

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54742; File No. SR-NASD-2006-122)

November 13, 2006

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Modify Pricing for NASD Members Using ITS/CAES, Brut, and Inet

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 1, 2006, 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 substantially prepared by Nasdaq. Nasdaq filed the proposed rule change pursuant to Section 19(b)(3)(A)(ii) of the Act,<sup>3</sup> and Rule 19b-4(f)(2) thereunder,<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 Substance of the Proposed Rule Change

Nasdaq proposes to modify the pricing for NASD members using the ITS/CAES System and the Brut and Inet facilities (collectively, the “Nasdaq Facilities”). Nasdaq states that it will implement this rule change on November 1, 2006. As indicated in the rule text, portions of the rule change would be in effect on a pilot basis, beginning November 1, 2006 and continuing through November 30, 2006. The text of the proposed rule change is set forth below. Proposed

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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> 15 U.S.C. 78s(b)(3)(A)(ii).

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

new language is underlined; proposed deletions are in [brackets].<sup>5</sup>

**7010. System Services**

(a) – (h) No change.

(i) ITS/CAES System, Brut, and Inet Order Execution and Routing

(1) The following charges shall apply to the use of the order execution and routing services of the ITS/CAES System, Brut, and Inet (the “Nasdaq Facilities”) by members for all Exchange-Traded Funds that are not listed on The NASDAQ Stock Market LLC. The term “Exchange-Traded Funds” shall mean Portfolio Depository Receipts, Index Fund Shares, and Trust Issued Receipts as such terms are defined in Rule 4420(i), (j), and (l), respectively, of The NASDAQ Stock Market LLC. For purposes of determining a member’s volume in all securities under Rule 7010(i), the term “Nasdaq Facilities” shall also be deemed to include the member’s volume in Nasdaq-listed securities through the facilities of The NASDAQ Stock Market LLC.

**Order Execution**

Order that accesses the Quote/Order of a market participant that does not charge an access fee to market participants accessing its Quotes/Orders through the Nasdaq Facilities:	
Charge to member entering order:	
Members with an average daily volume through the	\$0.0028 per share executed

<sup>5</sup> Nasdaq states that changes are marked to the rule text that appears in the electronic NASD Manual found at [www.nasd.com](http://www.nasd.com), as further amended on an immediately effective basis by File No. SR-NASD-2006-116. See Securities Exchange Act Release No. 54695 (November 2, 2006), 71 FR 65862 (November 9, 2006).

<p>Nasdaq Facilities in all securities during the month of (i) more than 30 million shares of liquidity provided, and (ii) more than 50 million shares of liquidity accessed and/or routed; or members with an average daily volume through the Nasdaq Facilities in all securities during the month of (i) more than 20 million shares of liquidity provided, and (ii) more than 60 million shares of liquidity accessed and/or routed</p>	<p>(or, in the case of executions against Quotes/Orders at less than \$1.00 per share, 0.1% of the total transaction cost)</p>
<p>Other members</p>	<p>\$0.0030 per share executed (or, in the case of executions against Quotes/Orders at less than \$1.00 per share, 0.1% of the total transaction cost)</p>
<p>Credit to member providing liquidity:</p>	
<p>Members with an average daily volume through the Nasdaq Facilities in all securities during the month of more than 30 million shares of liquidity provided</p>	<p>\$0.0025 per share executed (or \$0, in the case of executions against Quotes/Orders at less than \$1.00 per share)</p>
<p>Other members</p>	<p>\$0.0020 per share executed (or \$0, in the case of</p>

	executions against Quotes/Orders at less than \$1.00 per share)
Order that accesses the Quote/Order of a market participant that charges an access fee to market participants accessing its Quotes/ Orders through the Nasdaq Facilities:	
Charge to member entering order:	
Members with an average daily volume through the Nasdaq Facilities in all securities during the month of more than 500,000 shares of liquidity provided	\$0.001 per share executed (but no more than \$10,000 per month)
Other members	\$0.001 per share executed

**Order Routing for Exchange-Traded Funds Not Listed on Nasdaq**

Order routed to the New York Stock Exchange (“NYSE”) [through its DOT system]	See [DOT] <u>NYSE</u> fee schedule in Rule 7010(i)(7)
[Any other order entered by a member that is routed outside of the Nasdaq Facilities and that does not attempt to execute in the Nasdaq Facilities prior to routing]	[\$0.004 per share executed]
Order routed to the American Stock Exchange (“Amex”) [after attempting to execute in the	\$0.003 per share executed (plus, in the case of orders charged a fee by

Nasdaq Facilities]	the Amex specialist, \$0.01 per share executed)
[Order routed through the Intermarket Trading System (“ITS”) to NYSE Arca after attempting to execute in the Nasdaq Facilities]	[\$0.0028 per share executed]
[Any other order routed through the Intermarket Trading System (“ITS”) after attempting to execute in the Nasdaq Facilities]	[\$0.0007 per share executed]
[Any]All other orders [routed after attempting to execute in the Nasdaq Facilities]	\$0.003 per share executed

(2) – (5) No change.

