

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56004; File No. SR-NASD-2004-130)

July 2, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval of a Proposed Rule Change as Modified by Amendment Nos. 2 and 3 Relating to Amendments to Rule 2320(g) (Three Quote Rule) and Corresponding Recordkeeping Requirements under Rule 3110(b)

I. Introduction

On August 27, 2004, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“Commission” or “SEC”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend NASD Rule 2320(g) (“Three Quote Rule”) to exempt from the Three Quote Rule certain transactions in foreign securities of a foreign issuer that are part of an index calculated by the FTSE Group. On May 8, 2006, NASD filed Amendment No. 1 to the proposed rule change.³ On October 19, 2006, NASD filed Amendment No. 2 to the proposed rule change.⁴ The proposed rule change, as modified by Amendment No. 2, was published for comment in the Federal Register on October 31, 2006.⁵ The Commission received ten comment letters on the proposal.⁶ On April 3, 2007, NASD filed Amendment No. 3 to the proposed rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaced and superseded in its entirety the text of the original filing.

⁴ Amendment No. 2 replaced and superseded in its entirety the text of the original filing, as amended.

⁵ See Securities Exchange Act Release No. 54650 (October 25, 2006), 71 FR 63812 (“Notice”).

⁶ See letters from James Duncan, Senior Vice President & Director, International Trading, and Andrew Jappy, Chief Information Officer & EVP, Canaccord Capital Corporation, dated November 21, 2006 (“Canaccord Letter”); Achilles M. Perry, Associate General Counsel, CIBC World Markets Corp., dated November 21, 2006 (“CIBC Letter”); Grant Vingoe, Esq., Partner, Arnold Porter LLP, dated November 21, 2006 (“Arnold Porter

change⁷ and a response to the comment letters.⁸ This order provides notice of Amendment No. 3 and approves the proposed rule change as modified by Amendment Nos. 2 and 3 on an accelerated basis.

II. Description of the Proposal

Currently, the Three Quote Rule requires NASD members who execute a transaction in a non-exchange-listed security⁹ for or with a customer to contact and obtain the quotations from three dealers (or all dealers if less than three) to determine the best inter-dealer market for that security. The Three Quote Rule, however, does not apply if two or more priced quotations for a non-exchange-listed security are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis. NASD proposes to expand the categories of transactions that would be exempted from the Three Quote Rule. First, NASD proposes to exempt a transaction for or with a customer in a non-exchange-listed security of a foreign issuer that is part

Letter”); Bill Yancey, Chairman of the Board, and John C. Giese, President and CEO, Security Traders Association, dated November 21, 2006 (“STA Letter”); Rik Parkhill, Executive Vice President, TSX Group, Inc., President, TSX Markets, dated November 29, 2006 (“TSX Letter”); George W. Lennon, President, Canadian Security Traders Association, Inc., dated December 1, 2006 (“CSTA Letter”); Christopher Climo, Managing Director, Compliance and Chief Compliance Officer, TD Securities, Inc., dated December 7, 2006 (“TD Securities Letter”); James E. Twiss, Chief Policy Counsel, Market Regulation Services Inc., dated December 8, 2006 (“RS Letter”); Debra V. Moore, Manager – NASDAQ/OTC Equity Trading, and Glenn A. Hoback, Implementation Consultant – Internal Controls, Wachovia Securities, LLC, dated December 14, 2006 (“Wachovia Letter”); and Bryce Engel, Chief Brokerage Operations Officer, TD AMERITRADE, Inc., dated December 21, 2006 (“TD Ameritrade Letter”).

⁷ In Amendment No. 3, NASD proposes, among other things, to codify the existing exemptions relating to transactions in a non-exchange-listed security (as defined below) that are securities listed on a Canadian exchange.

⁸ See letter from Andrea D. Orr, Assistant General Counsel, NASD, to Nancy M. Morris, Secretary, Commission, dated April 3, 2007 (“NASD Response Letter”).

