



July 18, 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:

On May 22, 2007, Friedman, Billings, Ramsey & Co, Inc. (“FBR”) submitted a comment letter to the Securities and Exchange Commission (“SEC”) suggesting changes to The Nasdaq Stock Market’s (“Nasdaq”) proposal to reestablish the PORTAL Market system.<sup>1</sup> Nasdaq has filed a response to the comment letter submitted by FBR and suggests potential changes to the proposal to address FBR’s concerns.<sup>2</sup> FBR does not oppose Nasdaq’s PORTAL system or their goal of creating greater transparency in the secondary market for trading of securities purchased in private placement transactions (“Rule 144A securities”). However, FBR continues to believe that the proposal contains provisions that are not in the best interest of investors, will subject PORTAL Brokers and Dealers to potential regulatory and civil liability, and that there are less restrictive means available to Nasdaq to satisfy its obligations under the Securities Exchange Act of 1934 (“Exchange Act”).

### **I. Summary of FBR’s Position**

The differences between FBR and Nasdaq regarding the PORTAL proposal can be summarized as follows: FBR believes it has the legal obligation to treat its customers in accordance with just and equitable principles of trade and to provide them with the same market information it possess concerning the prices of securities its customers own or wish to trade (*e.g.*, indications of interest, quotes, and last sale prices). Nasdaq believes its obligations under the Exchange Act compel it to restrict this information, when it is displayed in PORTAL, to only those market participants approved by it. FBR does not dispute Nasdaq’s obligation to approve entities who seek to obtain this information directly from Nasdaq or one of its market data vendors, or who seek direct access to

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<sup>1</sup> Letter to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, from William J. Ginivan, General Counsel, FBR, dated May 22, 2007.

<sup>2</sup> Letter to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, from Thomas P. Moran, Associate General Counsel, Nasdaq, dated June 28, 2007. (“Nasdaq Response”)

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dealers, whether in writing or orally. FBR notes that the original PORTAL rules approved in 1990 did not include this broad restriction and that other less disruptive means are available to Nasdaq to satisfy their self-regulatory obligations.

FBR is proposing that Rule 6511 should be amended to allow PORTAL Brokers and Dealers to provide information displayed in PORTAL to anyone who is eligible to sell restricted shares pursuant to Rule 144A so that PORTAL Brokers and Dealers can comply with their duties to their customers, including the obligation of fair dealing and the duty to act in accordance with just and equitable principles of trade. FBR's proposal would include Accredited Investors and all QIBs, not just those approved by and registered with Nasdaq. With respect to Accredited Investors, FBR is proposing that the PORTAL Broker or Dealer must have a reasonable belief the Accredited Investor owns the security.

If the SEC approves Nasdaq's rule change as it currently stands, or with the potential changes suggested by Nasdaq, FBR respectfully requests the SEC to discuss and clearly articulate how Exchange Act Rule 10b-5 and a broker-dealer's overall obligation of fair dealing apply with respect to PORTAL and the disclosure limitations imposed by Rule 6511. Similarly, FBR believes the NASD should issue guidance as to how its rules (e.g., Rules 2110 and 2120) apply with respect to PORTAL.<sup>3</sup> This guidance is particularly important given that in its response to comments Nasdaq questions whether these legal obligations are applicable to the PORTAL system.<sup>4</sup>

## **II. Proposed Rule 6511**

At issue is Rule 6511, which as currently proposed, prohibits PORTAL Brokers and Dealers from orally or in writing disclosing any information that is displayed in PORTAL, including last sale information, indications of interest, and quotes, to any party that is not a PORTAL Participant. A PORTAL Participant is another PORTAL Broker or Dealer or a PORTAL Qualified Investor. A PORTAL Qualified Investor is a Qualified Institutional Buyer ("QIB") approved and registered with Nasdaq.<sup>5</sup> Therefore, Rule 6511 prohibits PORTAL Brokers and Dealer from orally or in writing disclosing market information displayed in PORTAL, information the PORTAL Broker or Dealer itself possesses, to (i) QIBs not approved and registered with Nasdaq, and (ii) Accredited Investors. Under Nasdaq's proposal, Accredited Investors will never be permitted to know the prices displayed in PORTAL, even if they own the security and can sell it in compliance with Rule 144A, because they cannot qualify as QIBs. A QIB can obtain this

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<sup>3</sup> 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 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.