(6) Except as provided in paragraph (7), the following charges shall apply to the use of the order execution and routing services of the Nasdaq Facilities by members for securities subject to the Consolidated Quotations Service and Consolidated Tape Association plans other than Exchange-Traded Funds (“Covered Securities”):

**Order Execution**

Order that accesses the Quote/Order of a Nasdaq Facility market participant:	
Charge to member entering order:	[\$0.0007 per share executed]

<u>On or after December 1, 2006</u>	<u>\$0.0007 per share executed</u>
<u>For a pilot period during the month of November 2006:</u>	
<u>Members with an average daily volume through the Nasdaq Facilities in Covered Securities during the month of (i) more than 100,000 shares of liquidity provided, and (ii) more than 100,000 shares of liquidity accessed and/or routed</u>	<u>\$0.0007 per share executed</u>
<u>Members with an average daily volume through the Nasdaq Facilities in Covered Securities during the month of (i) between 50,000 and 100,000 shares of liquidity provided, and (ii) between 50,000 and 100,000 shares of liquidity accessed and/or routed</u>	<u>\$0.001 per share executed</u>

<u>Other members</u>	<u>\$0.0015 per share executed</u>
Credit to member providing liquidity for a Covered Security listed on NYSE and The NASDAQ Stock Market LLC:	\$0.0007 per share executed
Credit to a member providing liquidity for other Covered Securities:	
Members with an average daily volume through the Nasdaq Facilities in Covered Securities during the month of more than 5 million shares of liquidity accessed, provided, or routed	\$0.0005 per share executed
Members with an average daily volume through the Nasdaq Facilities in Covered Securities during the month of 10 million or more shares of liquidity provided	\$0.0006 per share executed

Other members	No credit
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### Order Routing

Order routed to Amex	<del>[\$0.003]</del> <u>\$0.0028</u> per share executed (plus, in the case of orders charged a fee by the Amex specialist, \$0.01 per share executed)
Order routed to NYSE	See [DOT] <u>NYSE</u> fee schedule in Rule 7010(i)(7)
[Order routed to NYSE Arca] <u>All other orders</u>	\$0.0028 per share executed
[Order for NYSE-listed Covered Security routed to venue other than the NYSE, Amex, or NYSE Arca]	[\$0.001 per share executed]
[Order for Covered Security listed on venue other than the NYSE and routed to venue other than Amex, NYSE, or NYSE Arca]	[\$0.003 per share executed]
[Order routed through the ITS to NYSE Arca]	[\$0.0028 per share executed]
[Any other order routed	[\$0.0007 per share executed]

through the ITS]	
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(7) The following charges shall apply to the use of the Nasdaq Facilities by members for routing to the NYSE [through its DOT system] for all securities, including Exchange-Traded Funds:

Order charged a fee by the NYSE specialist	\$0.01 per share executed
Order that attempts to execute in the Nasdaq Facilities prior to routing and that is not charged a fee by the NYSE specialist <u>or that is routed to NYSE via ITS</u>	\$0.0002 per share executed (but no more than \$[60,000] <u>25,000</u> per month)
Order that does not attempt to execute in the Nasdaq Facilities prior to routing and that is not charged a fee by the NYSE specialist	\$0.0003 per share executed (but no more than \$[100,000] <u>75,000</u> per month)

(8) No change.

(j) - (v) No change.

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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 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 several changes to its price schedule for routing and execution of orders in non-Nasdaq exchange-listed securities. The changes are in response to fees being imposed by other trading venues on orders routed directly through Nasdaq Execution Services, LLC (Nasdaq’s broker-dealer subsidiary) and through the Intermarket Trading System (“ITS”). Several markets, including NYSE Arca, the Boston Stock Exchange, the National Stock Exchange, and the Chicago Stock Exchange, have announced or begun to impose fees of approximately \$0.003 per share for orders routed to them.

