

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-67655; File No. SR-NASDAQ-2012-059)

August 14, 2012

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Change to Establish “Benchmark Orders” under NASDAQ Rule 4751(f)

I. Introduction

On May 1, 2012, The NASDAQ Stock Market LLC (“NASDAQ” or “Exchange”) 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 to establish various “Benchmark Orders” under NASDAQ Rule 4751(f). The proposed rule change was published for comment in the Federal Register on May 17, 2012.<sup>3</sup> The Commission received no comments on the proposal. On June 26, 2012, the Commission extended to August 15, 2012, the time period in which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.<sup>4</sup> This order institutes proceedings under Section 19(b)(2)(B) of the Act to determine whether to approve or disapprove the proposed rule change.

II. Description of the Proposal

As set forth in more detail in the Notice, the Exchange has proposed to offer Benchmark Orders that would seek to achieve the performance of a specified benchmark – Volume Weighted Average Price (“VWAP”), Time Weighted Average Price (“TWAP”), or Percent of

---

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

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

<sup>3</sup> See Securities Exchange Act Release No. 66972 (May 11, 2012), 77 FR 29435 (May 17, 2012) (“Notice”).

<sup>4</sup> See Securities Exchange Act Release No. 67258 (June 26, 2012), 77 FR 39314 (July 2, 2012).

Volume (“POV”) – over a specified period of time for a specified security.<sup>5</sup> The entering party would specify the benchmark, period of time, and security, as well as the other order information common to all order types, such as buy/sell side, shares and price.<sup>6</sup>

Benchmark Orders would be received by NASDAQ but by their terms would not be executable by the NASDAQ matching engine upon entry.<sup>7</sup> Rather, NASDAQ would direct them to a system application (“Application”) that is licensed from a third-party provider and dedicated to processing Benchmark Orders.<sup>8</sup> The Application would process Benchmark Orders by generating “Child Orders” in a manner designed to achieve the desired benchmark performance, *i.e.*, VWAP, TWAP or POV, in accordance with the member’s instructions.<sup>9</sup> Child Orders would be executed within the NASDAQ system under NASDAQ’s existing rules, or made available for routing under NASDAQ’s current routing rules.<sup>10</sup> The Application would not be capable of executing Child Orders, but instead would send Child Orders, using the proper system protocol, to the NADAAQ matching engine or to the NASDAQ router as needed to complete the Benchmark Order.<sup>11</sup> NASDAQ represents that it considers the Application to be a functional offering of the NASDAQ Stock Market, and that it would be integrated closely with the

---

<sup>5</sup> See proposed NASDAQ Rule 4751(f)(15).

<sup>6</sup> Id.; see also Notice, 77 FR at 29436.

<sup>7</sup> See proposed NASDAQ Rule 4751(f)(15); see also Notice, 77 FR at 29435-36.

<sup>8</sup> See Notice, 77 FR at 29436.

<sup>9</sup> See proposed NASDAQ Rule 4751(f)(15); see also Notice, 77 FR at 29435-36.

<sup>10</sup> See Notice, 77 FR at 29435. Child Orders that require routing would be routed by NASDAQ Execution Services (“NES”), NASDAQ’s wholly-owned routing broker-dealer. See Notice, 77 FR at 29436 n.8. In addition, fees applicable to existing orders and trades would apply to Child Orders. See Notice, 77 FR at 29436.

<sup>11</sup> See Notice, 77 FR at 29435-36.

NASDAQ system and provided to members subject to NASDAQ's obligations and responsibilities as a self-regulatory organization.<sup>12</sup>

NASDAQ also represents that it would test the Application rigorously and regularly, monitor the Application performance on a real-time and continuous basis, and have access to the technology, employees, books and records of the third-party provider that are related to the Application and its interaction with NASDAQ.<sup>13</sup> In addition, NASDAQ represents that it would maintain control of and responsibility for the Application.<sup>14</sup>

III. Proceedings to Determine Whether to Approve or Disapprove SR-NASDAQ-2012-059 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change. Institution of these proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described in greater detail below, the Commission seeks and encourages interested persons to provide additional comment on the proposed rule change to inform the Commission's analysis of whether to approve or disapprove the proposed rule change.

As discussed above, the Benchmark Order would allow NASDAQ members to enter a single order in a single security that seeks to match the performance of one of three selected benchmarks – VWAP, TWAP or POV – over a pre-determined period of time. Benchmark Orders would not be executed by the NASDAQ matching engine, but would be directed to the

---

<sup>12</sup> See Notice, 77 FR at 29436.