<sup>4</sup> Nasdaq Response at page 10.

<sup>5</sup> Proposed Nasdaq Rule 6501(j) and Proposed Nasdaq Rule 6500 Series

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information from their PORTAL Broker or Dealer, but only if they are approved by Nasdaq as a QIB.

### **III. Nasdaq's Potential Modification of Rule 6511**

The potential change to Rule 6511 could subject PORTAL Brokers and Dealers to even greater scrutiny and potential liability than under the current version of proposed Rule 6511. In its response to comments, Nasdaq discusses a limited modification to Rule 6511 that would allow a PORTAL Broker or Dealer to disclose its proprietary quote to an "established" customer. Leaving aside what constitutes an "established" customer, Nasdaq's proposed modification could result in a situation in which a PORTAL Broker or Dealer is permitted to disclose to its customer the second, third, fourth, etc. best price available, but not the best price. In other words, if a PORTAL Broker or Dealer's quote is the second best price or any price other than the best price, the PORTAL Broker or Dealer is prohibited from telling the customer the best price at which a particular security can be bought or sold. Such a result is not in the best interest of investors and thus could violate a broker-dealer's duty of fair dealing and subject them to liability under Exchange Act Rule 10b-5.

Broker-dealers owe their customers the duty of fair dealing and are required by NASD Rule 2110 to "observe high standards of commercial honor and just and equitable principles of trade." Further, as FBR discussed in its May 22<sup>nd</sup> letter, 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 light of the circumstances under which they were made, not misleading. To avoid a charge of failing to disclose a material fact when its quote is not the best quote, a PORTAL Broker or Dealer will be required to disclose its price and then inform the customer that there is a better price available, which it cannot disclose to the customer because the customer is not approved by Nasdaq and registered with it. While one might argue that the SEC would not bring an action given that it approved Rule 6511, a private plaintiff may not exercise such restraint and could seek similarly situated shareholders. Rule 10b-5 often is used as a basis for asserting liability in securities class action lawsuits. Therefore, if the PORTAL system is approved with any rule that prohibits PORTAL Brokers and Dealers from providing market information to their customers who are eligible to sell securities in compliance with Rule 144A (*i.e.*, QIBs and Accredited Investors), FBR respectfully requests the SEC to address how Rule 10b-5 and the general duty of fair dealing apply in the context of the reestablished PORTAL system. Similarly, FBR believes the NASD should issue guidance so that its members understand their obligations under the NASD's rules.

Nasdaq's potential modification of Rule 6511 also does not address the disclosure of last sale information. Therefore, PORTAL Brokers and Dealers will continue to be prohibited from sharing with their customers not approved by Nasdaq the actual prices at which trades have been executed. As discussed in detail in its May 22<sup>nd</sup> letter, FBR believes last sale information is material information for customers seeking to buy or sell

securities and thus should be available to all QIBs. This information also should be available to Accredited Investors, subject to the limitations discussed below.

#### **IV. Accredited Investors**

In its May 22<sup>nd</sup> Letter, FBR proposed that PORTAL Brokers and PORTAL Dealers should be permitted to provide quotes, indications of interest, and last sale information to Accredited Investors that the PORTAL Broker or Dealer has a reasonable belief own the restricted security. Such a rule would 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 Rule 10b-5 and NASD Rules 2110, 2120, and the restrictions imposed by Nasdaq Rule 6511.

