

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-65868; File No. SR-NASDAQ-2011-158)

December 2, 2011

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Modify Its Optional Anti-Internalization Functionality

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 November 22, 2011, The NASDAQ Stock Market LLC (“NASDAQ” or the “Exchange”) 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 Exchange. NASDAQ has designated the proposed rule change as constituting a rule change under Rule 19b-4(f)(6) under the Act,<sup>3</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 Substance of the Proposed Rule Change

NASDAQ is filing with the Securities and Exchange Commission (“Commission”) a proposed rule change to modify its optional anti-internalization functionality.

The text of the proposed rule change is available at [nasdaq.cchwallstreet.com](http://nasdaq.cchwallstreet.com), at NASDAQ’s principal office, and at the Commission’s Public Reference Room.

---

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

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

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

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 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 provide a more granular alternative to the voluntary anti-internalization functionality. Under the proposal, market participants will be given the additional options of 1) assigning a group identification modifier at the port level; and 2) assigning different anti-internalization methodology to specific order entry ports.

Currently, anti-internalization processing is available only on an MPID-wide basis with only a single methodology being allowed per MPID. Market participants direct that a particular version of anti-internalization processing be applied to a particular MPID, which is then applied by the system to all quotes/orders entered using that MPID. Market participants have the option, when entering quotes/orders using the same MPID they do not wish to have automatically interact with each other in the System, to either direct the System to not execute any part of the interacting quotes/orders from the same MPID and, instead, cancel share amounts of the interacting quotes/orders back to the entering party with an arrangement that takes into

consideration the size of the interacting quotes/orders (Decrement); or, regardless of the size of the interacting quotes/orders, cancelling the oldest of them in full (Cancel Oldest).<sup>4</sup>

Under the proposal, market participants entering quotes/orders under a specific MPID may voluntarily assign a unique group identification modifier that represents a group of quotes/orders from the same market participant identifier and order entry port (“Group ID”). The Group ID will be a two-character code composed of alphanumeric characters and/or spaces, assigned to a specific order entry port and updated by NASDAQ on behalf of the market participant. This additional option will direct the System to execute any so designated incoming quotes/orders against all eligible resting quotes/orders except those with the both the same MPID and same Group ID.

If the market participant selects the option of utilizing the Group ID, the anti-internalization selection will be applied to all quotes/orders entered using both the same MPID and the same Group ID. If the incoming order has both the same MPID and the same Group ID, the two orders will not execute against each other. If the two orders have the same MPID and different Group IDs, then the order will be eligible to execute against each other as designated by the anti-internalization method. For example:

1. Incoming order “A” has an MPID of “ABCD” and Group ID “A1”, resting order “B” has an MPID of “ABCD” and Group ID “A1”: in this scenario, these two orders would not execute against each other.
2. Incoming order “C” has an MPID of “EFGH” and Group ID “XY”, resting order “D” has an MPID of “EFGH” and Group ID “ZZ”: in this scenario, these two orders would execute against each other.

---

<sup>4</sup> See Exchange Rule 4757(a)(4).

Additionally, market participants will now have the option to assign a different anti-internalization methodology (Decrement or Cancel Oldest) to different order entry ports. The anti-internalization method assigned to the port sending the incoming order will determine which methodology is applied to the orders prevented from matching. For example:

FIRM XX (MPID “ABCD”) utilizes three ports and has elected to assign Group IDs to their order entry ports for the purpose of Anti-Internalization. Additionally, the market participant selected different Anti-internalization methodologies per port as follows:

Port 1: Group ID A1; Anti-internalization methodology: Decrement

Port 2: Group ID A1; Anti-internalization methodology: Cancel Oldest

Port 3: Group ID B1; Anti-internalization methodology: Cancel Oldest

If an incoming order from Port 1 tries to interact with a resting order from Port 3, the orders will execute because they have the same MPID but different Group IDs.

