



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

DIVISION OF  
MARKET REGULATION

July 31, 2006

Ms. Ann Vlcek  
Vice President and Assoc. General Counsel  
Securities Industry Association  
1425 K Street, NW  
Washington, DC 20005-3500

Dear Ms. Vlcek,

RE: Request for Temporary No-Action Relief from Exchange Act Rules 17a-3 and 17a-25 Relative to NASDAQ's Commencement of Operation as an Exchange.

In your letter dated July 28, as supplemented by telephone conversations with the staff of the Division of Market Regulation ("Division"), you request on behalf of the Securities Industry Association's<sup>1</sup> ("SIA") NASDAQ Exchange Working Group confirmation that the Division will not recommend to the Commission enforcement action against a broker-dealer that reflects 1) NASDAQ as an over-the-counter (or "OTC") market instead of an exchange market, 2) NASDAQ securities as OTC securities instead of exchange-listed securities, and/or 3) a broker-dealer as a member of the NASD rather than as a member of NASDAQ (and vice versa) on books and records required under Rule 17a-3 of the Securities Exchange Act of 1934 ("Exchange Act") or in securities transaction information submitted to the Commission pursuant to Rule 17a-25 of the Exchange Act. In addition, you request that the Staff's no-action position extend until December 31, 2006.

**I. Background**

We understand the following facts are pertinent to your request:

On January 13, 2006, the Commission approved NASDAQ's application to register as a national securities exchange, pending completion of the conditions set forth

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<sup>1</sup> The Securities Industry Association brings together the shared interests of approximately 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93 million investors directly and indirectly through corporate, thrift and pension plans. In 2004, the industry generated \$236.7 billion in domestic revenue and an estimated \$340 billion in global revenues. More information about the SIA is available at: [www.sia.com](http://www.sia.com).

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in the Commission's approval order.<sup>2</sup> NASDAQ since has announced its intention to begin operation as an exchange in NASDAQ listed securities that are, for quotation and transaction reporting purposes, reported to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for NASDAQ-Listed Securities Traded on Exchanges on an Unlisted Trading Privilege Basis ("NASDAQ UTP Plan securities") on August 1, 2006.

In light of this announcement, broker-dealers and their vendors are working to reprogram and recode their systems as necessary to properly identify and designate NASDAQ as a national securities exchange rather than as part of the over-the-counter (or "OTC") market, NASDAQ UTP Plan securities as exchange-listed securities rather than OTC securities, and certain other broker-dealers as members of NASDAQ rather than as a member of the NASD on all relevant broker-dealer records and reports. Prior to implementation of these system changes, the broker-dealers and their vendors will need time to coordinate and test them to assure they achieve the intended purpose without unintended consequences. Consequently, some broker-dealers may be unable to implement the necessary systems changes by August 1, 2006.

## II. Requested Relief

### A. Rule 17a-3

Under Exchange Act Rule 17a-3, broker-dealers are required to create certain, specified books and records. Implicit in the Commission's recordkeeping rules is the requirement that information contained in a required book or record be accurate.<sup>3</sup> This requirement applies regardless of whether the information on the required record is mandated by the Rule.<sup>4</sup>

You state that Rule 17a-3 does not appear to require that a broker-dealer keep a record of market identification information, nor does it appear to require that a broker-dealer keep a record of whether another broker-dealer is a member of a particular market. However, broker-dealers may include this information on records they are required to create pursuant to Rule 17a-3. Because of the tight phase-in and implementation deadlines associated with NASDAQ's operation as a national securities exchange, many broker-dealers may be unable to implement the systems changes necessary to ensure that the above-described information is accurately described on their records and reports by August 1, 2006. As a result, firms may maintain required books and records that incorrectly identify NASDAQ as part of the OTC market, NASDAQ securities as OTC

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<sup>2</sup> Exchange Act Rel. No. 53128 (Jan. 13, 2006), 71 Fed. Reg. 3550 (Jan. 23, 2006).

<sup>3</sup> See, e.g., Armstrong Jones & Co., Exchange Act Release No. 8420 (Oct. 3, 1968), aff'd, Armstrong Jones & Co. v. SEC, 421 F.2d 359 (6th Cir. 1970).

<sup>4</sup> See Sinclair v. SEC, 444 F.2d 399, 401 (2d Cir. 1971); James F. Novack, Exchange Act Release No. 19,660, 47 S.E.C. 892 (Apr. 8, 1983).

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securities, and/or a broker-dealer as a member of the NASD rather than as a member of NASDAQ (and vice versa).

