

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53745; File No. SR-NASD-2005-140)

May 1, 2006

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change Regarding the Nasdaq Crossing Network

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 2, 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 February 28, 2006, Nasdaq filed Amendment No. 1 to the proposed rule change.³ On April 24, 2006, Nasdaq filed Amendment No. 2 to the proposed rule change.⁴ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

Nasdaq proposes to establish the Nasdaq Crossing Network for Nasdaq listed and certain exchange listed securities. The text of the proposed rule change is below. Proposed new

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaced and superseded the original filing in its entirety.

⁴ In Amendment No. 2, Nasdaq made certain representations related to the applicability of Rule 11a2-2(T) under the Act and the “Manning Rule” to the proposed rule change. In addition, Nasdaq indicated its plan to request exemptive relief from Rule 10a-1 under the Exchange Act and NASD Rule 3350 (“Short Sale Rule”), as well as from Rule 602 of Regulation NMS (“Quote Rule”). Nasdaq also made clarifying edits to the proposed rule change.

language is underlined.⁵

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4716. Nasdaq Crossing Network

(a) Definitions. For the purposes of this rule the term:

(1) “Nasdaq Reference Price Cross” shall mean the process for executing orders at a predetermined reference price at a randomly selected point in time during a one minute trading window beginning at 11:00 a.m., 1:00 p.m. and 3:00 p.m. during the regular hours session and at 4:30 p.m. during the after hours session.

(2) “Nasdaq Reference Price Cross eligible securities” shall mean Nasdaq-listed securities and securities listed on the New York Stock Exchange, the American Stock Exchange or a regional exchange.

(3) (A) “Reference Price Cross Order” or “RPC” shall mean a market or limit order to buy or sell in Nasdaq Reference Price eligible securities that may be executed only during a Nasdaq Reference Price Cross. RPC orders shall not be displayed and must be designated with a time-in-force value to participate either:

(i) in the next scheduled regular hours cross with unexecuted shares being immediately canceled back to the market participant after that cross (NXT);

(ii) in all remaining crosses during the trading day with unexecuted shares being immediately canceled back to the market participant after the final regular hours cross (REG); or

(iii) in all remaining crosses in the current day with unexecuted shares immediately canceled back to the market participant after the after hours cross (ALX).

⁵ Changes are marked to the rule text that appears in the electronic NASD Manual found at www.nasdaq.com. Prior to the date when The Nasdaq Stock Market LLC (“Nasdaq LLC”) commences operations, Nasdaq LLC will file a conforming change to the rules of Nasdaq LLC approved in Securities Exchange Act Release No. 53128 (January 13, 2006).

(B) Starting at 7:30 a.m. Eastern Time until the time of the last after hours session Reference Price Cross, participants may enter, cancel or correct RPC orders, but such orders shall not be available for execution until the next eligible Reference Price Cross. RPC orders must be entered in round lots with a minimum size of one round lot and may designate a minimum acceptable execution quantity. All RPC orders must be available for automatic execution.

(b) Processing of Nasdaq Reference Price Cross.

(1) Each Nasdaq Reference Price Cross shall occur during the regular hours session or the after hours session window commencing at such times as may be designated by Nasdaq upon prior notice to market participants.

(2) Nasdaq Reference Price Crosses that occur during the regular hours session shall be executed at the midpoint of the national best bid and offer, trade reported without identifying the contra party, and disseminated via the consolidated tape.

(3) Nasdaq Reference Price Crosses that occur during the after hours session shall execute at the Nasdaq Official Closing Price for Nasdaq-listed securities or at the official closing price of the primary market for securities listed on the New York Stock Exchange, the American Stock Exchange or a regional exchange, shall be trade reported without identifying the contra party, and disseminated via the consolidated tape.

(4) RPC orders will be allocated on a pro-rata basis, such that shares will be allocated pro-rata in round lots to eligible orders based on the original size of the order. If additional shares remain after the initial pro-rata allocation, those shares will continue to be allocated pro-rata to eligible orders until a number of round lots remain that is less than the number of eligible orders. Any remaining shares will be allocated to the oldest eligible order. If the allocation to an

eligible order would be less than the minimum acceptable execution quantity for that order, the order shall not be eligible for execution in that cross.

(5) If the reference price described in subparagraph (3) above is outside the benchmarks established by Nasdaq by a threshold amount at the time an after hours cross is scheduled to occur, the Nasdaq Reference Price Cross shall not occur for that security. Nasdaq management shall set and modify such benchmarks and thresholds from time to time upon prior notice to market participants.

