

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59275; File No. SR-NASDAQ-2008-104)

January 22, 2009

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change to Adopt a Modified Sponsored Access Rule

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 30, 2008, The NASDAQ Stock Market LLC (“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 January 8, 2009, Nasdaq filed Amendment No. 1 to the proposed rule change. 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 adopt a proposed rule change to modify the requirements for members that provide “Sponsored Access” to Nasdaq’s execution system.

The text of the proposed rule change is below. Proposed new language is underlined; proposed deletions are in brackets.³

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4611. Nasdaq Market Center Participant Registration

(a) – (c) No change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Changes are marked to the rule text that appears in the electronic manual of Nasdaq found at <http://nasdaq.complinet.com>.

(d) Members may provide “Sponsored Access” to the Nasdaq Market Center in accordance with the provisions below: [Sponsored Participants._ A Sponsored Participant may obtain authorized access to the Nasdaq Market Center only if such access is authorized in advance by one or more Nasdaq members as follows:]

[(1) Sponsored Participants must enter into and maintain customer agreements with one or more Sponsoring Members establishing proper relationship(s) and account(s) through which the Sponsored Participant may trade on the Nasdaq Market Center. Such customer agreement(s) must incorporate the Sponsorship Provisions set forth in paragraph (2) below.]

[(2) For a Sponsored Participant to obtain and maintain authorized access to the Nasdaq Market Center, a Sponsored Participant and its Sponsoring Member must agree in writing to the following Sponsorship Provisions:

(A) Sponsored Participant and its Sponsoring Member must have entered into and maintained a User Agreement with The NASDAQ Stock Market LLC. The Sponsoring Member must designate the Sponsored Participant by name in its User Agreement as such.

(B) Sponsoring Member acknowledges and agrees that

(i) All orders entered by the Sponsored Participants and any person acting on behalf of or in the name of such Sponsored Participant and any executions occurring as a result of such orders are binding in all respects on the Sponsoring Member and

- (ii) Sponsoring Member is responsible for any and all actions taken by such Sponsored Participant and any person acting on behalf of or in the name of such Sponsored Participant.
- (C) Sponsoring Member shall comply with the Nasdaq Certificate of Incorporation, Bylaws, Rules and procedures with regard to the Nasdaq Market Center and Sponsored Participant shall comply with Nasdaq Certificate of Incorporation, Bylaws, Rules and procedures with regard to the Nasdaq Market Center, as if Sponsored Participant were a Nasdaq Member.
- (D) Sponsored Participant shall maintain, keep current and provide to the Sponsoring Member a list of individuals authorized to obtain access to the Nasdaq Market Center on behalf of the Sponsored Participant.
- (E) Sponsored Participant shall familiarize its authorized individuals with all of the Sponsored Participant's obligations under this Rule and will assure that they receive appropriate training prior to any use or access to the Nasdaq Market Center.
- (F) Sponsored Participant may not permit anyone other than authorized individuals to use or obtain access to the Nasdaq Market Center.
- (G) Sponsored Participant shall take reasonable security precautions to prevent unauthorized use or access to the Nasdaq Market Center, including unauthorized entry of information into the Nasdaq Market Center, or the information and data made available therein. Sponsored Participant understands and agrees that Sponsored Participant is

responsible for any and all orders, trades and other messages and instructions entered, transmitted or received under identifiers, passwords and security codes of authorized individuals, and for the trading and other consequences thereof.

(H) Sponsored Participant acknowledges its responsibility to establish adequate procedures and controls that permit it to effectively monitor its employees', agents' and customers' use and access to the Nasdaq Market Center for compliance with the terms of this agreement.

(I) Sponsored Participant shall pay when due all amounts, if any, payable to Sponsoring Member, Nasdaq, or any other third parties that arise from the Sponsored Participant's access to and use of the Nasdaq Market Center. Such amounts include, but are not limited to applicable exchange and regulatory fees.]

[(3) The Sponsoring Member must provide Nasdaq with a Notice of Consent acknowledging its responsibility for the orders, executions and actions of its Sponsored Participant at issue.]