Nasdaq responded to FBR's suggestion by indicating they would be willing to consider such an amendment, but only after PORTAL is operational, because of the complexity of introducing Regulation D offerings into PORTAL during the initial roll-out of the system. FBR is not suggesting that Nasdaq make Regulation D offerings eligible in PORTAL. FBR is asking to be allowed to disclose pricing information to its Accredited Investor customers, for all the same reasons that it believes all QIBs, not just Nasdaq-approved and registered QIBs, should have access to this information. This change can be implemented without compromising the launch of the reestablished PORTAL system.

#### **V. Nasdaq's Obligations under Section 6 of the Exchange Act**

Nasdaq believes Rule 6511 is necessary for it to comply with its obligations under paragraph (b)(1) of Section 6. Section 6(b)(1) requires an exchange to be organized and have the capacity to carry out the purposes of the federal securities laws, and to have the ability to enforce compliance by its members with the federal securities laws and the exchange's rules. According to Nasdaq, Rule 144A, and thus Section 6(b)(1), requires it to take steps to prevent the disclosure of PORTAL market information to non-QIBs. Nasdaq believes this obligation can be satisfied only if they are the sole entity authorized to determine QIB status. This "Nasdaq only" QIB approval process exceeds what is required by Rule 144A, limits options provided in Rule 144A for determining who is a QIB, and is inconsistent with the rules approved by the SEC when PORTAL was originally approved. Furthermore, Nasdaq's existing authority to examine and audit PORTAL Brokers and Dealers is sufficient to satisfy their obligations under Section 6(b)(1).

Nasdaq's connection to transactions executed outside of the PORTAL system is tenuous and thus their obligations under Rule 144A are remote. Rule 144A is a rule that provides market participants the ability to sell private shares without having to register them pursuant to Section 5 of the Securities Act of 1933. For transactions executed in or outside of PORTAL, Nasdaq is neither the seller nor buyer of such shares. When the transactions are negotiated and executed outside of PORTAL, Nasdaq is not even providing a mechanism for the buyer and seller to consummate the transaction. Nasdaq's

connection is diminished even further when investors seek market information for other purposes, such as marking their portfolios to the market. Nasdaq's obligations under Section 6(b)(1) should be commensurate with their involvement with a Rule 144A transaction, with their duty the highest when QIBs seek direct access to PORTAL, not when PORTAL Brokers and Dealers seek merely to provide market information to their customers. Requiring Nasdaq to approve and register investors that seek direct access to their systems is appropriate and consistent with their obligations under Section 6(b)(1), but serves very little, if any, regulatory purpose and thus is unnecessary when investors are merely seeking market information from their PORTAL Brokers or Dealers. The requirement also in effect limits the options available under Rule 144A for PORTAL Brokers and Dealers to determine whether a purchaser is a QIB.

Rule 144A provides sellers several methods for forming a reasonable belief that a purchaser is a QIB, including relying on information contained in a recognized securities manual.<sup>6</sup> Nasdaq's proposal eliminates these options when a PORTAL Broker or Dealer seeks to disclose PORTAL market information. When a PORTAL Broker or Dealer wants to disclose to its QIB customer quotes, indications of interest, or last sale information displayed in PORTAL, they will not be able to rely on recognized securities manuals or any other means permitted by Rule 144A for establishing a reasonable belief that the purchaser is a QIB.<sup>7</sup> Nasdaq will be the only entity qualified to determine QIB status in these circumstances. Again, given Nasdaq's limited involvement in these situations, FBR submits that the Nasdaq only QIB approval requirement is not compelled by Section 6(b)(1).<sup>8</sup> Furthermore, the Nasdaq only QIB approval process is a departure from the approach adopted by Nasdaq when PORTAL was originally approved in 1990.

