

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51703; File No. SR-NASD-2004-033)

May 18, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving a Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto Seeking to Modify the Nasdaq Market Center Execution Service to Add an Optional Routing Feature

I. Introduction

On February 25, 2004, 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"), 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> a proposed rule change seeking to modify the Nasdaq Market Center execution service to add an optional routing feature. On July 15, 2004, Nasdaq submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> On February 23, 2005, Nasdaq submitted Amendment No. 2 to the proposed rule change.<sup>4</sup> On April 7, 2005, Nasdaq submitted Amendment No. 3 to the proposed rule change.<sup>5</sup> The proposed rule change, as amended, was published for comment in the Federal Register on April 13, 2005.<sup>6</sup> The Commission received no comments on the proposal.

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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> Amendment No. 1 replaced and superseded the originally filed proposed rule change.

<sup>4</sup> Amendment No. 2 replaced and superseded the originally filed proposed rule change, as amended.

<sup>5</sup> Amendment No. 3 replaced and superseded the originally filed proposed rule change, as amended.

<sup>6</sup> See Securities Exchange Act Release No. 51504 (April 7, 2005), 70 FR 19538 (April 13, 2005) (SR-NASD-2004-033).

## II. Description

Nasdaq has proposed to modify the Nasdaq Market Center execution service to create an optional outbound order routing feature that will route orders in Nasdaq-listed securities to other markets when those markets are displaying quotes at prices superior to those displayed on Nasdaq and that are accessible through the router.<sup>7</sup> Under the proposal, Nasdaq Market Center Participants will be able to choose on an order-by-order basis whether they want an order routed outside the Nasdaq Market Center. Such routed orders will be executed pursuant to the rules and regulations of the destination market. If more than one market is at a price level that is superior to Nasdaq's displayed price, the computer algorithm of the Nasdaq Market Center router will determine the market, or markets, to which the order will be sent, based on several factors including the number of shares being displayed, response time, likelihood of undisplayed trading interest, and the cost of accessing the market. If an order (or a portion of the order) remains unfilled after being routed, it will be returned to Nasdaq where, if the order is marketable, it will be returned to the Non-Directed Order processing queue, where it can be executed in Nasdaq, or routed again, if Nasdaq is not at the best price when the order is next in line in the processing queue. Once a routed limit order is no longer marketable, whether it becomes non-marketable upon return to Nasdaq or while in the execution queue, it will be placed on the Nasdaq Market Center book, if consistent with the order's time in force condition. Once on the book, however, an order will not be routed out of the Nasdaq Market Center, even if it becomes marketable against the quotes of another market.

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<sup>7</sup> Under the proposal, Nasdaq will access the quotes of exchanges through its broker-dealer subsidiary, Brut. See Securities Exchange Act Release No. 51326 (March 7, 2005), 70 FR 12521 (March 14, 2005).

### III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a self-regulatory organization.<sup>8</sup> In particular, the Commission believes that the proposed rule change, as amended, is consistent with Section 15A(b)(6) of the Act,<sup>9</sup> which requires, among other things, that NASD's rules be designed to protect investors and the public interest.

The Commission notes that the proposed routing functionality is an optional feature and that Nasdaq Market Center Participants will be able choose whether or not to participate in routing on an order-by-order basis. The Commission also notes that orders flagged for routing will only in fact route when a superior price is available in another market that is accessible through the router. Therefore, the Commission believes that the proposed outbound order routing feature should help investors to reach better prices available outside the Nasdaq Market Center and thereby enhance the national market system.

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<sup>8</sup> The Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>9</sup> 15 U.S.C. 78q-3(b)(6).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change (File No. SR-NASD-2004-033), as amended, be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>10</sup> 15 U.S.C. 78s(b)(2).

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