



THE NASDAQ STOCK MARKET  
ONE LIBERTY PLAZA, 50TH FLOOR  
NEW YORK, NY 10006

July 23, 2007

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

**Re: SR-NASDAQ-2006-65 – Second Response to Comments**

Dear Ms. Morris:

The NASDAQ Stock Market LLC (“Nasdaq”) welcomes the opportunity to respond to further comments submitted by Friedman Billings Ramsey & Co. Inc. (“FBR”) in connection with the above-captioned rule proposal, which would reestablish an indicative quotation and trading system for securities that are designated by The PORTAL® Market as PORTAL Securities (the “Proposal”). In its most recent comments, FBR repeats its previously stated opposition to proposed PORTAL rules and processes that limit access to PORTAL market quotation and trade report information to entities that Nasdaq, as a self-regulatory organization (“SRO”), has determined meet SEC-approved qualifications. Specifically, proposed Rule 6511 provides that brokers and dealers operating in PORTAL must limit access to PORTAL market information to customers that Nasdaq has determined to be qualified institutional buyers (“QIBs”) through its own review and approval processes. As outlined in more detail below, Nasdaq continues to disagree with FBR and believes that Nasdaq’s proposed rules and processes for access to PORTAL Market information are appropriate, consistent with the Securities Exchange Act of 1934 (“Exchange Act”), and in the public interest.

**FBR’s Position**

FBR argues that it should be free to provide PORTAL Market information to its customers, regardless of whether Nasdaq has determined the customers to be QIBs. In essence, FBR argues that Nasdaq should deputize FBR and other PORTAL brokers and PORTAL dealers to determine whether customers are legally entitled to access the information. By contrast, Nasdaq believes that, as an SRO, it has an obligation to ensure that PORTAL Market information is provided only to entities that Nasdaq itself has determined to be QIBs. FBR also asserts that the original PORTAL rules approved in 1990 did not include broad restrictions on information dissemination similar to those contained in proposed Rule 6511.

### **Nasdaq Response**

Nasdaq believes that the dissemination by PORTAL Dealers and PORTAL Brokers of PORTAL Market quotations and last sale report information of other PORTAL Dealers and PORTAL Brokers to investors not qualified by Nasdaq could constitute a prohibited general solicitation of Rule 144A transactions, contrary to the SEC's historical efforts to limit access to such information to investors that are qualified as QIBs by the system operator.<sup>1</sup> Although Rule 144A does not expressly limit the manner of offering or selling eligible Rule 144A securities, we believe the SEC intended that Rule 144A would establish a "private resale market" that operated in a manner consistent with the SEC's offering and sale limitations on private placements of securities. Such prohibitions on general solicitation and general advertising, like those contained in Section 502(c) of Regulation D and also applicable to the exemptions provided by Sections 4(2) and 4(6), are for the purpose of preserving the nonpublic character of transactions in restricted securities. This position was initially expressed in the SEC's approval order for Rule 144A, which states that "[T]he transactions covered by the safe harbor are private transactions that, on the basis of a few objective standards, can be defined as outside the purview of section 5 . . . ."<sup>2</sup> It was also clear from the SEC's Rule 144A proposing release that the SEC intended that Rule 144A would operate in a manner to "prevent an unregistered non-exempt distribution,"<sup>3</sup> thereby preserving the exemption provided by Rule 144A to the seller from registration of the securities under Section 5 of the Securities Act of 1933 ("Securities Act") and from being an underwriter within the meanings of Sections 2(11) and 4(1) of the Securities Act on the basis that the transaction is not a "distribution."<sup>4</sup>

Staff of the SEC's Division of Corporation Finance has specifically addressed issues relating to the permissible scope of general solicitation in the context of secondary market trading of Rule 144A securities by electronic means in *The Institutional Real Estate Clearing House* ("IREC") No-Action Letter dated May 28, 1996. In IREC, SEC staff indicated that it would not take enforcement action against an entity facilitating the trading of unregistered securities in the Rule 144A secondary market through the operation of a closed, screen-based information system. In order to avoid a general solicitation, the staff's response was conditioned in part on the requirement that the investor-participants in the system must be qualified by IREC as QIBs under Rule 144A. In that case, IREC was the sole broker/dealer "participating" in the IREC system as well as the system operator.

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<sup>1</sup> Hicks, J. William, *Resales of Restricted Securities*, Thomson West (2007 Ed), at 499 *et seq.*

<sup>2</sup> SEC Release No. 33-6862 (April 23, 1990); 55 FR 17933 (April 30, 1990), at 17934.

<sup>3</sup> SEC Release No. 33-6806 (Oct. 25, 1988); 53 FR 44016 (Nov 1, 1988) ("Rule 144A Proposing Release"), at 44030.

<sup>4</sup> Rule 144A Proposing Release, at 44026.