If an incoming order from Port 1 tries to interact with a resting order from Port 2, then the anti-internalization method selected for Port 1 will apply to the order. In this case, the Decrement method would apply.

If an incoming order from Port 2 tries to interact with a resting order from Port 1, then the anti-internalization method selected for Port 2 will apply. In this case, the Cancel Oldest methodology would apply.

Anti-internalization functionality is designed to assist market participants in complying with certain rules and regulations of the Employee Retirement Income Security Act (“ERISA”) that preclude and/or limit managing broker-dealers of such accounts from trading as principal with orders generated for those accounts. It can also assist market participants in reducing execution fees potentially resulting from the interaction of executable buy and sell trading

interest from the same firm. NASDAQ notes that use of the functionality does not relieve or otherwise modify the duty of best execution owed to orders received from public customers. As such, market participants using anti-internalization functionality will need to take appropriate steps to ensure that public customer orders that do not execute because of the use of anti-internalization functionality ultimately receive the same execution price (or better) they would have originally obtained if execution of the order was not inhibited by the functionality.

## 2. Statutory Basis

NASDAQ believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>5</sup> in general, and with Sections 6(b)(5) of the Act,<sup>6</sup> in particular, in that the proposal is designed to prevent fraudulent and manipulative acts 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. Specifically, the Group ID allows firms to better manage order flow and prevent undesirable executions against themselves. NASDAQ notes that a similar functionality was effective upon filing with the Commission for EDGX Exchange, Inc.<sup>7</sup>

---

<sup>5</sup> 15 U.S.C. 78f.

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>7</sup> See EDGX Exchange, Inc. Rule 11.9(f); Securities and Exchange Release No. 53428 (December 3, 2010), 75 FR 76763 (December 9, 2010)(SR-EDGX-2010-18), which was based on NYSEArca Equities Rule 7.31(qq). NASDAQ's current proposal differs from EDGX Rule 11.9(f) and NYSEArca Equities Rule 7.31(qq) in that there are additional methods relating to additional modifiers that do not apply to NASDAQ. Furthermore, EDGX utilizes the additional identity modifier at the port level as well as at the order level.

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

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>8</sup> and Rule 19b-4(f)(6) thereunder.<sup>9</sup>

A proposed rule change filed pursuant to Rule 19b-4(f)(6) under the Act<sup>10</sup> normally does not become operative for 30 days after the date of its filing. However, Rule 19b-4(f)(6)<sup>11</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. NASDAQ requests that the Commission waive the 30-day operative delay so that NASDAQ may immediately offer its market participants the

---

<sup>8</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>9</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. NASDAQ has satisfied this requirement.

<sup>10</sup> 17 CFR 240.19b-4(f)(6).

<sup>11</sup> 17 CFR 240.19b-4(f)(6).

ability to better manage their order flow and prevent undesirable executions with themselves, which in turn may decrease costs to customers of such firms. The Commission notes that the proposal is based on similar rules of other exchanges<sup>12</sup> and believes that waiving the 30-day operative delay<sup>13</sup> is consistent with the protection of investors and the public interest. Therefore, the Commission designates the proposal operative upon filing.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend 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.

#### 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](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2011-158 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.

---

<sup>12</sup> See EDGX Exchange, Inc. Rule 11.9(f) and NYSEArca Equities Rule 7.31(qq).

<sup>13</sup> For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

All submissions should refer to File Number SR-NASDAQ-2011-158. 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 website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission,<sup>14</sup> 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 website viewing and printing 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 also will be available for inspection and copying at the principal office of the Exchange. 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 publicly available. All submissions should refer

---

<sup>14</sup> The text of the proposed rule change is available on the Commission's website at <http://www.sec.gov/rules/sro.shtml>.



to File Number SR-NASDAQ-2011-158 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>15</sup>

Kevin M. O'Neill  
Deputy Secretary

---

<sup>15</sup> 17 CFR 200.30-3(a)(12).