⁹ NASD Rule 6610(c) defines the term “non-exchange-listed security” as “any equity security that is not traded on any national securities exchange” and “shall not include ‘restricted securities,’ as defined by SEC Rule 144(a)(3) under the Securities Act of 1933, nor any securities designated in the PORTAL Market, the Rule 6700 Series.”

of the FTSE All-World Index, if such transaction is executed during the regular business hours of the foreign market for the foreign security and no trading halt or other similar trading or quoting restriction is in effect in any foreign market on which such security is listed. Second, in response to comments following publication of its proposal, NASD proposes to codify certain exemptions previously issued by NASD staff under the Three Quote Rule's exemptive process.¹⁰

Specifically, NASD proposes to exempt a transaction for or with a customer pertaining to the execution of an order in a non-exchange-listed security that is listed on a Canadian exchange as long as the customer order is executed by the NASD member or a person associated with the member on a Canadian exchange in an agency or riskless principal capacity and the member or a person associated with the member conducts regular and rigorous reviews of the equality of the execution of such orders in such securities, pursuant to the member's duty of best execution. NASD has also proposed to amend its recordkeeping requirement to provide a corresponding exclusion with respect to these proposed exemptions.

Under the proposed rule change, NASD members would continue to be required to comply with their best execution obligations under NASD Rule 2320 and, to the extent applicable, the suitability obligations under NASD Rule 2310.

III. Summary of Comments and NASD's Response

The Commission received ten comment letters on the proposal.¹¹ NASD submitted the NASD Response Letter,¹² and corresponding Amendment No. 3 to address the issue regarding application of the proposed rule change to Canadian-listed securities that was raised by the

¹⁰ See, e.g., Letter to Kenneth W. Perlman, General Counsel, Mayer & Schweitzer, Inc., from Alden S. Adkins, Senior Vice President and General Counsel, NASD Regulation, Inc., on May 29, 1998.

¹¹ See supra note 6.

¹² See supra note 8.

commenters. While some commenters expressed general support for NASD's proposal to exempt from the Three Quote Rule foreign securities that are part of the FTSE All-World Index,¹³ all of the commenters objected to NASD's proposed withdrawal of the exemptions from the Three Quote Rule for Canadian issuers' securities. Specifically, NASD proposed to withdraw all existing exemptions granted under the Three Quote Rule with respect to Canadian securities executed on a Canadian exchange in an agency or riskless principal basis.¹⁴ Were these exemptions withdrawn, NASD members would be required to comply with the Three Quote Rule in connection with transactions in Canadian securities that are not part of the FTSE All-World Index. The commenters argued that this result would be contrary to the duty of best execution,¹⁵ would cause significant delays in execution,¹⁶ and would increase the cost of transactions in Canadian securities that are not part of the FTSE All-World Index.¹⁷

In light of the comments, NASD revised its previous position and clarified that the proposal would not supersede any exemptions previously granted. Contemporaneously with the NASD Response Letter, NASD filed Amendment No. 3 to codify the relief previously granted in the existing exemptions.

¹³ See, e.g., Canaccord Letter, CIBC Letter, STA Letter, TSX Letter, CSTA Letter, and TD Ameritrade Letter.

¹⁴ See Notice, supra note 5, 71 FR at 63813 n.13.

¹⁵ See, e.g., Canaccord Letter, STA Letter, TXS Letter, CSTA Letter, RS Letter, and Wachovia Letter.

¹⁶ See, e.g., Canaccord Letter, CIBC Letter, Arnold Porter Letter, STA Letter, TD Securities Letter, Wachovia Letter, and TD Ameritrade Letter.

¹⁷ See, e.g., STA Letter and TD Securities Letter.