These fee changes have created a pricing structure for trading securities listed on the New York Stock Exchange (“NYSE”) that is in a state of flux, characterized by dramatic differences in fees for effectively the same services. For example, the markets listed above charge 28 or 30 cents per 100 shares for accessing liquidity, while the NYSE charges 2.5 cents per 100 shares (less if the firm’s total fees reach a \$750,000 per month cap), and Nasdaq currently charges 7 cents per 100 shares. Furthermore, while several markets rebate approximately 20 cents per 100 shares for providing liquidity, Nasdaq either provides no rebate, or rebates only 5 or 6 cents per

100 shares; the NYSE, by contrast, charges 2.5 cents per 100 shares. Nasdaq believes that the market will find an equilibrium pricing structure, because the disparities listed above are unstable due to the interconnectivity of the market. In order to transition to a more stable fee structure, Nasdaq is proposing several fee changes. These changes should be viewed in light of the dramatic disparities in pricing listed above.

For orders in non-Nasdaq-listed exchange-traded funds (“ETFs”) routed to venues other than the NYSE, Nasdaq is proposing to eliminate current specific fees for orders routed through ITS or that route without checking the books of the Nasdaq Facilities, and is instituting a flat fee of \$0.003 per share executed (plus \$0.01 per share in the case of orders charged a fee by an American Stock Exchange (“Amex”) specialist). Thus, fees would be reduced for orders that do not attempt to execute prior to routing, would be increased for orders routed through ITS, and would remain unchanged for all other routed ETF orders.

For orders in non-Nasdaq-listed securities other than ETFs that are routed to venues other than the NYSE, Nasdaq is proposing to eliminate current specific fees that differentiate among orders based on a security’s listing market and/or the order’s destination market and instituting a flat fee of \$0.0028 per share executed (plus \$0.01 per share in the case of orders charged a fee by an Amex specialist). As a result, fees would remain unchanged for orders routed to NYSE Arca, would decrease slightly for orders routed to Amex and for orders in non-NYSE-listed securities routed to regional exchanges or ECNs, and would increase for orders in NYSE-listed securities routed to regional exchanges or ECNs and for orders routed through ITS.

For orders in all securities routed to the NYSE for execution, Nasdaq is proposing to institute a decrease (from \$0.0007 to \$0.0002 per share executed) for orders routed through the ITS, and would apply to these charges the same monthly fee cap that applies to orders routed

through NYSE's DOT system after checking the books of the Nasdaq Facilities. Moreover, Nasdaq would reduce this monthly cap from \$60,000 to \$25,000. Nasdaq is also reducing the monthly fee cap for DOT orders that do not check the Nasdaq Facilities' books, from \$100,000 to \$75,000.

Finally, to encourage firms to utilize Nasdaq in non-Nasdaq-listed securities, Nasdaq is proposing to introduce a higher pricing tier of \$0.0015 per share executed for members to access liquidity when those members provide an average of less than 50,000 shares of liquidity per day and access and/or route an average of less than 50,000 shares of liquidity per day in non-Nasdaq securities through the Nasdaq Facilities during the month. In addition, Nasdaq is introducing an intermediate pricing tier of \$0.001 per share executed for members to access liquidity when those members provide an average of between 50,000 shares and 100,000 shares of liquidity per day and access and/or route an average of between 50,000 shares and 100,000 shares of liquidity per day.<sup>6</sup> Because this change is made on a pilot basis, Nasdaq states that it will review the effect of the price change and determine whether to submit an additional filing regarding these fees by December 1, 2006.

Although the Nasdaq Facilities have enjoyed substantial growth in the share of non-Nasdaq-listed stocks that they execute over the past year, many members that use the Nasdaq Facilities still do so only on a minimal basis. In fact, if the new fees had been in place in September 2006, a higher rate would have applied to over 84% of the firms trading non-Nasdaq

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<sup>6</sup> Nasdaq would continue to charge \$0.0007 per share executed for all other members to access liquidity (*i.e.*, when those members provide an average of more than 100,000 shares of liquidity per day and access and/or route an average of more than 100,000 shares of liquidity per day). Telephone conversation among John Yetter, Senior Associate General Counsel, Nasdaq, David Liu, Special Counsel, Division of Market Regulation ("Division"), Commission, and Theodore Venuti, Attorney, Division, Commission, on November 8, 2006.

securities through the Nasdaq Facilities. By setting the thresholds for lower rates at the modest levels of 50,000 and 100,000 shares per day, Nasdaq hopes to encourage all of these firms to rethink their routing and quoting practices, in lieu of reflexively sending their orders to just one market. Nasdaq believes that incentives aimed at encouraging a modest level of use by a broader number of members would further enhance the quality of Nasdaq markets for trading these securities.

