

November 28, 2006

**VIA ELECTRONIC MAIL
AND FIRST CLASS MAIL**

James A. Brigagliano, Esq.
Acting Associate Director
Division of Market Regulation
U.S. Securities and Exchange Commission
Division of Market Regulation
100 F Street, N.E.
Washington, D.C. 20549

Re: Request for No-Action Relief on National Stock Exchange's
Outbound Routing Arrangement

Dear Mr. Brigagliano:

On behalf of the National Stock Exchange, Inc. ("NSX" or the "Exchange"), we respectfully request that the staff of the Division of Market Regulation (the "Staff") of the Securities and Exchange Commission ("SEC" or "Commission") not recommend enforcement action to the Commission under Rule 10b-10(a) and Rule 203(b) under the Securities Exchange Act of 1934 (the "Exchange Act"), Regulation T or Section 15(b)(8) of the Exchange Act if the NSX implements an outbound routing arrangement and the associated execution and settlement services arrangement, as described herein, in order to comply with Rule 611 of Regulation NMS (the "Outbound Routing Arrangement").¹

A. Description of Outbound Routing Arrangement

Regulation NMS requires a trading center, such as NSX, to establish procedures reasonably designed to prevent the execution of trades on that trading center at prices inferior to protected quotations displayed by other trading centers.² A trading center may comply with Rule 611 of Regulation NMS in one of three ways: (1) canceling any order the execution of which would result in an impermissible trade-through; (2) matching the prices of the automated NBBO; or (3) routing a member's order to another trading center

¹ See SR-NSX-2006-15, filed November 21, 2006.

² See 70 FR 37496 (June 29, 2005) and Rule 611 of Regulation NMS.

that is displaying a better-priced protected quotation. NSX is choosing the third option³ and instituting an Outbound Routing Arrangement, as described below.⁴

When a NSX Equity Trading Permit Holder (the "Originating Broker-Dealer") sends a buy or sell order to the NSX in an NMS stock as to which there is a better protected offer or protected bid available at another trading center (the "Away Market Center"), NSX will route the order to the Away Market Center through an account at a broker-dealer that is a member of both NSX and the Away Market Center (the "Dual Member"). Currently, NSX proposes to use Citigroup Global Markets Inc. ("CGMI") as the Dual Member. CGMI will be responsible for transmitting the order for execution on the Away Market Center (any such executed trade, an "Outbound Trade") and for clearing and settling the Outbound Trade with the relevant broker-dealer at the Away Market Center. As soon as a trade has been executed, NSX will receive a trade notification containing the price and quantity, and NSX will inform the Originating Broker-Dealer.

NSX will establish a dedicated account at the National Securities Clearing Corporation ("NSCC") solely for the purposes of facilitating clearance and settlement of Outbound Trades executed by the Dual Member (the "NMS Facilitation Account"). At the end of each business day, the Dual Member will "summarize" all locked in Outbound Trades executed by it on behalf of NSX in respect of any NMS stock and will submit to NSCC an entry for the NMS Facilitation Account reflecting the summarized amount of sales and purchases in respect of any NMS stock under the Outbound Trades.

NSX will authorize NSCC to make available to the Dual Member records of Outbound Trades submitted to the NMS Facilitation Account by the Originating Broker-Dealer. At the end of each business day, the balance of the NMS Facilitation Account will be reconciled. Furthermore, the Dual Member will provide NSX with information showing balances, positions and transaction activity each business day as well as a daily settlement statement at the end of each month.

B. Discussion

Generally, an SEC registered broker-dealer has certain obligations with respect to its customers' trades, including the issuance of confirmations pursuant to Rule 10b-10 under the Exchange Act,⁵ locate requirements under Regulation SHO⁶ and the

³ See 70 FR 37496 (June 29, 2005) and Rule 611 of Regulation NMS.

⁴ The Exchange has also formed a broker-dealer, NSX Securities LLC which it will use as an outbound router as well. NSX Securities, LLC has applied to be a member of NASD and its membership is currently pending (NSX is not requesting any relief under this letter for the future activities of NSX Securities LLC). Until such membership has been approved, NSX proposes to institute the Outbound Routing Arrangement described below.

⁵ See Rule 10b-10 under the Exchange Act.

⁶ See Rule 203(b) under the Exchange Act.

collection of margin or full cash payment under Regulation T.⁷ Although many of these obligations do not apply when the party sending a bid or offer that results in a trade is another SEC registered broker-dealer, these exceptions are not explicitly available when the party transmitting the order is a national securities exchange such as NSX acting in accordance with Regulation NMS.

1. Rule 10b-10(a)

Rule 10b-10(a) under the Exchange Act requires a broker-dealer to send a trade confirmation to its customer at or before completion of each transaction. Although Rule 10b-10(d)(1) explicitly excludes a broker-dealer from the definition of “customer” for purposes of Rule 10b-10, a national securities exchange, such as NSX is not excluded from the definition of “customer.”⁸ Absent relief, the Dual Member in the Outbound Trading Arrangement must send a trade confirmation to NSX as if it were a customer.

The purpose of Rule 10b-10(a) is to ensure full disclosure to investors of the terms of the transactions that they conduct with their broker-dealers. NSX has no interest in receiving Rule 10b-10(a) confirmations because it does not need the particular information from such confirmations. Fees charged by Dual Member will be set forth in a written agreement between NSX and Dual Member. Furthermore, the execution price of the trades will be available to NSX through the trade reporting done by Dual Member. The investor in the Outbound Trade, that is, the customer submitting the order to the Originating Broker-Dealer will be receiving trade confirmations in compliance with Rule 10b-10(a) from the Originating Broker-Dealer; this fulfills the policy concerns of Rule 10b-10.