**B. Rule 17a-25**

Pursuant to Exchange Act Rule 17a-25, broker-dealers submitting blue sheet information to the Commission are required to identify the “exchange or other market” where a transaction was executed.<sup>5</sup> As described above, broker-dealers may be unable to implement the systems changes necessary to ensure that NASDAQ is identified as an exchange market and NASDAQ securities are identified as exchange-listed securities, respectively, before August 1, 2006. Consequently, these firms may instead identify NASDAQ as part of the OTC market or NASDAQ securities as OTC securities on their blue sheet reports.

**C. Requested Timeframe**

The Intermarket Surveillance Group,<sup>6</sup> on behalf of various self-regulatory organizations, granted broker-dealers an extension of time until December 31, 2006 so they can remediate their systems in order to submit accurate market identification information in their electronic blue sheet reports.<sup>7</sup> Consequently, you would like any Staff no action position to correspond to the ISG relief and extend until December 31, 2006.

**III. Response**

Based on your representations and the facts presented, and without necessarily concurring in your analysis, the Division will not recommend to the Commission enforcement action under Exchange Act Rule 17a-3 before December 31, 2006 if a broker-dealer reflects 1) NASDAQ as an OTC market instead of an exchange market, 2) NASDAQ securities as OTC securities instead of exchange-listed securities, and/or 3) a broker-dealer as a member of the NASD rather than as a member of NASDAQ (and vice versa) on books and records required under Exchange Act Rule 17a-3. Broker-dealers should maintain sufficient additional records to identify, if such is the case, that a given transaction was effected on an exchange market, that the security is an exchange-listed security, and/or that the broker-dealer is either a member of NASD or NASDAQ (whichever is the case).

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<sup>5</sup> 17 C.F.R. 240.17a-25(a)(1)(viii).

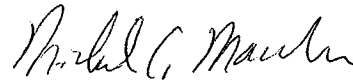
<sup>6</sup> The Intermarket Surveillance Group (“ISG”), is comprised of the following self-regulatory organizations: American Stock Exchange LLC (AMEX), Boston Stock Exchange, Inc. (BSE), Chicago Board Options Exchange, Inc. (CBOE), Chicago Stock Exchange, Inc. (CHX), International Securities Exchange (ISE), NASD Inc. (NASD), NASDAQ Stock Market (NASDAQ), National Stock Exchange (NSX), New York Stock Exchange LLC (NYSE), NYSE Arca (NYSEArca) and Philadelphia Stock Exchange, Inc. (PHLX).

<sup>7</sup> See NASD Notice to Members 06-33 (June 2006).

In addition, the Division will not recommend to the Commission enforcement action under Exchange Act Rule 17a-25 before December 31, 2006 if a broker-dealer reflects NASDAQ as an OTC market instead of an exchange market and/or NASDAQ securities as OTC securities instead of exchange-listed securities in securities transaction information submitted to the Commission pursuant to Exchange Act Rule 17a-25.

This position concerns enforcement action only and does not represent a legal conclusion with respect to the applicability of statutory or regulatory provisions of the federal securities laws. Moreover, this position is based on the facts you have presented and the representations you have made, and any different facts or conditions may require a different response. This position is subject to modification or revocation if at any time the Commission or the Division determines that such action is necessary or appropriate in furtherance of the purposes of the Exchange Act. The Division expresses no view with respect to any other questions that the proposed activities may raise, including the applicability of other federal or state laws or self-regulatory organization rules to those activities.

Sincerely,



Michael A. Macchiaroli  
Associate Director



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July 28, 2006

Michael A. Macchiaroli  
Associate Director, Division of Market Regulation  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Dear Mr. Macchiaroli,

Re: Temporary No-Action Request Pursuant to NASDAQ's Commencement of Operation as an Exchange: Systems Requirements

**I. Overview**

In anticipation of the commencement of NASDAQ's operation as a national securities exchange, the NASDAQ Exchange Working Group of the Securities Industry Association<sup>1</sup> ("SIA") requests that the Staff of the Division of Market Regulation advise us that it will not recommend any enforcement action to the Securities and Exchange Commission ("SEC" or "Commission") if broker-dealers do not reflect accurately NASDAQ or NASDAQ securities as an exchange market and exchange-listed securities, respectively, on books and records required under Rule 17a-3 of the Securities Exchange Act of 1934 ("Exchange Act") or in securities transaction information submitted to the Commission pursuant to Rule 17a-25 of the Exchange Act. We request that the Staff's no-action position extend until December 31, 2006.