(6) If the national best bid and offer is crossed at the time of a Reference Price Cross during the regular hours session, the cross shall be delayed for up to five minutes beyond the time the Reference Price Cross was scheduled to occur and shall execute at the midpoint of the national best bid and offer when the quote becomes uncrossed. In the event the quote remains crossed beyond five minutes after the time of the scheduled Reference Price Cross, the cross will not occur and unexecuted NXT orders shall be returned to market participants.

(7) If the national best bid and offer is locked at the time of a Reference Price Cross during the regular hours session, the cross shall execute at the lock price.

(8) If trading in a security is halted for regulatory or other reasons at the time a cross is scheduled to occur, the cross will not occur and all unexecuted NXT orders shall be returned to market participants.

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 proposes to extend the success of Nasdaq's Opening and Closing Cross matching functionality,⁶ which has been widely accepted in the industry, with the introduction of the Nasdaq Crossing Network. The Nasdaq Crossing Network would provide a new execution option to market participants trading in Nasdaq-listed securities and securities listed on the New York Stock Exchange ("NYSE"), the American Stock Exchange ("Amex") or a regional exchange. During the regular hours session, a series of Nasdaq Reference Price Crosses would allow market participants to place orders to be executed at the midpoint of the National Best Bid and Offer ("NBBO"). An additional cross would take place after the close of the trading day and eligible orders would be executed at the Nasdaq Official Closing Price ("NOCP") for Nasdaq-listed securities or the official closing price of the primary market for securities listed on the NYSE, Amex or a regional exchange ("Primary Market Close"). Initially, the Nasdaq Reference

⁶ See Securities Exchange Act Release Nos. 50405 (September 16, 2004), 69 FR 57118 (September 23, 2004) (SR-NASD-2004-071) and 49406 (March 11, 2004), 69 FR 12879 (March 18, 2004) (SR-NASD-2003-173), respectively.

Price Crosses would commence at 11:00 a.m., 1:00 p.m., 3:00 p.m. and 4:30 p.m. (Eastern Time or “ET”). Orders would be designated for one or more Nasdaq Reference Price Crosses with a time-in-force indicator.

While the Opening and Closing Crosses act as price discovery facilities, the purpose of the Nasdaq Crossing Network would be to provide market participants and investors with an accurate single trading price at specific times during the trading day, resulting in an enhanced ability to execute block trades quickly and anonymously, while minimizing market impact and associated price movements.⁷ The Reference Price Crosses are designed to occur at an externally derived price and in accordance with a predetermined algorithm. Participation in the Reference Price Crosses would be voluntary and would not result in any advantage to market participants over those market participants that do not choose to participate.

Orders. Market participants would be able to enter orders in the Nasdaq Market Center for participation in the Reference Price Crosses without restriction from the session open at 7:30

⁷ In connection with Nasdaq’s application for registration as a national securities exchange, Nasdaq submitted a letter to Commission Staff (“Rule 11a2-2(T) Letter”) requesting interpretive guidance with respect to the application of Exchange Act Rule 11a2-2(T) (known as the “effect and execute” rule) to transactions effected through the Nasdaq Market Center, Brut or Inet (collectively “Nasdaq Execution Systems”). See Letter to Nancy M. Morris, Secretary, Commission, and Elizabeth King, Associate Director, Division of Market Regulation, Commission, from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq, dated January 12, 2006. The “effect and execute” rule provides exchange members with an exemption from the Section 11(a) prohibition against a member of a national securities exchange effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises discretion unless an exception applies. In reliance on Nasdaq’s representations in its letter, the Commission concluded in its order approving Nasdaq’s exchange registration application that Nasdaq Exchange members that enter orders into Nasdaq Execution Systems satisfy the requirements of Exchange Act Rule 11a2-2(T). See Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131). Nasdaq represents that the proposed rule change will not change the continued accuracy of the representations made by Nasdaq in the Rule 11a2-2(T) Letter.

a.m. until the post-close cross is initiated. Orders would be able to be submitted as existing market or limit order types and would be designated by the firm upon entry with a time-in-force indicator as follows: (i) participate in the next scheduled regular hours cross with unexecuted shares being immediately canceled back to the user after that cross (NXT), (ii) participate in all of the regular hours crosses (i.e., 11:00 a.m., 1:00 p.m. or 3:00 p.m. ET) with unexecuted shares being immediately canceled back to the user following the last regular hours cross (REG) or (iii) participate in all crosses for the current day (i.e., 11:00 a.m., 1:00 p.m., 3:00 p.m. and 4:30 p.m. ET) with unexecuted shares immediately canceled back to the user following the after hours cross (AHX).⁸ Orders that are designated for one or more Reference Price Crosses would not be displayed.