NSX respectfully requests that the Staff not recommend enforcement action to the Commission under Rule 10b-10(a) of the Exchange Act if the Dual Member does not send a trade confirmation to NSX containing all information as provided under Rule 10b-10(a) for Outbound Trades.

2. Regulation SHO

Rule 203(b)(1) of Regulation SHO requires that a broker-dealer “locate” the underlying equity security prior to accepting a short sale from another person. Rule 203(b)(2) exempts a broker-dealer from the locate requirement if, among other things, the short sale order is from another registered broker-dealer. Absent relief, Dual Member arguably must perform the locate obligation prior to accepting a short sale order routed from NSX under the Outbound Trading Arrangement. This would be the case even though the Originating Broker-Dealer would have already been obligated to perform the locate requirement prior to transmitting the order to NSX. We believe such duplicative locate obligation is unnecessary.

⁷ See e.g. Regulation T Sections 220.4 and 220.8.

⁸ See Rule 10b-10(d)(1) under the Exchange Act; Sections 220.2 and 220.7 of Regulation T; and Rule 203(b)(2) under the Exchange Act.

Based on the foregoing, NSX respectfully requests that the Staff not recommend enforcement action to the Commission under Rule 203(b)(1) of Regulation SHO if the Dual Member does not perform a locate when accepting short sale Outbound Trades under the Outbound Routing Arrangement, subject to the following conditions:

- (i) In no event shall either the Exchange or the Dual Member change the Originating Broker-Dealer's marking of an order "long," "short," or "short-exempt."
- (ii) Except as otherwise stated herein, all parties to the Outbound Routing Arrangement shall comply with Regulation SHO.
- (iii) All parties to the Outbound Routing Arrangement shall maintain an audit trail of all trades effected under the Outbound Routing Arrangement, which is capable of being produced promptly upon request to Commission staff and other appropriate self-regulatory organizations.
- (iv) NSX shall monitor transactions effected under the Outbound Routing Arrangement for compliance with Regulation SHO, including the "marking" requirement of Rule 200(g) and the locate requirement of Rule 203(b) and either take action with regard to entities where NSX is the appropriate self-regulatory organization or refer actions to the appropriate self-regulatory organization as necessary.

3. Regulation T

Generally under Regulation T, a customer that buys securities on a cash basis through one broker-dealer and settles them through another broker-dealer is required to obtain a so-called "letter of free funds" in connection with each transaction.⁹ This requirement would obviously be impractical under this Outbound Routing Arrangement.

By contrast, a broker-dealer (referred to as a "creditor" in Regulation T) can buy securities in an account with one broker-dealer (e.g., the Dual Member) and settle with another broker-dealer (e.g. the "Originating Broker-Dealer") in a "broker-dealer credit account" without the need for a letter of free funds. Although NSX is not a broker-dealer, we believe that the Dual Member should be able to treat NSX's account with it as a "broker-dealer credit account" given that the only purpose of the account is to achieve compliance with Regulation NMS.

Accordingly, NSX respectfully request the Staff not recommend enforcement action to the Commission under Regulation T if the Dual Member treats NSX's account opened with it in connection with the arrangement discussed above as a "broker-dealer credit account" for purposes of Regulation T.

⁹ See Regulation T Section 220.8(c)(2)(ii).

4. Section 15(b)(8) and Rule 15b9-1

Under Section 15(b)(8) of the Exchange Act, an SEC-registered broker-dealer has to be a member of a securities association registered pursuant to Section 15A of the Exchange Act unless it effects transactions solely on a national securities exchange of which it is a member. Rule 15b9-1 under the Exchange Act provides a conditional exemption from this membership requirement. A broker-dealer relying on this rule may not have annual gross income derived from purchases and sales of securities otherwise than on a national securities exchange of which it is a member in an amount greater than \$1,000. The annual gross income limitation does not apply to "income derived from transactions...through the Intermarket Trading System." Rule 15b9-1 defines the Intermarket Trading System ("ITS") as "the intermarket communications linkage operated jointly by certain self-regulatory organizations pursuant to a plan filed with, and approved by, the Commission." Although this exception is not explicitly available for income derived from transactions through the Outbound Routing Arrangement, we believe that it would be consistent with the intent of the ITS exception in Rule 15b9-1 to exclude income derived from transactions through the Outbound Routing Arrangement.

Accordingly, NSX respectfully requests that the Staff not recommend enforcement action to the Commission under Section 15(b)(8) if a broker-dealer that is only a member of NSX¹⁰ treats income derived from transactions through the Outbound Routing Arrangement as "income derived from transactions ... through the Intermarket Trading System" for purposes of the exemption provided in Exchange Act Rule 15b9-1.

* * *

In light of the foregoing, we believe that the SEC-registered broker-dealers should be able to, for purposes of the cited securities rules and regulations implicated by the Outbound Routing Arrangement, look through NSX to the Originating Broker-Dealer or Dual Member, as the case may be. Please do not hesitate to contact the undersigned at 312-786-8893 or Lori Ragus at 312-786-8077 regarding this request.

Very truly yours,

James C. Yong
Chief Regulatory Officer

cc: Brian A. Bussey, Esq.(SEC)
Michael Hershaft, Esq. (SEC)
Lori Ragus, Esq. (NSX)

¹⁰ One of NSX's members, who are referred to in NSX's rules as "ETP Holders", is also a member of the NYSE Arca Inc., but not a member of NASD.