IV. Discussion

After careful review, the Commission believes that the proposed rule change is consistent with the requirements of the Act and the regulations thereunder applicable to NASD.¹⁸ In particular, the Commission believes that the proposal is consistent with Section 15A(b)(6) of the Act¹⁹ and Section 15A(b)(9) of the Act.²⁰ Section 15A(b)(6) of the Act requires that the rules of a national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Section 15A(b)(9) of the Act requires that rules of an association not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

The Commission approved NASD's proposal to institute the Three Quote Rule in 1988.²¹ The Three Quote Rule was an amendment to NASD's interpretation relating to best execution of retail transactions in non-Nasdaq securities. The Three Quote Rule's purpose is to assure that NASD members fulfill their duty to provide customers with best execution for transactions in non-exchange-listed securities, especially illiquid securities with non-transparent prices. The Commission subsequently approved NASD's proposal providing NASD staff authority to grant

¹⁸ In approving the proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁹ 15 U.S.C. 78o-3(b)(6).

²⁰ 15 U.S.C. 78o-3(b)(9).

²¹ See Securities Exchange Act Release No. 25637 (May 2, 1988), 53 FR 16488 (May 9, 1988).

exemptions from the Three Quote Rule in 1997.²² Subsequently, NASD granted exemptions from the Three Quote Rule for customer transactions in Canadian securities executed on a Canadian exchange.²³ In 2000, the Commission approved NASD's proposal to limit the Three Quote Rule's applicability to those situations when fewer than two priced quotes for a non-Nasdaq security are posted in an inter-dealer quotation medium.²⁴

The Commission finds that NASD's proposal to add the two new exceptions to the Three Quote Rule is consistent with the Act. In its order granting NASD staff exemptive authority with respect to the Three Quote Rule, the Commission noted that "one situation where exemptive relief might be applied would be trading in certain foreign securities. In some circumstances the foreign exchange market may constitute the best market for the securities that are listed on that market, and the time delay involved in contacting three dealers in advance of a customer transaction could hinder obtaining the best execution for the customer."²⁵

Thus, the Commission believes that it is reasonable for NASD to exempt from the Three Quote Rule transactions in a foreign security that are included in the FTSE All-World Index and transactions in a security listed on a Canadian exchange, subject to the conditions specified in the amended Three Quote Rule. The Commission notes that, whether or not a transaction in a non-

²² See Securities Exchange Act Release No. 39266 (October 22, 1997), 62 FR 56217 (October 29, 1997).

²³ See supra note 10.

²⁴ See Securities Exchange Act Release No. 43319 (September 21, 2000), 65 FR 58589 (September 29, 2000). Pursuant to this exception, if two or more priced quotations for a non-exchange-listed security are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis, then NASD members are not be required to obtain quotes from three dealers.

²⁵ Securities Exchange Act Release No. 39266 (October 22, 1997), 62 FR 56217 (October 29, 1997).

exchange-listed security is subject to the Three Quote Rule, the NASD member executing the transaction must satisfy its duty of best execution.

V. Accelerated Approval

The Commission finds good cause to approve NASD's proposal, as amended, prior to the thirtieth day after the amendment is published for comment in the Federal Register pursuant to Section 19(b)(2) of the Act. NASD submitted Amendment No. 3 in response to comments received on its proposal. The amendment codifies exemptions NASD staff previously issued under the Three Quote Rule's exemptive process,²⁶ and as described above, proposes a corresponding exclusion to the recordkeeping requirements if a member establishes and documents the exemption. Accordingly, Amendment No. 3 does not raise any new issues.

The Commission therefore finds good cause to approval NASD's proposal on an accelerated basis.

VI. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 3, including whether Amendment No. 3 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2004-130 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and

²⁶ See supra note 22.

Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2004-130. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2004-130 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁷ that the proposed rule change (SR-NASD-2004-130), as modified by Amendment Nos. 2 and 3, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁸

Florence E. Harmon
Deputy Secretary

²⁷ 15 U.S.C. 78s(b)(2).

²⁸ 17 CFR 200.30(a)(12).