

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-61668; File No. SR-NASDAQ-2010-028)

March 5, 2010

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Modify Routing of Orders from NASDAQ Options Market to an Affiliated Exchange

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 February 26, 2010, The NASDAQ Stock Market LLC (“Nasdaq”) 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 Nasdaq. Nasdaq has designated the proposed rule change as constituting a non-controversial 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 proposes to amend Chapter VI, Sections 1(e)(7) and 11(b) of the Rules of the NASDAQ Options Market (“NOM”) to modify the restriction on routing of certain orders to an exchange that is an affiliate of NOM.

The text of the proposed rule change is below. Proposed new language is underlined; proposed deletions are in [brackets].

Options Rules

Chapter VI Trading System

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

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## Sec. 1 Definitions

The following definitions apply to Chapter VI for the trading of options listed on NOM.

(a) – (d) No change.

(e) The term “Order Type” shall mean the unique processing prescribed for designated orders that are eligible for entry into the System, and shall include:

(1) – (6) No change.

(7) “Exchange Direct Orders” are orders that are directed to an exchange other than NOM as directed by the entering party without checking the NOM book. If unexecuted, the order (or unexecuted portion thereof) shall be returned to the entering party. This order type may only be used for orders with time-in-force parameters of IOC.

Exchange Direct[ed] Orders may not be directed to a facility of an exchange that is an affiliate of Nasdaq other than the Boston Options Exchange or NASDAQ OMX PHLX.

(8) No change.

(f) – (h) No change.

## Sec. 11 Order Routing

(a) No change.

(b) For Non-System securities, the order routing process shall be available to Participants from 9:30 a.m. Eastern Time until market close and shall route orders based on the participant’s instructions. Notwithstanding the foregoing, the order routing process will

not be available to route Non-System Securities to a facility of an exchange that is an affiliate of Nasdaq other than the Boston Options Exchange or NASDAQ OMX PHLX.

(c) – (e) 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

a. Background

NASDAQ OMX PHLX, Inc. (“PHLX”) is a wholly-owned subsidiary of The NASDAQ OMX Group, Inc. (“NASDAQ OMX”), a Delaware corporation. NASDAQ OMX also indirectly owns NASDAQ Options Services, LLC (“NOS” or the “Routing Facility”), a registered broker-dealer and a PHLX member. Thus, NOS is deemed an affiliate of PHLX.

b. Affiliation and Order Routing

Nasdaq is proposing that NOS be permitted to route Exchange Direct Orders in System Securities<sup>4</sup> to PHLX without checking the NOM book prior to routing. Exchange Direct Orders

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<sup>4</sup> Pursuant to Chapter VI, Section 1(b), “System Securities” are all options that are currently trading on NOM pursuant to Chapter IV of the NOM rules. All other options are “Non-System Securities.”

are orders that route directly to other options markets on an immediate-or cancel basis without first checking the NOM book for liquidity.<sup>5</sup> In addition, the proposed rule change would permit the routing by NOS of orders (including Exchange Direct Orders) in Non-System Securities from NOM to PHLX.

NOS is the approved outbound routing facility of Nasdaq for NOM. Under NOM Rule Chapter VI, Section 11: 1) NOM routes orders in options via NOS, which serves as the sole “Routing Facility” of NOM; 2) the sole function of the Routing Facility is to route orders in options to away markets pursuant to NOM rules, solely on behalf of NOM; 3) NOS is a member of an unaffiliated self-regulatory organization, which is the designated examining authority for the broker-dealer; 4) the Routing Facility is subject to regulation as a facility of Nasdaq, including the requirement to file proposed rule changes under Section 19 of the Act; 5) NOM must establish and maintain procedures and internal controls reasonably designed to adequately restrict the flow of confidential and proprietary information between Nasdaq and its facilities (including the Routing Facility), and any other entity; and 6) the books, records, premises, officers, directors, agents, and employees of the Routing Facility, as a facility of Nasdaq, shall be deemed to be the books, records, premises, officers, directors, agents, and employees of Nasdaq for purposes of and subject to oversight pursuant to the Act, and the books and records of the Routing Facility, as a facility of Nasdaq, shall be subject at all times to inspection and copying by Nasdaq and the Commission.

The Commission has approved NOS’s affiliation with PHLX subject to the conditions that: (1) NOS remains a facility of Nasdaq; (2) use of NOS’s routing function by Nasdaq

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<sup>5</sup> See Chapter VI, Section 1(e)(7) of the NOM Rules.

members continues to be optional<sup>6</sup> and (3) NOS does not provide routing of orders in options from NOM to PHLX or any trading facilities thereof, unless such orders first attempt to access any liquidity on the NOM book.<sup>7</sup>

Currently, Chapter VI, Section 1(e)(7) of the NOM rules prohibits the routing of Exchange Direct Orders to a facility of an exchange that is an affiliate of Nasdaq, with the exception of Exchange Direct Orders routed to the Boston Options Exchange (“BOX”), a facility of BX, which is an affiliate of Nasdaq. In order to modify the conditions noted above regarding the operation of NOS and allow NOS to route Exchange Direct Orders directly to PHLX, Nasdaq is proposing to amend Chapter VI, Section 1(e)(7) of the NOM Rules to expand the exception for routing to affiliates to permit routing by NOS to PHLX. Under the proposed rule change, an Options Participant could enter an order into NOM designated as an “Exchange Direct Order” with instructions to route that order directly to PHLX without first checking the NOM book.