Orders would be required to be entered in round lots with a minimum of one round lot and may designate a minimum acceptable quantity (“MAQ”) for execution. No mixed or odd lot execution amount would be permitted. Orders may not be canceled or replaced during the time of the cross, but may at any other time, including periods when trading in the applicable security is halted. Like Nasdaq Opening and Closing Cross orders, Reference Price Cross orders would be required to be available for automatic execution. The Reference Price Cross would have no order delivery capability and no special orders would be accommodated. Both automatic execution and order delivery participants, however, would be able to enter eligible orders into the Nasdaq Market Center to participate in the Reference Price Cross, so long as the orders are

⁸ Until such time as an exemption or other relief is granted, short sale orders that participate in the Nasdaq Reference Price Crosses must comply with applicable short sale rules. Nasdaq intends to propose a rule change to the NASD’s short sale rule, NASD Rule 3350, and to submit to the Commission a request for exemptive relief from the Short Sale Rule to permit short sales of certain securities at the midpoint of the NBBO effected during the Reference Price Crosses. In addition, Nasdaq plans to submit to the Commission a request for exemptive relief from the Quote Rule.

available for automatic execution.

Automatic execution. Like closing and opening cross orders, crossing network orders would be required to be available for automatic execution. The cross would have no order delivery capability and no special orders could be accommodated. The only eligible order types would be limit orders or market orders. Although there would be no order delivery capability, both automatic execution and order delivery participants would be able to enter eligible orders into the Nasdaq Market Center so long as the orders are available for auto execution.

Nasdaq Reference Price Crosses. The Nasdaq Reference Price Crosses initially would commence at 11:00 a.m., 1:00 p.m., 3:00 p.m. and 4:30 p.m. ET. In order to minimize the opportunity for manipulation, Nasdaq would execute the cross through an automated and random matching mechanism at a randomly selected time during the predetermined one minute cross trading window. All eligible orders for the trading day crosses would be executed in accordance with a predetermined algorithm at the NBBO midpoint on a pro-rata basis and at the NOCP or Primary Market Close, as applicable, for post-close cross executions.

Upon initiation of the cross, available shares would be treated as if they were the same price and would be allocated on a pro rata basis to eligible orders. In order to prevent orders that participate in more than one cross from being disadvantaged with regard to their execution priority based on diminishing size, shares would be allocated based on the original size of the order, not on the value of the remaining unexecuted shares. If additional shares remain after the initial pro-rata allocation, those shares would continue to be allocated pro-rata to eligible orders until a number of round lots remain that is less than the number of eligible orders. Any remaining shares would be allocated to the oldest eligible order. In addition, in the case of an order that has designated a MAQ, if the pro rata allocation would be less than the MAQ, the

order would not be eligible for execution in that cross.

For example, assume the following orders are received in the following sequence:

| | |
|--|--|
| Orders: 1. Sell 10,000@MKT 2. Sell 10,000@MKT 3. Buy 10,000@MKT 4. Sell 10,000@MKT 5. Sell 10,000@MKT (where 2,000 unexecuted shares remain from a prior cross where 8,000 shares of the order were executed) | Liquidity Pool: Buy 10,000@MKT Sell 32,000@MKT |
|--|--|

Based on these orders and the available liquidity pool, the cross would operate as if there are 10,000 shares to buy and 32,000 shares to sell with the algorithm allocating 2,500 shares to each sell order. Although order #5 consists of only 2,000 unexecuted shares, it receives an allocation (2,500 shares) based on the original size of the order (10,000 shares). Since order #5 can only execute 2,000 shares, the remaining 500 shares are allocated to the other orders pro rata. After each order is allocated an additional 100 shares, the remaining 200 shares are allocated to the oldest eligible order. The executions resulting from this cross would be as follows:

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|------------------------|
| Order 1: 2,800 shares |
| Order 2: 2,600 shares |
| Order 3: 10,000 shares |

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|-----------------------|
| Order 4: 2,600 shares |
| Order 5: 2,000 shares |