Later, in the *Net Roadshow, Inc.*, SEC No-Action Letter dated January 30, 1998 (“Net Roadshow”), the SEC dealt with the transmission of “road show” information over the Internet for private offerings made only to QIBs by the initial purchaser of the securities (described as the “Seller” in the SEC Letter). There, the SEC permitted a company to transmit road shows over its Internet Web Site on behalf of a Seller if, among other things, access to the transmission was limited to institutions that the Seller had confirmed were QIBs and a confidential password was assigned to the QIB for a particular road show that expired after the show. In that case, each Seller-broker/dealer was responsible for determining the eligibility of investors under Rule 144A to view a road show for the specific Rule 144A offering made by the Seller.

Nasdaq believes that proposed Rule 6511 and the Nasdaq QIB qualification process is fully consistent with the IREC and Net Roadshow guidance that the operators of Rule 144A trading systems have a non-delegable duty to qualify QIBs for access to Rule 144A quotation and trade information from those systems. Such a review is necessary to ensure that the dissemination of information by PORTAL Dealers and PORTAL Brokers about PORTAL securities does not constitute a prohibited general solicitation of Rule 144A transactions.<sup>5</sup> A sale of a Rule 144A security by a Nasdaq member in a manner that does not comply with the exemption would result in the broker/dealer being subject to a civil enforcement action by the SEC, Nasdaq or the NASD for violation of Section 5 of the Securities Act. Further, under Section 12(a)(1) of the Securities Act, the Nasdaq dealer would “be liable ... to the person purchasing such security from him,” for rescission of the transaction. Such liability is close to absolute. Moreover, the Nasdaq member would be subject to underwriter liability within the meaning of Sections 2(11) and 4(1) of the Securities Act in a civil action by the purchaser of the security for the disclosure that was provided in connection with the sale transaction. As an SRO, Nasdaq has an obligation under Section 6 of the Exchange Act to enforce compliance by its members with these SEC rules.

Contrary to FBR’s assertions, the SEC’s efforts to limit access to quotation and trade information in order to prevent a prohibited general solicitation of Rule 144A transactions is also reflected in the historical limitations that the SEC required to be included in the original and amended PORTAL Rules. The original version of the PORTAL Market Rules approved in 1990<sup>6</sup> sought to establish an entirely “closed” system for the trading of Rule 144A-eligible securities in which trades in PORTAL securities were, with very limited exceptions, only permitted in the PORTAL system by NASD approved PORTAL Dealers, PORTAL Brokers, and PORTAL Qualified Investors. The original version of the PORTAL rules not only required that the investor “demonstrate to the satisfaction of [NASD] that: it is eligible to purchase securities in

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<sup>5</sup> Nasdaq does not believe, however, that its potential modification to proposed 6511 to allow PORTAL Dealers to share their own proprietary quote with existing customers would result in a prohibited solicitation, as that disclosure is limited to the quote of the PORTAL Dealer to an established customer.

<sup>6</sup> SEC Release No. 34-27956 (April 27, 1990); 55 F.R. 18781 (May 4, 1990).

Rule 144A . . . ,” but also required that the investor be a member of a PORTAL depository organization that would maintain PORTAL securities in an account segregated from all other accounts of the investor and agree to maintain all PORTAL securities in the segregated account unless the securities were sold in a transaction in the PORTAL Market or in a transaction to a non-PORTAL account in a “qualified exit transaction.”<sup>7</sup> A “qualified exit transaction” was allowed in the case of securities, for example, registered with the SEC under Section 5 of the Securities Act or in the case of a transaction pursuant to Regulation S, Rule 144, or Rule 145. Any other resale in reliance on Rule 144A outside of the closed PORTAL Market system was only allowed if permitted by the NASD upon the submission of an opinion of counsel. Thus, there was no need for the original version of the PORTAL rules to include a specific provision comparable to proposed Rule 6511 to restrict the dissemination of PORTAL Market information outside of the PORTAL market because an investor could only execute a transaction in a PORTAL security if the investor registered as a PORTAL Qualified Investor and executed the transaction through a PORTAL Dealer or PORTAL Broker through the PORTAL Market system. However, when the SEC adopted Rule 144A without a proposed requirement that Rule 144A transactions only be effected in an approved private placement system, such as PORTAL, the NASD amended the pending PORTAL Market proposal just prior to its approval to permit “exit transfers” by a PORTAL participant to a non-PORTAL account, thereby permitting such participants to sell PORTAL securities “without complying with PORTAL exit restrictions and without immediate NASD oversight of the subsequent sale or transfer.”<sup>8</sup> As a result, firms did not trade or quote at all in the original PORTAL Market system nor did they submit trade reports with respect to PORTAL securities, and the issue of the dissemination of PORTAL Market information outside of PORTAL was effectively moot.

