



May 22, 2007

Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
Station Place
100 F Street, NE
Washington, DC 20549-1090

Re: File No. SR-NASDAQ-2006-65 – Nasdaq’s PORTAL Market

Dear Ms. Morris:

Friedman, Billings, Ramsey & Co, Inc. (“FBR”) welcomes the opportunity to submit its comments on The Nasdaq Stock Market’s (“Nasdaq”) proposal to reestablish the PORTAL Market system. FBR is a broker-dealer registered with the Securities and Exchange Commission pursuant to Section 15 of the Securities Exchange Act of 1934 (“Exchange Act”), and is a member of the NASD and Nasdaq. FBR is a Nasdaq market maker for nearly 900 stocks, its research department covers approximately 625 companies and fixed income securities, and it offers a full range of investment banking services, including advising on mergers and acquisitions and underwriting equity offerings. In 2006, FBR’s investment banking team executed 87 banking assignments with a total transaction value of over \$16.1 billion, including \$3.1 billion in 15 sole managed private placement transactions. Since 2001, FBR is the market leader in private placement equity transactions.¹ The goal of the PORTAL Market is to provide greater transparency for the secondary market trading of securities issued in such private placement transactions (“Rule 144A securities”).

I. Summary of FBR’s Position

FBR believes that with some modifications Nasdaq’s proposal could achieve its goal of increasing transparency in the secondary market for Rule 144A securities. As currently structured, however, the proposal will have the opposite effect in that it will create a hidden market and ultimately make secondary market trading more difficult, including placing broker-dealers in conflict with their obligations of full and fair disclosure to their customers. Many of the deficiencies in Nasdaq’s proposal can be cured by eliminating the concept of “Nasdaq-approved QIBs” and by allowing PORTAL Brokers and PORTAL Dealers to disclose PORTAL Market quotes, indications of interest (e.g., “bid

¹ FBR is ranked as the number one bookrunner for Rule 144A common equity transactions executed between January 2001 and May 22, 2007. FBR’s 38 transactions account for more than 70 percent of the capital raised through such offerings during this period. Source: Dealogic

wanted” indications), and last sale information (“PORTAL Market Information”) to certain Accredited Investors.²

FBR also believes the Securities and Exchange Commission (“SEC”) should eliminate the link between PORTAL registration and the eligibility of Rule 144A equity securities at The Depository Trust Company (“DTC”). Requiring an issuer to register its Rule 144A equity securities with PORTAL to obtain depository eligibility provides Nasdaq an unfair competitive advantage over other potential trading venues and no longer serves any regulatory or public policy objective. DTC can perform the review currently performed by Nasdaq, but without the attendant competitive complications.

II. The Nasdaq-Approved QIB Concept Creates a Hidden Market and Imposes Unnecessary and Potentially Harmful Administrative Burdens

The PORTAL Market is intended to provide a marketplace for the trading of securities pursuant to Rule 144A under the Securities Act. Rule 144A provides an exemption from registration under Section 5 of the Securities Act for resales of privately placed securities to investors that meet the eligibility requirements of being a qualified institutional buyer (“QIB”) under Rule 144A(a)(1). The QIB exemption focuses on the status of the purchaser of the security. As long as the purchaser qualifies as a QIB, the seller can take advantage of the exemption (assuming Rule 144A’s other conditions are satisfied as well).³

Nasdaq has proposed limiting participation in the PORTAL Market to QIBs approved by it.⁴ This limitation not only restricts who can directly access the PORTAL Market, but it also prevents PORTAL Brokers and PORTAL Dealers from orally or in writing providing quotes, indications of interest, last sale information and other information to their customers, if such information is displayed in PORTAL and the customers have not been approved by Nasdaq.⁵ Nasdaq offers no justification or explanation for such a far-reaching restriction. However, the ramifications of this limitation are clear.

By creating the concept of Nasdaq-approved QIBs, the proposal will create a hidden market similar to the one that existed for the trading of Nasdaq-listed securities in the

² The terms PORTAL Broker and PORTAL Dealer are defined in Nasdaq Rule 6501. The term Accredited Investor is defined in Rule 501 of the under the Securities Act of 1933 (“Securities Act”).

³ For example, paragraph (d)(2) of Rule 144A requires the seller and any person acting on its behalf to take reasonable steps to ensure that the purchaser is aware that the seller may rely on Rule 144A.