The executions would be reported to the market participants via Nasdaq Market Center execution reports as a single trade reflecting the aggregate shares executed. In order to reduce information leakage that could lead to adverse price movements, executions would be reported as anonymous trades, without identifying a contra party. Each execution would be reported to the Nasdaq Market Center trade reporting service for trade reporting, clearance and settlement.⁹ Trades from the regular hours cross would be disseminated regular way, and trades from the post close cross would be disseminated with a .PRP sale condition modifier. In the event that a Reference Price Cross order that executes at the midpoint of the NBBO results in a Nasdaq member trading ahead of a held customer order by less than \$0.01 (i.e., \$0.005), Nasdaq believes that a Manning obligation would be triggered under NASD IM-2110-2, Rule on Trading Ahead of Customer Limit Order (known as the “Manning Rule”). Under this rule, a firm cannot trade ahead of a held customer limit order without executing the customer order unless it trades at a price that is at least \$0.01 better than the customer limit order price.

If based on usage and demand, Nasdaq desires to add more frequent crosses or to modify the time of the crosses in the future, it would submit a rule change to the Commission. Nasdaq would publish the information about any changes via its public NasdaqTrader Web site.

⁹ Nasdaq will submit each underlying trade to the National Securities Clearing Corporation for clearing. When Nasdaq is operational as a national securities exchange these trades will be reported as “covered sales” of the exchange for the purposes of Section 31 of the Act. If the Reference Price Crossing Network is launched before Nasdaq is operational as an exchange, these trades will be reported by the NASD for the purposes of Section 31 of the Act.

Reference Price Cross Circuit Breaker. As it did with the Nasdaq Opening Cross and Nasdaq Closing Cross, Nasdaq would establish a circuit breaker for Nasdaq Reference Price Crosses that occur during the after hours session. The circuit breaker would protect against unusual occurrences when the market has moved significantly from the NOCP or the Primary Market Close based on information that becomes available after the market close. In this situation, Nasdaq may decide to cancel the cross rather than execute the cross at a price that no longer reflects the sentiment of the marketplace.

If the post-close cross would not execute within a preset boundary (“Threshold Percentage”) of the consolidated last sale price of the security, the cross would not take place. Initially, the Threshold Percentage would be set at ten percent, with a \$0.50 minimum spread. Thus, if the difference between the NOCP or Primary Market Close, as applicable, and the consolidated last sale price of the security would be ten percent or more, but not less than the minimum value of \$0.50, then the cross would be canceled.

As in the case of the Nasdaq Opening and Closing Crosses, Nasdaq believes that market conditions and experience with the Nasdaq Reference Price Crosses may require Nasdaq to adjust the Threshold Percentage at a future point in time. Any changes to the Threshold Percentage would be made in advance and communicated to members. Nasdaq would publish any changes to the Threshold Percentage via its public NasdaqTrader Web site.

In addition, if trading in a security is halted at the time a cross is scheduled to occur, the cross would be canceled and orders that are not designated for any future crosses would be returned to the market participants.

Locked or Crossed Markets. In the event of a crossed NBBO at the time of a Reference Price Cross during the regular hours session, the cross would be delayed and would execute

based on the midpoint NBBO when the quote becomes uncrossed. If the quote remains crossed, however, for five minutes beyond when the cross normally would have occurred, the cross would be canceled and orders that are not designated for any future crosses would be returned to the market participants. In the event of a locked NBBO at the time of a Reference Price Cross during the regular hours session, the cross would execute at the lock price.

2. Statutory Basis

Nasdaq believes that the proposed rule change, as amended, is consistent with the provisions of Section 15A of the Act,¹⁰ in general, and with Section 15A(b)(6) of the Act,¹¹ in particular, which requires the NASD's rules to be designed, among other things, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities. Nasdaq believes that the proposed rule change is consistent with these requirements in that the changes are designed to expand the types of crossing products available to members and to provide additional tools for facilitating transactions.

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.

¹⁰ 15 U.S.C. 78q-3.

¹¹ 15 U.S.C. 78q-3(b)(6).

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 NASD consents, the Commission will:

- (A) by order approve such proposed rule change, as amended, or
- (B) institute proceedings to determine whether the proposed rule change, as amended, 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. Please include File Number SR-NASD-2005-140 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 Number SR-NASD-2005-140. 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 Nasdaq's principal office. 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-2005-140 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.¹²

Nancy M. Morris
Secretary

¹² 17 CFR 200.30-3(a)(12).