

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51668; File No. SR-NASD-2005-056)

May 9, 2005

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change, and Amendment No. 1 thereto, National Association of Securities Dealers, Inc. Eliminating the Directed Order Process in The Nasdaq Market Center

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 April 21, 2005, 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 May 2, 2005, Nasdaq filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice, as amended, 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

Nasdaq is filing a proposed rule change to eliminate the Directed Order Process from the Nasdaq Market Center.<sup>4</sup> Nasdaq will implement the proposed rule change within 90 days of approval with the exact date being provided to market participants via a

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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> In Amendment No. 1, Nasdaq amended NASD Rule 7010 to reflect the proposed elimination of the Directed Order Process.

<sup>4</sup> Nasdaq notes it has previously filed to eliminate the Directed Order Process as part of File No. NASD-2004-181. See Securities Exchange Act Release No. 50845, (December 13, 2004), 69 FR 76022 (December 20, 2004). Nasdaq will amend NASD-2004-181 to reflect the proposed elimination of the Directed Order process in the immediate filing.

Head Trader Alert on [www.nasdaqtrader.com](http://www.nasdaqtrader.com). The text of the proposed rule change is available on Nasdaq's Web site (<http://www.nasdaq.com/LegalCompliance.stm>), 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 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 eliminate the Directed Order process from the Nasdaq Market Center. The Directed Order Process replicates SelectNet functionality that predated the implementation of Nasdaq's SuperMontage system (since re-named the Nasdaq Market Center). Directed Orders are not integrated with the Non-Directed Order process and are processed independently of Non-Directed Orders in the Nasdaq Market Center.

Currently, member A can send a Directed Order to sell to member B, who is displaying quotes in the Nasdaq Market Center. Unless member B has expressly indicated it will accept liability orders through the Directed Order process, member B is not obligated to trade with the incoming order. Member B can reject the order, respond with a counter offer, or execute the order. Because the Directed Order process is used to negotiate trades, orders can be executed at prices inferior to the best prices displayed in

the Nasdaq Market Center. In addition, because Directed Orders are not integrated in Non-Directed Order execution algorithm, trades are executed without consideration of the time priority of orders in the Non-Directed Order process.

The maintenance of a separate order delivery processing infrastructure for Directed Orders, outside of the Nasdaq Market Center's main Non-Directed Order process, increases costs and system complexity for Nasdaq. In addition, the current ability of Directed Orders to be processed without regard for the best prices displayed in the Nasdaq Market Center, or the time priority of other orders in the system, impairs the overall trading efficiency of the system and Nasdaq's ongoing efforts to enhance price/time priority within the Nasdaq Market Center. Finally, given recent elimination of Nasdaq's pre-open Trade-or-Move requirements that obligated market participants to send Directed Orders containing a Trade-or-Move messages, Nasdaq feels that now is an appropriate time to eliminate the Directed Order Process from the Nasdaq Market Center.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,<sup>5</sup> in general and with Section 15A(b)(6) of the Act,<sup>6</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, remove impediments to a free and open market and a national market system, and, in general, to protect investors and the public interest. Nasdaq believes that the proposed changes are consistent with the obligations of Section 15A(b)(6) of the Act because they will provide for greater time priority

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<sup>5</sup> 15 U.S.C. 78q-3.

<sup>6</sup> 15 U.S.C. 78q-3(b)(6).

protection in Nasdaq's execution service. In addition, because the obligations under Section 15A(b)(6) and Section 6(b)(5) are the same, the proposed changes also are consistent with the obligations applicable to registered exchanges.

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.

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, 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](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2005-056 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-2005-056. 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. Copies of such filing also will 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 Number SR-NASD-2005-056 and should be submitted on or before **[insert date 21 days from publication in the Federal Register]**.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>7</sup> 17 CFR 200.30-3(a)(12).