⁴ Nasdaq Rule 6506

⁵ Under proposed Nasdaq Rule 6501(m) the term “PORTAL Market Information” means “quotation, transaction and other data and information displayed in the PORTAL Market that is accessed directly through the PORTAL Market system or indirectly through a third-party distributor of PORTAL Market information.”

early 1990's, before the SEC adopted the Order Handling Rules.⁶ The Order Handling Rules were adopted in response to the two-tiered, or hidden, market that existed for the trading of Nasdaq-listed securities. The SEC found that Nasdaq market makers, in some instances, were displaying their best quotes in private systems where the prices were not displayed to the public or other market participants who were not subscribers of these systems.⁷ As a result, there was unequal distribution of important market information, which allowed market makers to trade at one price with customers and at better prices with subscribers of these private systems.⁸ The Order Handling Rules eliminated the hidden market by requiring market makers to display their best prices to the public, whether through their own quote or through an electronic communication network who makes its best prices available to the public. Because of these new rules, all investors have an equal opportunity to see the best prices for a stock.

The hidden market created by the Nasdaq QIB concept will not be the result of a gap in securities regulation, as the earlier hidden market was, but instead will be imposed purposefully by a rule of a self-regulatory organization. It is a rule that will make it illegal for PORTAL Brokers and PORTAL Dealers to share material information with their customers – customers who can buy and sell shares in full compliance with Rule 144A. The following example demonstrates the difficulties created by Nasdaq's proposal for a closed system.

A QIB, who is not a Nasdaq-approved QIB, purchases shares from FBR during the initial distribution of shares. This transaction complies with Rule 144A because the sale by FBR to its customer is a sale to a QIB. However, FBR is now prohibited from sharing any PORTAL Market Information with its customer because the customer is not a Nasdaq-approved QIB. Even if the customer wants to place a limit order with FBR, FBR cannot share with its customer the current quoted price, indications of interest, or the last sale price – information that is indispensable in determining at what price the limit order should be placed. FBR would even be prohibited from sharing with its customer FBR's quote and indications of interest, if that quote or indication of interest is displayed in PORTAL. Similarly, FBR would be prohibited from sharing with this customer the price at which FBR last purchased or sold the security, if that information is displayed in PORTAL. If a QIB not approved by Nasdaq is seeking to buy or sell PORTAL eligible securities, it must do so blindly, just as customers bought and sold blindly prior to the Order Handling Rules.

FBR is concerned that its inability to share information with its customers is in conflict with its obligations under NASD and SEC Rules. The NASD Rule 6700 Series imposes obligations on NASD members who trade PORTAL securities. Among the rules that apply are NASD Rules 2110 and 2120. These rules collectively impose the legal

⁶ The Order Handling Rules refers to amendments to existing rules and several new rules adopted by the SEC in 1996. *See* Securities Exchange Act Release No. 37619A (Sept. 6, 1996), 61 FR 48290 (Sept. 12, 1996).

⁷ *Id.* at 48308.

⁸ *Id.*

standards an NASD member must meet when dealing with its customers. Rule 2110 requires members to “observe high standards of commercial honor and just and equitable principles of trade.” Rule 2120 mirrors Exchange Act Rule 10b-5 and prohibits members from effecting any transaction in, or inducing the purchase or sale of, any security by means of any manipulative, deceptive, or other fraudulent device or contrivance. In particular, Rule 10b-5 makes it illegal in connection with the purchase or sale of a security to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. To satisfy the materiality requirement, “there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information available.”⁹ FBR questions whether it is consistent with these obligations to withhold – as required by Nasdaq’s proposed rule – information as important as current quotes, indications of interest, and last sale prices. This information is being withheld from investors who have every right to buy and sell these securities and can do so in compliance with Rule 144A.¹⁰

The process for obtaining “Nasdaq QIB” status creates problems as well. If a QIB, who is not a Nasdaq-approved QIB, needs to liquidate its position immediately or wants to take advantage of breaking news about a company, it will have to wait until it obtains Nasdaq’s approval before it can obtain quotes, indications of interest, and last sale information. FBR understands that Nasdaq intends to make the process as efficient as possible. However, delays inevitably will occur. For example, a customer might decide before or after normal market hours – when Nasdaq staff might be unavailable – that it wants to buy or sell the stock. FBR cannot share quote, indications of interest, and last sale information, and the actual trade could not be executed, until Nasdaq staff was available to review and approve the QIB application. In addition, because the QIB is required to execute a subscriber agreement, most QIBs, if not all, will want to review the agreement carefully before executing it. The delays caused by the Nasdaq approval process could cost the customer an opportunity to trade or result in a less favorable price, if the trade is executed.