(1) Definition. Sponsored Access is the practice by a member firm ("Sponsoring Member") of providing access to Nasdaq to another firm or customer ("Sponsored Participant"). Sponsored Access takes multiple forms, including but not limited to: (a) direct market access, where the Sponsored Participant's orders pass through the Sponsoring Member's systems prior to reaching Nasdaq ("Direct Market Access"), (b) sponsored access, where the Sponsored Participant enters orders directly into Nasdaq via a dedicated port provided by the Sponsoring Member ("Direct Sponsored Access"), and (c) direct

access where a service bureau or other third party provides Sponsored Participants with technology to access Nasdaq under the auspices of and via an arrangement with the Sponsoring Member (“Third Party Sponsored Access”).

(2) Compliance. Irrespective of the form of Sponsored Access provided, Sponsoring Members are responsible for the conduct of their Sponsored Participants as if the conduct were their own. To ensure that Sponsored Access is consistent with high market quality and the protection of investors, Sponsoring Members shall at a minimum comply with the Contractual Provisions, Financial Controls, and Regulatory Controls set forth in sections (3), (4), and (5) below.

(3) Contractual Provisions. A Sponsoring Member that provides Direct Sponsored Access or Third Party Sponsored Access shall execute and maintain agreements with each Sponsored Participant containing the commitments below. A Sponsoring Member that provides Third Party Sponsored Access must execute and maintain agreements with each service bureau or other entity that facilitates such Third Party Sponsored Access providing that such entity will execute and maintain agreements with each Sponsored Participant containing the commitments below for the benefit of the Sponsoring Member.

(A) All trading activity by the Sponsored Participant shall comply with all applicable federal securities laws and rules and Exchange rules, including but not limited to the Nasdaq Certificate of Incorporation, Bylaws, Rules and procedures with regard to the Nasdaq Market Center (“Regulatory Requirements”).

(B) Sponsored Participant shall provide Sponsoring Member with access to its books and records promptly upon request, and otherwise cooperate with the

Sponsoring Member in furtherance of Sponsoring Member's compliance with applicable Regulatory Requirements.

(C) Sponsored Participant shall maintain its trading activity within the credit, product or other financial limits specified by the Sponsoring Member.

(D) Sponsored Participant shall maintain all technology permitting sponsored access to Nasdaq in a physically secure manner and may not permit unauthorized individuals to use or obtain access to Nasdaq. Sponsored Participant shall familiarize its authorized individuals with the Regulatory Requirements and will provide appropriate training prior to use or access to Nasdaq.

(E) Sponsored Participant shall provide the Sponsoring Member complete and current corporate and financial information about the Sponsored Participant.

(F) Sponsored Participant shall agree that the Sponsoring Member or Nasdaq may immediately terminate the Sponsored Access if the Sponsored Participant or third party access provider fails to abide by its commitments.

(4) Financial Controls. Each Sponsoring Member shall establish adequate procedures and controls that permit it to effectively monitor and control the Sponsored Access to systemically limit the Sponsoring Member's financial exposure. At minimum, the Sponsored Access system shall:

(A) Prevent each Sponsored Participant from entering orders that in aggregate exceed appropriate pre-set credit thresholds. Sponsoring Members may also set finely-tuned credit thresholds by sector, security or otherwise.

(B) Prevent Sponsored Participants from trading products that the Sponsored Participant or Sponsoring Member is restricted from trading.

(C) Prevent Sponsored Participants from submitting erroneous orders by providing for the rejection of orders that exceed certain price or size parameters, on an order-by-order basis or over a short period of time, or that indicate duplicative orders.

(5) Regulatory Controls.

(A) Each Sponsoring Member shall have systemic controls to ensure compliance by the Sponsored Participant with applicable Regulatory Requirements, including but not limited to compliance with rules relating to short selling; trading halts; proper uses of order types; proper use of Intermarket Sweep Orders; trading ahead of customer limit orders; prohibitions against manipulative trading practices, including wash sales and marking the close; restricted lists of securities for purposes of SEC Rule 10b-18; and applicable margin rules.