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<sup>1</sup> The Securities Industry Association brings together the shared interests of approximately 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93 million investors directly and indirectly through corporate, thrift and pension plans. In 2004, the industry generated \$236.7 billion in domestic revenue and an estimated \$340 billion in global revenues. More information about the SIA is available at: [www.sia.com](http://www.sia.com).

The SIA has been working with NASD, NASDAQ, NYSE and SIA member firms to address various implementation issues in connection with the commencement of NASDAQ's operation as a national securities exchange with respect to NASDAQ UTP Plan securities, described below, which currently is scheduled to begin August 1, 2006. We have become concerned that the systems broker-dealers use to create books and records required under Rule 17a-3 under the Exchange Act and to generate electronic "blue sheets" as required under Exchange Act Rule 17a-25 may inaccurately label NASDAQ and NASDAQ securities as part of the over-the-counter ("OTC") market or OTC securities, respectively, because firms may not have adequate time to implement necessary systems and coding changes.

## **II. Discussion**

On January 13, 2006, the Commission approved NASDAQ's application to register as a national securities exchange, pending completion of the conditions set forth in the Commission's approval order.<sup>2</sup> NASDAQ since has announced its intention to begin operation as an exchange in NASDAQ-listed securities that are, for transaction reporting purposes, reported to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for NASDAQ-Listed Securities Traded on Exchanges on an Unlisted Trading Privilege Basis ("NASDAQ UTP Plan securities") on August 1, 2006. NASDAQ also has announced its intention to begin operations as a national securities exchange for securities listed on other national securities exchanges and reported to the Consolidated Tape Association Plan ("CTA Plan Securities") on October 1, 2006.<sup>3</sup>

As we recently discussed with the Staff, in light of the relatively recent announcement that NASDAQ would begin operation as a national securities exchange as of August 1, 2006, SIA member firms have been working diligently to reprogram and recode their systems as necessary to properly identify and designate NASDAQ as a national securities exchange rather than as part of the OTC market, and NASDAQ UTP Plan securities as exchange-listed securities, on all relevant book and records and communications with regulators and customers. Notwithstanding these efforts, many member firms may not have the ability to make the necessary systems changes and/or to test them by the August 1 start date for NASDAQ's operation as a national securities exchange.

This problem has arisen for two reasons. First, many member firms have not had sufficient time to make the necessary coding changes to their systems because, although

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<sup>2</sup> Exchange Act Rel. No. 53128 (Jan. 13, 2006), 71 Fed. Reg. 3550 (Jan. 23, 2006).

<sup>3</sup> See NASDAQ Head Trader Alert 2006-111 (July 27, 2006), available at <http://www.nasdaqtrader.com/Trader/News/2006/headtraderalerts/hta2006-111.stm>. The SEC approved this phased in approach on June 30, 2006. See Exchange Act Rel. No. 54085 (June 30, 2006), 71 Fed. Reg. 38910 (July 10, 2006).

the phased approach had been discussed as a possibility for many months, it was formally adopted only a month ago. Second, firms continue to receive guidance from regulatory entities concerning system and coding changes that need to be made in connection with NASDAQ's operation as a national securities exchange.<sup>4</sup> Firms are concerned that neither they nor their vendors will have adequate time to coordinate and test these system changes.<sup>5</sup>

### **III. Requested Relief**

#### **A. Rule 17a-3**

Under Exchange Act Rule 17a-3, broker-dealers are required to maintain accurate books and records. Although not specifically required by the rule, many firms include market identification information in the books and records they maintain pursuant to Rule 17a-3. Because of the tight phase-in and implementation deadlines associated with NASDAQ's operation as a national securities exchange, it is likely that many firms may not be able to make the systems changes necessary to ensure that NASDAQ and NASDAQ-listed securities are accurately described as an exchange market and exchange-listed securities, respectively, before August 1, 2006. As a result, firms may maintain required books and records that contain inaccurate information because they incorrectly identify NASDAQ and NASDAQ securities as part of the OTC market or OTC securities, respectively.

Therefore, we are requesting assurances from the Staff that, for a temporary period of time, it will not recommend enforcement action to the Commission for any inaccuracies in the identification of NASDAQ or NASDAQ securities as part of the "over-the-counter" market or as "OTC securities" for purposes of Rule 17a-3. Our request also would cover inaccurately identifying broker-dealers as members of the NASD rather than NASDAQ and vice versa.