Nasdaq believes that the fee would result in overall monthly fees and rebates with respect to accessing and providing liquidity through Nasdaq that are significantly lower than fees and rebates on other venues. For example, a market participant providing no liquidity would pay \$0.0015 per share accessed and receive no rebate; under pricing recently introduced by NYSE Arca, a market participant providing no liquidity would pay twice as much – \$0.003 per share accessed – and receive no rebate.

Although the absence of liquidity provider credits on the NYSE itself makes comparison more difficult, it should be noted that recent fee increases by that venue clearly had a disparate impact on Nasdaq Execution Services and other market participants that do not charge customers high commissions – in the case of Nasdaq Execution Services, increasing monthly charges to route orders to the NYSE from an average of \$3,620 per month during the six months prior to the fee increase to \$750,000 per month, an increase of 20,600 percent. In addition, Nasdaq and others routing orders to the NYSE must often pay unfiled specialist charges of \$0.01 per share for many orders that they route to the NYSE. Nevertheless, the NYSE's filed rate for transactions of \$0.00025 per share executed, coupled with its new monthly fee cap of \$750,000 per month, results in dramatically lower average execution fees for large participants in its market. For example, a firm with a average daily volume of 300 million shares per day during

October 2006 would pay an average per share charge of \$0.000114, less than half the per share rate paid by firms not reaching the cap. In contrast to the NYSE's steep discount, however, which serves simply to reduce the relative fees of its largest customers, Nasdaq's change is designed specifically to encourage use of the Nasdaq system that enhances market quality and thereby benefits investors choosing to enter orders into Nasdaq.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,<sup>7</sup> in general, and with Section 15A(b)(5) of the Act,<sup>8</sup> in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system which the NASD operates or controls. Nasdaq states that the proposed rule change would put lower caps on fees to route orders to the NYSE, thereby reducing charges to members that make substantial use of Nasdaq's routing facilities. Nasdaq states that the proposal also imposes more uniform charges for routing to other venues. Finally, Nasdaq states that the proposed change introduces a higher fee for accessing Nasdaq Facility liquidity in cases where a market participant's use of the Nasdaq Facilities does not meet certain minimal thresholds. Nasdaq believes that this change is consistent with an equitable allocation of fees because lower overall fees are charged to market participant that enhance market quality by providing liquidity.

### 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. In particular, Nasdaq does not believe that the proposed change to fees to access liquidity in non-

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<sup>7</sup> 15 U.S.C. 78q-3.

<sup>8</sup> 15 U.S.C. 78q-3(b)(5).

Nasdaq securities through the Nasdaq Facilities would impose a burden on competition by other markets that route orders to the Nasdaq Facilities for execution. First, as discussed in greater detail above, Nasdaq's fees applicable to members accessing substantially more liquidity than they provide are one-half of NYSE Arca's, while NYSE Arca provides greater rebates to liquidity providers. Thus, to the extent that NYSE Arca, for example, routes only marketable orders to Nasdaq, it would receive more beneficial pricing than it offers under similar circumstances. Second, it should be noted that status as an execution venue does not equate to acting solely as a liquidity accessor with respect to other markets. Through its Nasdaq Execution Services broker-dealer, Nasdaq provides substantial liquidity on the floor of the NYSE, because Nasdaq views this as a valuable service that can be offered to its members. Thus, if the NYSE had a comparable fee structure in place, Nasdaq would easily qualify for a reduced rate when accessing liquidity at that venue. Finally, the change is broad in its application, in that it currently would apply to over 84% of firms trading non-Nasdaq securities through the Nasdaq Facilities, all of which are equally eligible to increase their use of the Nasdaq Facilities in Nasdaq in order to qualify for more favorable pricing.

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

The foregoing rule change is subject to Section 19(b)(3)(A)(ii) of the Act<sup>9</sup> and subparagraph (f)(2) of Rule 19b-4 thereunder<sup>10</sup> because it establishes or changes a due, fee, or other charge applicable only to a member imposed by the self-regulatory organization.

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<sup>9</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>10</sup> 17 CFR 240.19b-4(f)(2).

Accordingly, the proposal is effective upon Commission receipt of the filing. 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.

#### 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 No. SR-NASD-2006-122 on the subject line.

##### Paper comments:

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

All submissions should refer to File No. SR-NASD-2006-122. 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 will also be available for inspection and copying at the principal office of the NASD. 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 No. SR-NASD-2006-122 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.<sup>11</sup>

Nancy M. Morris  
Secretary

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<sup>11</sup> 17 CFR 200.30-3(a)(12).