(B) Each Sponsoring Member shall ensure that compliance personnel receive timely reports of all trading activity by its Sponsored Participants sufficient to permit the Sponsoring Member to comply with applicable Regulatory Requirements, and to monitor for illegal activity such as market manipulation or insider trading. At minimum, the member firm's compliance unit should receive immediate post-trade execution reports of trading activity of its Sponsored Participants, including their identities; all required audit trail information by no later than the end of the trading day; all information necessary to create and maintain the trading records required by Regulatory Requirements by no later than the end of the trading day.

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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

Nasdaq proposes to modify Rule 4611(d) which sets forth the requirements applicable to Nasdaq members that provide “Sponsored Access” by providing customers with electronic access to Nasdaq’s execution system using the member’s market participant identifier (“MPID”). Currently, Rule 4611(d) is substantially similar to Sponsored Access rules adopted by other national securities exchanges, including New York Stock Exchange Rule 123B and NYSE Arca Exchange Rule 7.29(b). Nasdaq is proposing to amend Rule 4611(d) to ensure that member firms that are assuming responsibility for their customers’ trading activity have effective financial and regulatory oversight of the Sponsored Participant, and that Nasdaq has access to all information necessary to provide effective exchange oversight.

The proposal defines Sponsored Access as taking one of three general structures. First, “direct market access” occurs where the Sponsored Participant’s orders pass-through the member’s systems prior to reaching the exchange. Member firms routinely offer this form of access in the ordinary course of business presumably with effective regulatory and financial controls in place that are equivalent to those applied to the member firm’s own orders. Second,

“direct sponsored access” occurs where the Sponsored Participant is provided a dedicated line or port to Nasdaq, so that its orders do not first pass through the member’s systems. As explained in more detail below, each port that permits entry of quotes and orders into Nasdaq is registered to and affiliated with a unique Nasdaq member firm but Nasdaq is not able to control or determine what external controls exist to ensure that quotes and orders entered into that port comply with applicable regulatory requirements. Third, “third party sponsored access” occurs where a service bureau, such as LAVA Trading, provides Sponsored Participants the technology to access the exchange and arranges for use of the member’s MPID in connection with that arrangement under the auspices and via an arrangement with the Sponsoring Member. These definitions are non-exhaustive and designed to address the changing needs of the marketplace with flexibility while maintaining rigorous oversight.

The proposed rule re-affirms that member firms that offer any form of Sponsored Access assume responsibility for their Sponsored Participants’ trading activity. The member firm must effectively assure compliance by each Sponsored Participant with appropriate financial controls and applicable regulatory requirements. As described more fully below, this would be accomplished through a combination of contractual commitments, financial and regulatory controls, and the monitoring of current activity reports that is designed to limit financial exposure and bolster regulatory compliance.

To facilitate effective oversight of Sponsored Access arrangements by Nasdaq and the member firms, Nasdaq is proposing to require members to obtain a contractual commitment from each Sponsored Access Participant that is provided direct access to Nasdaq through a dedicated port (“Direct Sponsored Access”). Access to Nasdaq’s system is available through telecommunications ports that Nasdaq’s offers exclusively to Nasdaq members. Each port is

uniquely identified and is registered to one and only one Nasdaq member. Each message delivered to that port, delivered from that port into Nasdaq's systems, or delivered to the port by Nasdaq is tagged with the unique identifier for that port. As a result, every quotation, order, or execution that interacts with or is processed by Nasdaq's systems is attributable to a single Nasdaq member. That member is responsible for all trading activity occurring via that port, including activity of Sponsored Participants.

Where Sponsored Access is provided through a third party such as a service bureau ("Third Party Sponsored Access"), the member registers for a port but enables the service bureau to manage access to and activity of that port. In that case, the member firm will be required to obtain a contractual commitment from the service bureau that would include a commitment by the service bureau to obtain from each of its Sponsored Participant an appropriate contractual commitment for the benefit of the member firm. Through these contractual arrangements, Nasdaq will have the ability to obtain from its members any information necessary properly to monitor and address trading activity of Sponsored Participants. Pursuant to Rule 8210, members are required to comply with all requests for information, such as those stemming from investigations and enforcement actions, which may require the provision of information regarding individual Sponsored Participants.