Nasdaq does not state a reason for imposing the market information blackout on QIBs not approved by it. FBR understands and does not object to Nasdaq approving QIBs who will have direct access to the PORTAL system to negotiate trades or those who obtain quotes, indications of interest, and last sale information directly from Nasdaq or through a third-party data vendor. In these situations there is privity between Nasdaq and the QIB, and thus an agreement defining the relationship is appropriate. The troublesome

⁹ *Basic Inc. v. Levison* 485 U.S. 224, 231-232, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988).

¹⁰ The impact of this information sharing restriction will be exacerbated exponentially if Nasdaq is permitted to display through PORTAL last sale reports or other information about trades that occur outside the PORTAL system. Once information is displayed through PORTAL it becomes restricted information that can only be shared with Nasdaq-approved QIBs and other PORTAL Brokers and PORTAL Dealers (See Nasdaq Rules 6501(m) and 6511). For example, if the NASD were to share with Nasdaq for inclusion in PORTAL last sale reports of transaction in Rule 144A securities executed outside of the PORTAL system, these trade reports would be considered PORTAL Market Information and thus subject to information the sharing restrictions contained in Rule 6511.

aspect of the proposal is the restriction with respect to those QIBs who merely want to obtain quotes, indications of interest, and last sale information from PORTAL Brokers or PORTAL Dealers. The restriction prohibits even oral disclosure of this information.

If the objective of the restriction is to prevent the disclosure of PORTAL Market Information to non-QIBs, this goal can be obtained without creating a hidden market and without the added complications imposed by the Nasdaq approval process. Nasdaq can retain the limitation on information disclosure, but put the onus on the PORTAL Brokers and PORTAL Dealers to determine who is a QIB.¹¹ The rule could require PORTAL Brokers and PORTAL Dealers to satisfy the existing standard under Rule 144A, which is that they must have a reasonable basis for believing the customer satisfies the QIB standard.¹² Such a rule would allow PORTAL Brokers and PORTAL Dealers and their customers to act quickly when trading opportunities present themselves and, most importantly, it will eliminate the hidden market. Lifting the information blackout will maximize the opportunities for QIBs to participate in the market and thus could increase liquidity for the securities traded in it.

III. Accredited Investors

The proposal will limit an Accredited Investor's ability to sell shares in compliance with Rule 144A and place PORTAL Brokers and PORTAL Dealers in conflict with their obligations to their Accredited Investor customers. As discussed above, the Rule 144A exemption focuses on the status of the purchaser of the security. As long as the purchaser qualifies as a QIB, the seller can take advantage of the exemption (assuming the other requirements of Rule 144A are satisfied).¹³ The exemption not only allows QIBs to sell to other QIBS, but also allows Accredited Investors to sell to QIBS. An Accredited Investor can obtain private shares by purchasing them in a transaction that complies with Regulation D under the Securities Act. However, Nasdaq has stated that PORTAL will not be available for securities sold pursuant to Regulation D. Again, Nasdaq does not state a reason for this restriction, but they do describe how different CUSIP numbers are used to identify securities sold pursuant to Rule 144A and those sold pursuant to Regulation D.

The different CUSIP numbers should not prevent legitimate sales by Accredited Investors through PORTAL. Transactions between Accredited Investors and QIBs occur today. The transfer agent is informed that an Accredited Investor has sold shares to a QIB and the respective global certificates are updated accordingly. In other words, the transfer agent decreases the number of shares reflected by the Accredited Investor global

¹¹ FBR also believes that brokers should be permitted to provide quote, indications of interest, and last sale information to Accredited Investors in certain situations. FBR discusses this issue in the following section of this letter.

¹² Rule 144A(d)(1).

¹³ *Supra* note 2.

certificate and increases the QIB global certificate by the same number of shares. The same settlement procedures can be utilized for trades executed through PORTAL.