#### **B. Rule 17a-25**

Under Exchange Act Rule 17a-25, broker-dealers submitting blue sheet information to the Commission are required to identify the "exchange or other market" where a transaction was executed.<sup>6</sup> Firms may encounter the same compliance difficulties described above in providing this information because they may not be able to make the systems changes necessary to ensure that NASDAQ and NASDAQ-listed

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<sup>4</sup> Although the "NASDAQ Exchange Registration Operational Issues Frequently Asked Questions (FAQs)" detail a number of areas with respect to which guidance has been provided and/or compliance grace periods adopted, it also identifies a few areas where additional regulatory guidance is needed. Available at [http://www.nasdaqtrader.com/trader/er/erop\\_faqs.pdf](http://www.nasdaqtrader.com/trader/er/erop_faqs.pdf).

<sup>5</sup> Firms have noted that vendors also are currently still addressing start-up problems concerning OATS Phase III implementation.

<sup>6</sup> 17 C.F.R. 240.17A-25(a)(1)(viii).

securities are accurately described as an exchange market and exchange-listed securities, respectively, before August 1, 2006. Therefore, we are requesting temporary no-action relief in connection with any inaccuracies in the identification of NASDAQ or NASDAQ securities as part of the "over-the-counter" market or as "OTC securities," respectively, for purposes of Rule 17a-25.

### **C. Requested Time Frame**

We request that the Staff's no action position extend until December 31, 2006. This time frame would be consistent with that extended by the Intermarket Surveillance Group on behalf of various self-regulatory organizations with respect to the submission of electronic blue sheet information.<sup>7</sup> In addition, assuming that NASDAQ also begins operating as an exchange with respect to CTA Plan securities within a reasonable time frame, by December 31, 2006 firms will have been able to make and test systems changes encompassing the fully defined universe of securities traded on NASDAQ, and thereby properly reflect the designation of exchange-traded and OTC securities, and reflect NASDAQ as an exchange rather than as part of the OTC market.<sup>8</sup> We do not believe that the no-action relief requested for this limited time period will impede the successful operation of NASDAQ as an exchange or otherwise frustrate the purposes of Rules 17a-3 and 17a-25.<sup>9</sup>

### **IV. Conclusion**

Allowing firms adequate time to modify and test their systems and coding to accurately indicate NASDAQ's new status as a national securities exchange is a necessary step in NASDAQ's smooth transition from being part of the OTC market to becoming a national securities exchange. Temporary no-action relief from Exchange Act Rules 17a-3 and 17a-25 until December 31, 2006 will permit firms to make these necessary changes without incurring unwarranted exposure for any inadvertent inaccuracies in their books and records or in information provided to the Commission that are due solely to their inability to make the required systems changes by the

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<sup>7</sup> The Intermarket Surveillance Group ("ISG"), acting on behalf of the various self-regulatory organizations, extended the deadline for compliance with its Electronic Blue Sheet requirements until December 31, 2006. See NASD Notice to Members 06-33 (June 2006).

<sup>8</sup> SIA member firms may require similar no-action relief for CTA Plan securities for a period after December 31, 2006 should NASDAQ's operation as a national securities exchange for these securities be unreasonably delayed.

<sup>9</sup> In connection with this request for relief, we have been or may be seeking certain other relief pertaining to NASDAQ's exchange operations. We are discussing exemptive relief under Section 16(d) of the Exchange Act with the SEC Division of Corporate Finance concerning short swing trading as it pertains to OTC markets versus NASDAQ as an exchange, and we also have been or may be requesting similar temporary relief from the NYSE and NASD with respect to the relevant rules of these SROs as they pertain to NASDAQ's exchange operations.



Michael A. Macchiaroli  
July 28, 2006  
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upcoming implementation dates. As a result, we respectfully request that the Staff grant this temporary no-action relief.

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If you have any questions with regard to this request, please contact the undersigned at 202.216.2000.

Respectfully submitted on behalf of the  
SIA NASDAQ Exchange Working Group,

Ann Vlcek  
Vice President and Associate General  
Counsel  
Securities Industry Association

cc: Chairman Christopher Cox, Securities and Exchange Commission  
Commissioner Paul S. Atkins, Securities and Exchange Commission  
Commissioner Roel C. Campos, Securities and Exchange Commission  
Commissioner Annette L. Nazareth, Securities and Exchange Commission  
Commissioner Kathleen L. Casey, Securities and Exchange Commission  
Robert L.D. Colby, Securities and Exchange Commission  
Elizabeth King, Securities and Exchange Commission  
Bonnie L. Gauch, Securities and Exchange Commission  
Andre Owens, WilmerHale  
Cristie March, WilmerHale