To satisfy the proposed Contractual Provisions requirement, the Sponsored Participant or service bureau, as appropriate, will be required at minimum to commit to the following:

- All trading activity by the Sponsored Participant shall comply with all applicable federal securities laws and rules and Exchange rules, including but not limited to the Nasdaq Certificate of Incorporation, Bylaws, Rules and procedures with regard to the Nasdaq Market Center ("Regulatory Requirements").

- Sponsored Participant shall provide Sponsoring Member with access to its books and records promptly upon request, and otherwise cooperate with the Sponsoring Member in furtherance of Sponsoring Member's compliance with applicable Regulatory Requirements.
- Sponsored Participant shall maintain its trading activity within the credit, product or other financial limits specified by the Sponsoring Member.
- Sponsored Participant shall maintain all technology permitting sponsored access to Nasdaq in a physically secure manner and may not permit unauthorized individuals to use or obtain access to Nasdaq. Sponsored Participant shall familiarize its authorized individuals with the Regulatory Requirements and will provide appropriate training prior to use or access to Nasdaq.
- Sponsored Participant shall provide the Sponsoring Member complete and current corporate and financial information about the Sponsored Participant.
- Sponsored Participant shall agree that the Sponsoring Member or Nasdaq may immediately terminate the Sponsored Access if the Sponsored Participant or third party access provider fails to abide by its commitments.

Nasdaq is also proposing that member firms be required to assure that the Sponsored Access front-end or other functionality includes controls that systemically limit the member firm's financial exposure. At minimum, the Sponsored Access system must:

- Prevent each Sponsored Participant from entering orders that in aggregate exceed appropriate pre-set credit thresholds. Sponsoring Members may also set finely-tuned credit thresholds by sector, security or otherwise.

- Prevent Sponsored Participants from trading products that the Sponsored Participant or Sponsoring Member is restricted from trading.
- Prevent Sponsored Participants from submitting erroneous orders by providing for the rejection of orders that exceed certain price or size parameters, on an order-by-order basis or over a short period of time, or that indicate duplicative orders.

The member firm would be required to assure that the Sponsored Access front-end or other functionality includes controls that assure compliance with SEC and Nasdaq rules that can be systemically enforced. At minimum, the Sponsored Access system should assure compliance with: rules relating to short selling; trading halts; proper uses of order types; proper use of Intermarket Sweep Orders; trading ahead of customer limit orders; prohibitions against manipulative trading practices, including wash sales and marking the close; restricted lists of securities for purposes of SEC Rule 10b-18; and applicable margin rules.

Finally, Nasdaq is proposing that member firms be required to assure that its compliance unit receives timely reports of all trading activity by its Sponsored Participants sufficient to permit the member firm to comply with applicable SEC and Nasdaq recordkeeping and reporting requirements, and to monitor for illegal activity such as market manipulation or insider trading. At minimum, the member firm's compliance unit should receive immediate post-trade execution reports of trading activity of its Sponsored Participants, including their identities; all required audit trail information no later than the end of the trading day; all information necessary to create and maintain the trading records required by Regulatory Requirements, no later than the end of the trading day.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,⁴ in general and with Section 6(b)(5) of the Act,⁵ in particular, in that it is designed to promote just and equitable principles of trade and to protect investors and the public interest. The proposal is consistent with these obligations because it updates the standards for providing Sponsored Access, and clearly articulates the obligations in the Nasdaq's rules.

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 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

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.

⁴ 15 U.S.C. 78(f).

⁵ 15 U.S.C. 78f-3(6) [sic].

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. Please include File Number SR-NASDAQ-2008-104 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-2008-104. 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, 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-2008-104 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.⁶

Florence E. Harmon
Deputy Secretary

⁶ 17 CFR 200.30-3(a)(12).