The ineligibility of Regulation D shares for trading in PORTAL is not the only part of Nasdaq's proposal that will complicate legitimate sales by Accredited Investors. The culprit again is Nasdaq's limitation as to who can obtain PORTAL Market Information. The discussion above focuses on how the concept of a Nasdaq-approved QIB can lead to a hidden market. Accredited Investors will be subject to this information blackout as well, but these investors find themselves in an even worse position because they do not even have the choice of registering with Nasdaq - they do not qualify as QIBs. However, Accredited Investors can legitimately sell private shares pursuant to Rule 144A, albeit blindly if the information sharing restriction is not eliminated.

FBR proposes that PORTAL Brokers and PORTAL Dealers should be permitted to provide quote and last sale information to Accredited Investors as long as they have a reasonable belief that the Accredited Investor owns the restricted security for which it is seeking market information. Such a rule will allow Accredited Investors to make fully informed decisions when selling restricted shares in compliance with Rule 144A, and similarly will relieve brokers of the conflict between the duties imposed by NASD Rules 2110, 2120, and Rule 10b-5, and the blackout restrictions imposed by Nasdaq Rule 6511.

IV. Depository Eligibility Should Not Be Dependent on PORTAL Eligibility

Premising depository eligibility of a security on PORTAL eligibility is unnecessary. Nasdaq's filing states that DTC can make Rule 144A securities depository eligible if the securities are designated for inclusion in a system of a self-regulatory organization for the reporting, quoting, and trading of Rule 144A securities.¹⁴ As Nasdaq admits in its filing, the sole function of the Portal Market today is to review whether the securities meet the eligibility requirements of Rule 144A.¹⁵ DTC can conduct the same type of review performed by Nasdaq, but without raising certain anti-competitive concerns.

Given that the reestablished PORTAL system will be the only system that currently satisfies the DTC eligibility standard, equity issues of Rule 144A securities will be required to register with Nasdaq's PORTAL Market to become depository eligible. This de facto mandatory PORTAL registration requirement could impede competition between Nasdaq and alternative trading systems ("ATSS"). Because DTC eligibility is important to investors, issuers of Rule 144A equity securities nearly always make their securities depository eligible. As a result, these issuers are presently, and will be forced in the future, to make their equity securities eligible for trading in PORTAL. Linking DTC eligibility to PORTAL registration provides Nasdaq a steady stream of product for PORTAL. An ATS that seeks to offer a trading system to compete with Nasdaq's PORTAL Market will have to limit its system to securities that are already registered

¹⁴ Securities Exchange Act Release No. 34-55669 (Apr. 27, 2007), 72 FR 23874, 23875 (May 1, 2007).

¹⁵ *Id.*

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with PORTAL. There is no public policy reason to allow Nasdaq or any other exchange to be the gatekeeper for depository eligibility when eligibility can be and should be decided by DTC. DTC already is the sole decider of depository eligibility with respect to nonconvertible debt securities and nonconvertible preferred stock that is rated in one of the top four categories by a nationally recognized statistical rating organization. DTC could employ the same analysis for equity securities as it uses for investment grade nonconvertible debt and nonconvertible preferred securities.

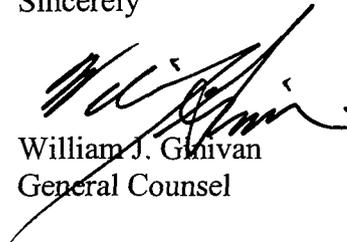
V. Conclusion

FBR believes that with the modifications described above Nasdaq's reestablished PORTAL Market has the opportunity to provide greater transparency to the secondary market trading of Rule 144A securities. If these changes are not made, however, the proposal could actually reduce liquidity in this market, and ultimately the system will have a limited opportunity for success because the information sharing restrictions will discourage Nasdaq members from participating in it. Furthermore, eliminating the nexus between PORTAL registration and DTC eligibility will level the playing field between Nasdaq and potential alternative trading venues.

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If you have any questions concerning FBR's comments, please feel free to call me at (703) 469-1040, or Peter R. Geraghty, Associate General Counsel, at (703) 312-1835.

Sincerely



William J. Ghivvan
General Counsel

Cc: The Honorable Christopher Cox
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Annette L. Nazareth
The Honorable Kathleen L. Casey
Erik R. Sirri, Director, Division of Market Regulation