<sup>13</sup> Id.

<sup>14</sup> See Notice, 77 FR at 29437.

Application that is dedicated to processing Benchmark Orders. The Application would generate and send Child Orders to the NASDAQ matching engine or to the NASDAQ router, pursuant to current NASDAQ order handling and routing rules, in a manner designed to achieve the desired benchmark selected by the entering firm.

Pursuant to Section 19(b)(2)(B), the Commission is providing notice of the grounds for disapproval under consideration. The sections of the Act applicable to the proposed rule change that provide the grounds for approval or disapproval under consideration are Section 6(b)(5)<sup>15</sup> and Section 6(b)(8).<sup>16</sup> Section 6(b)(5) of the Act<sup>17</sup> requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, 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; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. Section 6(b)(8) of the Act<sup>18</sup> requires that the rules of the exchange do not impose any burden on competition not necessary or appropriate in furtherance of the Act.

NASDAQ's proposal raises concerns under the Act regarding whether Benchmark Orders and Child Orders would be subject to appropriate controls to manage risk. In particular, the Commission is concerned that NASDAQ has not adequately addressed how or whether Child Orders, which would be generated solely by the Application and presumably outside the control and supervision of the broker-dealer firm that entered the initial Benchmark Order, would be

---

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

<sup>16</sup> 15 U.S.C. 78f(b)(8).

<sup>17</sup> 15 U.S.C. 78f(b)(5).

<sup>18</sup> 15 U.S.C. 78f(b)(8).

subject to adequate pre-trade risk checks. NASDAQ's proposal makes reference to the Market Access Rule, Rule 15c3-5 under the Act,<sup>19</sup> which requires pre-trade controls to be applied by brokers entering orders onto an exchange but NASDAQ's proposal does not indicate how or whether pre-trade controls would be applied to Child Orders generated by the Application.<sup>20</sup> The application of appropriate risk controls under Rule 15c3-5 is critically important to maintaining a robust market infrastructure supporting the protection of investors, investor confidence, and fair, orderly, and efficient markets for all participants.

Another concern stems from the requirements in Sections 6(b)(5) and 6(b)(8) of the Act that exchange rules not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to impose an unnecessary burden on competition. NASDAQ's Benchmark Order functionality would compete with the algorithms that member firms and other market participants currently use to achieve VWAP, TWAP or POV performance. The Commission is concerned whether NASDAQ's proposal would enable Benchmark Orders and Child Orders generated by the Application to receive unfair or unreasonable preferential treatment by NASDAQ (such as through more effective access to the matching engine) as compared to orders generated by market participants that may choose to use a competing algorithm.

#### IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any others they

---

<sup>19</sup> 17 CFR 240.15c3-5. Rule 15c3-5 is designed to ensure that broker-dealers appropriately control the risks associated with market access, so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, or the stability of the financial system. See Securities Exchange Act Release No. 63241 (November 3, 2010), 75 FR 69792 at 69794 (November 15, 2010).

<sup>20</sup> See Notice, 77 FR at 29436.

may have identified with the Exchange's proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposal is consistent with Sections 6(b)(5) and 6(b)(8) under the Act, or any other provision of the Act or rule or regulation thereunder. Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.<sup>21</sup>

The Commission is asking that commenters address the merit of NASDAQ's statements in support of the proposal, in addition to any other comments they may wish to submit about the proposed rule change. Specifically, the Commission is requesting comment on the following:

- What are commenters' views as to whether NASDAQ has adequately addressed the potential risks to the market related to the handling of Child Orders by NASDAQ's Application? How could such risks be addressed and mitigated by NASDAQ?
- What are commenters' views with regard to whether NASDAQ's proposal to offer trading algorithms that would compete with other market participants would impose an undue burden on competition or result in unfair discrimination? In this regard, has NASDAQ provided adequate assurances and information regarding whether or not it would offer preferential treatment to its service as compared to similar competing services offered by other market participants? For example, what are commenters' views

---

<sup>21</sup> Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

regarding whether NASDAQ's proposal could allow for more effective access to the matching engine that could confer advantages related to timing, priority, or otherwise?

Interested persons are invited to submit written data, views and arguments regarding whether the proposal should be approved or disapproved by [insert date 45 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 60 days from publication in the Federal Register]. 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-2012-059 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-2012-059. 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, 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 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-2012-059 and should be submitted on or before [insert date 45 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 60 days from publication in the Federal Register.]

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>22</sup>

Kevin M. O'Neill  
Deputy Secretary

---

<sup>22</sup> 17 CFR 200.30-3(a)(57).