

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-56007; File No. SR-NASD-2007-046)

July 3, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Allow NASD Members to Use the NASD/Nasdaq Trade Reporting Facility to Process Transaction Fees Charged by One Member to Another Member

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 3, 2007, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been substantially prepared by the NASD. NASD has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,<sup>3</sup> which renders the proposal effective upon receipt of this filing by the Commission.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

NASD is proposing to (1) amend NASD Rule 6130 (Trade Report Input) to allow NASD members to use the NASD/Nasdaq Trade Reporting Facility (the “NASD/Nasdaq TRF”) to process transaction fees charged by one member to another member on trades in NMS stocks, as defined in Rule 600(b)(47) of Regulation NMS under the Act, effected otherwise than on an

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 17 CFR 240.19b-4.

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

exchange; and (2) repeal NASD Interpretive Material (IM)-2230 (“Third Market” Confirmations) to ensure the efficacy of the transaction fee transfer mechanism proposed herein.

The text of the proposed rule change is available at the NASD, the Commission’s Public Reference Room, and [www.nasd.com](http://www.nasd.com).

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the NASD included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The NASD has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Background

Historically, there has been no mechanism for members to charge each other commissions or other explicit transaction fees through the NASD trade reporting and clearance submission process. Generally, members that want to charge other members an explicit transaction fee must bill and collect these fees directly from the other member outside the transaction reporting and clearing process.

Some members, however, trade on a “net” basis, meaning that the broker-dealer’s compensation is implicitly included in the execution price disseminated to the tape and reported for clearance and settlement to the National Securities Clearing Corporation (“NSCC”). For example, broker-dealer 1 (B/D 1) wants to purchase a security at \$10, with a transaction fee of

\$.01 per share from broker-dealer 2 (B/D 2). Rather than selling the security at \$10 and then charging a separate transaction fee of \$.01 per share, B/D 2 will sell the security to B/D 1 “net” at a price of \$10.01. Because \$10.01 is the reported price, the transaction fee is included as part of the trade and is transferred as part of the clearance and settlement process. However, with the adoption of the Regulation NMS Order Protection Rule (Rule 611 of Regulation NMS under the Act), trades reported on a “net” basis are more apt to trade through protected quotes than those reported on a gross basis. For example, in the scenario above, if the protected inside market was \$9.95 to \$10, a trade at \$10.01 may constitute a trade-through for the purposes of the Regulation NMS Order Protection Rule (i.e., the trade is at a price worse than the best displayed offer for the security).

The Securities Industry and Financial Markets Association (SIFMA), on behalf of certain NASD member firms, approached Nasdaq and NASD concerning this issue and requested that the NASD/Nasdaq TRF facilitate the processing of transaction fees between members. They indicated that upon the implementation of the Regulation NMS Order Protection Rule, many member firms intend to stop trading “net” and begin charging an explicit transaction fee for each trade.

#### Proposed Amendments to Allow Inclusion of Transaction Fees in Clearing Reports

NASD is proposing to adopt new paragraph (h) of Rule 6130,<sup>5</sup> which provides that NASD members may agree in advance to transfer a transaction fee charged by one member to another member on a transaction in NMS stocks, as defined in Rule 600(b)(47) of Regulation NMS under the Act, effected otherwise than on an exchange through the submission of a clearing report to the NASD/Nasdaq TRF. The report submitted to the NASD/Nasdaq TRF shall provide,

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<sup>5</sup> In this rule filing, NASD is proposing to redesignate current paragraph (h) of Rule 6130 as paragraph (i).

in addition to all other information required to be submitted by any other rule, a total per share or contract price amount, inclusive of the transaction fee. As a result, members would submit two price amounts as part of their report to the NASD/Nasdaq TRF: one price including the transaction fee, which would be submitted by the NASD/Nasdaq TRF to NSCC for clearance and settlement; and one price exclusive of the transaction fee, which would be reported to the appropriate Securities Information Processor for public dissemination. For example, if B/D 1 purchases from B/D 2 at \$10.00 and B/D 1 and B/D 2 agree to a transaction fee of \$.01 per share, the trade price that would be publicly disseminated would be \$10.00, while the trade would be cleared and settled by NSCC at \$10.01.<sup>6</sup> The parties to the trade would know both prices – the price reported for public dissemination and the clearance/settlement price.

In addition, the proposed rule provides that both members and their respective clearing firms, as applicable, must execute an agreement, as specified by NASD, permitting the facilitation of the transfer of the transaction fee through the NASD/Nasdaq TRF, as well as any other applicable agreement, such as a give up agreement pursuant to Rule 4632(h). Such agreement must be executed and submitted to the NASD/Nasdaq TRF before the members can transfer any transaction fee under the proposed rule. Among other things, the form of agreement specified by NASD would expressly provide that the acceptance and processing by the NASD/Nasdaq TRF of the transaction fee as part of a trade report shall not constitute an estoppel as to NASD or bind NASD in any subsequent administrative, civil or disciplinary proceeding with respect to the transaction fee transferred. In other words, processing of a transaction fee by the NASD/Nasdaq TRF should not be taken to mean that NASD approved that transaction fee or its amount or its appropriateness under NASD rules or federal securities laws. The mere fact that

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<sup>6</sup> Today, if this transaction were effected on a net basis, the transaction at a price of \$10.01 would both be reported to the tape and submitted to NSCC.

the transaction fee flowed through an NASD facility will not be a defense to any action taken by NASD relating to the fee. The proposed rule also provides that the relevant agreements are considered member records for purposes of NASD Rule 3110(a) and must be made and preserved by both members in conformity with applicable NASD rules.