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<sup>6</sup> Under Rule 144A, a seller can determine whether a purchaser is a QIB by relying on (i) the prospective purchaser's most recent publicly available financial statements; (ii) the most recent publicly available information appearing in documents filed by the prospective purchaser with the SEC or other domestic or foreign regulators; (iii) the most recent publicly available information appearing in a recognized securities manual; or (iv) a certification by the chief financial officer, a person fulfilling an equivalent function, or other executive officer of the purchaser, specifying the amount of securities owned and invested on a discretionary basis by the purchaser as of a specific date on or since the close of the purchaser's most recent fiscal year, or, in the case of a purchaser that is a member of a family of investment companies, a certification by an executive officer of the investment adviser specifying the amount of securities owned by the family of investment companies as of a specific date on or since the close of the purchaser's most recent fiscal year. With respect to items (i) through (iii), the statements must contain information as of a date within 16 months preceding the date of the sale of the securities pursuant to Rule 144A. For a foreign purchaser, the statements must contain information as of a date within 18 months preceding the date of the sale of the securities pursuant to Rule 144A.

<sup>7</sup> The problem is not solved even if Nasdaq qualifies as a recognized securities manual because Rule 6511 will continue to restrict information dissemination to only those QIBs approved by Nasdaq.

<sup>8</sup> Nasdaq's potential amendment to Rule 6511 to allow PORTAL Brokers and Dealers to disclose their proprietary quotes to all their QIB customers, not just those approved by Nasdaq, supports FBR's contention that the information restriction and the Nasdaq only approval process are not necessary for Nasdaq to satisfy its obligations under Section 6(b)(1). If PORTAL Brokers and Dealers are qualified to determine QIB status when they are seeking to disclose their own quote, they should be similarly qualified when disclosing the quotes of others, including those that reflect better prices.

The original PORTAL system approved by the SEC did not confer on Nasdaq sole authority for determining QIB status and there was no prohibition regarding oral or written disclosures by PORTAL Brokers or Dealers. An investor could obtain PORTAL market information directly from Nasdaq, or indirectly from a third-party vendor, as long as a PORTAL dealer represented to Nasdaq that the investor was a QIB.<sup>9</sup> Under the current proposal, investors can obtain this type of access only if they are approved by Nasdaq. Again, FBR does not object to Nasdaq reviewing and approving investors who seek access to Nasdaq's systems. However, Nasdaq is imposing this same obligation on investors who are seeking market information from their PORTAL Brokers or Dealers. The SEC previously approved PORTAL without the Nasdaq only QIB approval process and thus FBR believes the SEC can approve the current PORTAL proposal without this restriction.

Nasdaq already has in place the means to satisfy its obligation under Section 6(b)(1) when PORTAL Brokers and Dealers seek to share PORTAL market information with their customers. Nasdaq can examine PORTAL Brokers and Dealers to assess whether they have adequate policies and procedures for determining who qualifies as a QIB, and they can audit a firm's compliance with Rule 144A by examining whether purchasers were indeed QIBs. These measures are sufficient to satisfy Nasdaq's obligations under Section 6(b)(1) and do not present the complications discussed above and in FBR's May 22<sup>nd</sup> letter (*e.g.*, delayed caused by the Nasdaq QIB approval requirement and missed trading opportunities).

## **VI. Conclusion**

Modifying the proposal as suggested by FBR will serve the needs and best interest of investors and contribute to the success of the reestablished PORTAL system. Retaining the Nasdaq only QIB approval process when investors are simply seeking market information from their PORTAL Brokers or Dealers is not required by the Exchange Act, will harm investors, subject PORTAL Brokers and Dealers to potential liability, and ultimately provide a disincentive to participating in PORTAL. Nasdaq's existing

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<sup>9</sup> NASD By-Laws Schedule I, Part IV, Section 1(a)(2). A PORTAL Qualified Investor also was required to execute a subscriber agreement. (NASD Manual 1994)

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authority to examine and audit its members satisfies Nasdaq's self-regulatory organization obligations in these circumstances.

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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

A handwritten signature in black ink, appearing to read 'W. Ginivan', with a long horizontal flourish extending to the right.

William J. Ginivan  
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