In addition, Nasdaq is proposing to amend Chapter VI, Section 11(b) of the NOM Rules to permit the routing of orders in Non-System Securities via NOS from NOM to PHLX. As a result, orders in Non-System Securities that are routed to away markets under normal procedures could be routed to PHLX, as well as those that are entered as Exchange Direct Orders with instructions to route directly to PHLX.

Nasdaq and other exchanges previously have adopted rules that permit exchanges to accept routing of inbound orders from affiliates, subject to certain limitations and conditions

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<sup>6</sup> Because only Nasdaq members who are Options Participants may enter orders into NOM, it also follows that routing by NOS is available only to Nasdaq members who are Options Participants. Pursuant to Chapter I, Section 1(a)(40) of the NOM Rules, the term “Options Participant” means a firm, or organization that is registered with Nasdaq for purposes of participating in options trading on NOM as a “Nasdaq Options Order Entry Firm” or “Nasdaq Options Market Maker”.

<sup>7</sup> See Securities Exchange Act Release No. 58179 (July 17, 2008), 73 FR 42874 (July 23, 2008).

intended to address the Commission's concerns regarding affiliation.<sup>8</sup> Specifically, the proposed rule change to Chapter VI, Section 1(e)(7) is consistent with: (i) Nasdaq adopting rule changes to permit NOS, in its operation as a routing facility for NOM, to route orders from NOM to BOX, a facility of BX, which is an affiliate of Nasdaq, and (ii) in the equities markets, by Nasdaq in adopting rule changes to permit NASDAQ Execution Services, Inc., in its operation as the routing facility of Nasdaq, to route orders from Nasdaq to BX.<sup>9</sup>

In the orders approving the above-mentioned rule changes, the Commission noted its concerns about potential informational advantages and conflicts of interest between an exchange's self-regulatory obligations and its commercial interest when the exchange is affiliated with one of its members, but determined that the proposed limitations and conditions were sufficient to mitigate its concerns.

With respect to concerns identified by the Commission regarding the potential for informational advantages favoring NOS vis-à-vis other non-affiliated PHLX members, these concerns are addressed by: (i) existing NOM Rule Chapter VI, Section 11(e) which requires NOS to establish and maintain procedures and internal controls reasonably designed to adequately restrict the flow of confidential and proprietary information between Nasdaq and its facilities (including NOS) and any other entity and (ii) existing PHLX Rule 1080(m)(iii)(C)

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<sup>8</sup> See Securities Exchange Act Release Nos. 60354 (July 21, 2009), 74 FR 37074 (July 27, 2009)(SR-NASDAQ-2009-065); 60349 (July 20, 2009), 74 FR 37071 (July 27, 2009)(SR-BX-2009-035); 59153 (December 23, 2008), 73 FR 80485 (December 31, 2008)(SR-NASDAQ-2008-098); 59154 (December 23, 2008), 73 FR 80468 (December 31, 2008)(SR-BSE-2008-48); 59010 (November 24, 2008), 73 FR 73373 (December 2, 2008) (SR-NYSEArca-2008-130); 58681 (September 29, 2008), 73 FR 58285 (October 6, 2008)(SR-NYSEArca-2008-90); 58680 (September 29, 2008), 73 FR 58283 (October 6, 2008)(SR-NYSE-2008-76); 58673 (September 29, 2008), 73 FR 57707 (October 3, 2008)(SR-Amex-2008-62) (collectively, the "Affiliation Orders").

<sup>9</sup> See Securities Exchange Act Release Nos. 60354 (July 21, 2009), 74 FR 37074 (July 27, 2009)(SR-NASDAQ-2009-065); 59153 (December 23, 2008), 73 FR 80485 (December 31, 2008)(SR-NASDAQ-2008-098).

which requires PHLX to establish and maintain procedures and internal controls reasonably designed to adequately restrict the flow of confidential and proprietary information between PHLX and NOS and any other entity, including any affiliate of NOS.

In addition, PHLX is proposing a rule change and certain undertakings intended to manage the flow of confidential and proprietary information between NOS and PHLX and to minimize potential conflicts of interest.<sup>10</sup>

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>11</sup> in general, and with Section 6(b)(5) of the Act,<sup>12</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. The proposed rule changes would permit routing of Exchange Direct Orders from NOM to PHLX through NOS while minimizing the potential for conflicts of interest and informational advantages involved where a broker-dealer is affiliated with an exchange facility to which it is routing orders.

### 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

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<sup>10</sup> See SR-Phlx-2010-036.

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

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

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 proposed rule change: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, the proposed rule change 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>

A proposed rule change filed under 19b-4(f)(6) normally may not become operative prior to 30 days after the date of filing.<sup>15</sup> However, Rule 19b-4(f)(6)(iii)<sup>16</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. Nasdaq has requested that the Commission waive the 30-day operative delay. The Commission notes that Nasdaq's proposal is consistent with its rules regarding order routing to BOX<sup>17</sup> and the rules of other national securities exchanges and does not raise any new

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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> 17 CFR 240.19b-4(f)(6)(iii). In addition, Rule 19b-4(f)(6)(iii) requires that a self-regulatory organization submit to the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of 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>16</sup> Id.

<sup>17</sup> See supra note 9.



substantive issues.<sup>18</sup> For these reasons, the Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest, and designates the proposed rule change to be operative upon filing with the Commission.<sup>19</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.

#### 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-2010-028 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.

All submissions should refer to File Number SR-NASDAQ-2010-028. This file number should be included on the subject line if e-mail is used. To help the Commission process and review

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<sup>18</sup> See Affiliation Orders, supra note 8.

<sup>19</sup> For the 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).

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 Web site 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 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-2010-028 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>20</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>20</sup> 17 CFR 200.30-3(a)(12).