In 1993, when the NASD proposed to revise the PORTAL rules to better reflect a trading environment for PORTAL securities that included trades both outside, and potentially inside, the PORTAL Market, it again addressed the availability of PORTAL Market information. While the amended version of the PORTAL rules adopted at the end of 1993, and cited by FBR, did not include a provision exactly similar to proposed Rule 6511, registration requirements for PORTAL broker/dealers and investors were adopted at that time and were specifically structured to restrict access to PORTAL Market information to broker/dealers and investors registered as PORTAL participants. As the SEC release approving the 1993 PORTAL rules changes makes clear, “[T]o subscribe to PORTAL Market information directly through the PORTAL Market system or indirectly through a third-party distributor, an entity will be required to register as either a PORTAL dealer, a PORTAL broker, or a PORTAL qualified investor (collectively, “PORTAL participants”).”<sup>9</sup> The introduction to the registration requirements for

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<sup>7</sup> See NASD Notice to Members 90-29

<sup>8</sup> This history is set forth in SEC Release No. 34-33326 (December 13, 1993); 58 FR 66388 (December 20, 1993) (the “1993 Approval Order”), at footnote 11.

<sup>9</sup> 1993 Approval Order, at 66388

investors in the 1993 PORTAL Market Rules is the same as that proposed by Nasdaq in the new PORTAL Rule 6506(1)(a), and in each case states “No investor . . . shall subscribe to PORTAL Market information directly through the PORTAL Market system or indirectly through a third-party distributor . . . except if the investor registered as a PORTAL Qualified Investor.”

Thus, both the 1993 version of the PORTAL Rules and proposed Rule 6511 would only allow an investor to access PORTAL Market information if the investor was registered as a PORTAL Qualified Investor. Further, the 1993 rule provision permitted, as does the Proposal, PORTAL Qualified Investors to obtain PORTAL Market information either directly by accessing the PORTAL Market system or indirectly through a PORTAL Dealer or PORTAL Broker, another PORTAL Qualified Investor (e.g., an investment adviser acting for such investor), or an approved third-party distributor. At all times, however, registration as a PORTAL Qualified Investor was required. When viewed against this backdrop, the currently proposed PORTAL rules and processes regarding QIB qualification and information dissemination are not a departure from past approaches, but a continuation of a long-standing SEC-approved practice that places control of access to PORTAL information with the operator of the PORTAL Market system, not its participants, in order to prevent broker/dealers from engaging in a prohibited general solicitation of a Rule 144A transaction. New PORTAL Rule 6511 merely codifies and makes it explicit.

Put another way, there is nothing in Nasdaq’s proposed rules or processes regarding PORTAL information access that would preclude any FBR QIB customer, or any other QIB, from viewing or acting upon PORTAL Market information. Those customers and QIBs must simply be qualified by Nasdaq as being eligible to participate in the system and receive restricted 144A security quote and trade information. As previously outlined in Nasdaq’s original response to comments, the qualification process is not expected to be overly burdensome or time-consuming. In particular, Nasdaq disagrees with FBR’s formulation of the issue as a conflict between FBR’s duties to its customers and Nasdaq’s duties as an SRO. If such a conflict exists, it would arise only if an FBR customer refuses to submit to Nasdaq’s review of its qualifications for access. FBR’s proposed resolution of having it review the qualifications of QIBs to view PORTAL Market information is not compelled by any regulatory or statutory provision, and would require Nasdaq to unwisely rely on FBR and similar brokers in determining whether appropriate limits on access exist.

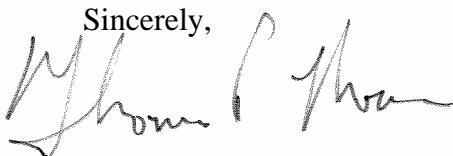
Beyond their historical and regulatory support, Nasdaq’s QIB qualification process and information dissemination restrictions are also important to the overall viability of the PORTAL Market system itself. Under FBR’s approach of unfettered access to all PORTAL Market information for all FBR-certified customers, the incentive for a significant number of parties to actively participate in the PORTAL system is seriously diminished. In short, there is no need to place quotes and orders in the PORTAL Market system when you can obtain the system’s information without establishing any contractual or operational link to it. The reduced number of participants would in turn

discourage others, and the system may be unable to establish sufficient liquidity to be of benefit to market participants.<sup>10</sup> This risk is especially acute in the case of the proposal's PORTAL Market system, as it is totally voluntary and but one of many venues that may trade Rule 144A securities.

Based on the above, FBR's references to past QIB qualification practices and Nasdaq's limited role in 144A transactions taking place outside of the PORTAL Market system are an insufficient basis for eliminating Nasdaq's proposed QIB qualification process for PORTAL. As the operator of a Rule 144A trading system obligated to qualify users, Nasdaq should be permitted to operate its system qualification processes in a manner that it determines is the most efficient and in keeping with its regulatory obligations.

We thank the Commission for providing this opportunity to respond to further comments on the proposal.

Sincerely,



Thomas P. Moran  
Associate General Counsel

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<sup>10</sup> Nasdaq believes that approval of the PORTAL Market system with its proposed limitations on the dissemination of PORTAL Market information is necessary in order to achieve the SEC's goal of "a more liquid and efficient institutional resale market for unregistered securities." *See* SEC Release No. 33-6862 (April 23, 1990); 55 F.R. 17933 (April 30, 1990), at 17934.