the continuous market. In many cases this gives a participant time to cancel an order before the crossing process begins.

NASDAQ believes that market participants who wish to trade at prices further away from the NBBO than the Collared Order thresholds would permit, may still accomplish their strategy by submitting a marketable limit order to NASDAQ. In the example above, a market participant with such a strategy could have input a limit order with a price of \$7.00, which would have executed up to its full size, either on NASDAQ or on other market centers if the order was routable.

NASDAQ's proposal is similar to a rule change recently implemented by BATS Exchange, Inc.<sup>10</sup>

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<sup>10</sup> See Securities Exchange Act Release No. 59258 (Jan. 15, 2009), 74 FR 4788 (Jan. 27, 2009) (SR-BATS-2009-001) (Amendment to BATS Rule 11.9, entitled "Orders and Modifiers"). NASDAQ's proposed thresholds of the greater of \$0.25 or 5 percent are tighter than the BATS thresholds of the greater of \$0.50 or 5 percent. NASDAQ believes the tighter thresholds may reduce the impact of unpriced orders at lower prices, where \$0.50 constitutes a comparatively large percentage move.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>11</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>12</sup> in particular, in that it is designed to promote just and equitable principles of trade, 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, by avoiding execution of unpriced orders (either on NASDAQ or on other market centers as a result of orders routed by NASDAQ) at prices that are significantly worse than the NBBO at the time the order is initially received by NASDAQ. NASDAQ believes that the NBBO provides reasonable guidance of the current value of a given security and therefore that market participants should have confidence that their unpriced orders will not be executed at a significantly worse price than the NBBO. NASDAQ also believes that this proposal is similar to thresholds for market orders recently implemented by BATS Exchange, Inc.

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

The NASDAQ Exchange 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.

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

Written comments on the proposed rule change were neither solicited nor received.

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<sup>11</sup> 15 U.S.C. 78f(b).

<sup>12</sup> 15 U.S.C. 78f(b)(5).

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>13</sup> and Rule 19b-4(f)(6) thereunder.<sup>14</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

NASDAQ has requested that the Commission waive the 30-day operative delay set forth in Rule 19b-4(f)(6). The Commission notes (i) the proposal is similar to existing thresholds on market orders adopted by the BATS Exchange, Inc.; (ii) it presents no novel issues; and (iii) the functionality is voluntary, and it may provide a benefit to market participants. For these reasons, the Commission believes it is consistent with the protection of investors and the public interest to waive the 30-day operative delay, and hereby grants such waiver.<sup>15</sup>

### IV. Solicitation of Comments

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<sup>13</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>14</sup> 17 CFR 240.19b-4(f)(6).

<sup>15</sup> For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule change's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).



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](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2009-070 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NASDAQ-2009-070. 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 on official business days between the hours of 10:00 a.m. and 3:00 p.m. 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-NASDAQ-2009-070 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.<sup>16</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>16</sup> 17 CFR 200.30-3(a)(12).