Furthermore, the proposed rule expressly provides that it shall not relieve a member from its obligations under NASD rules and federal securities laws, including but not limited to, NASD Rule 2230 (Confirmations) and SEC Rule 10b-10. To the extent that any transaction fee is passed onto the customer, members should review their customer confirmation obligations to ensure that they are disclosing such fees in compliance with all applicable rules and regulations, as well as other NASD rules, including but not limited to, NASD Rules 2320 (Best Execution) and 2440 (Fair Prices and Commissions).

The proposed rule relates solely to transaction fees charged by one NASD member to another NASD member. Members would not be able to use the NASD/Nasdaq TRF to facilitate the transfer of fees for transactions with a customer (i.e., clients that are not brokers or dealers) or a non-member. In addition, the NASD/Nasdaq TRF can only be used to facilitate the transfer of transaction fees. Members would not be able to use the NASD/Nasdaq TRF to transfer access fees or rebates on transactions.

Pursuant to SR-NASD-2007-040,<sup>7</sup> NASD proposed amendments to prohibit members from submitting to an NASD Facility (i.e., a Trade Reporting Facility or the Alternative Display Facility) any report associated with a previously executed trade that was not reported to that NASD Facility. Thus, members will not be permitted to use the NASD/Nasdaq TRF to transfer transaction fees on any trades that were previously reported to another NASD Facility.

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<sup>7</sup> See Securities Exchange Act Release No. 55962 (June 26, 2007), 72 FR 36536 (July 3, 2007) (notice of filing and immediate effectiveness of SR-NASD-2007-040).

NASD also is proposing to amend Rule 6130(d) (Trade Information To Be Input) to require that for any transaction for which the NASD/Nasdaq TRF is used to transfer a transaction fee between two NASD members, the trade report must comply with the requirements of proposed Rule 6130(h).

Finally, IM-2230 (“Third Market” Confirmations) requires any member that absorbs a transaction fee transferred pursuant to proposed Rule 6130(h) to include a legend to that effect on the customer confirmation. However, given that such a transaction fee, by definition, has been absorbed by the member and, as appropriate, incorporated into the fee paid by and disclosed to the customer on the confirmation, such disclosure provides no or minimal additional information to the customer. Accordingly, NASD is proposing to repeal IM-2230 because it could be unduly burdensome on members and potentially reduce the efficacy of the transaction fee transfer mechanism proposed herein, in light of the anticipated increase in the number of trades for which a transaction fee will be charged, while providing only minimal additional information to customers.

NASD notes that the proposed rule change does not include any proposed rules relating to fees for use of the NASD/Nasdaq TRF to transfer transaction fees pursuant to proposed new Rule 6130(h). Such fees will be the subject of a future rule filing with the Commission.

NASD has filed the proposed rule change for immediate effectiveness and requested a waiver of the 30-day operative delay to allow the proposed rule change to become operative on the Regulation NMS Pilot Stocks Phase Date, July 9, 2007.

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>8</sup> which requires, among other things, that NASD rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that by automating and improving fee transfers as a value-added service, the proposed rule change will assist members in complying with their obligations under Regulation NMS.

### B. Self Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

NASD has neither solicited nor received written comments on the proposed rule change.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>9</sup> and subparagraph (f)(6) of Rule 19b-4<sup>10</sup> thereunder because it does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest.<sup>11</sup>

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<sup>8</sup> 15 U.S.C. 78o-3(b)(6).

<sup>9</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>10</sup> 17 CFR 240.19b-4(f)(6).

<sup>11</sup> Rule 19b-4(f)(6)(iii) requires that a self-regulatory organization submit to the Commission written notice of its intent to file the proposed rule change, along with a

Under Rule 19b-4(f)(6) of the Act,<sup>12</sup> the proposal does not become operative for 30 days after the date of its filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest. The Commission believes that the proposed rule change is beneficial because it will: (1) make transaction fees transparent by virtue of their being separately reported; and (2) assist members in conducting their business consistent with their obligations under Regulation NMS that commence on the Pilot Stocks Phase date of July 9, 2007. Therefore, the Commission believes that it is consistent with the protection of investors and the public interest to waive the 30-day operative date so that the proposal may take effect upon filing.<sup>13</sup>

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. NASD has satisfied the five-day pre-filing notice requirement.

<sup>12</sup>

Id.

<sup>13</sup>

For purposes only of waiving the operative delay for this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).



#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change 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 e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2007-046 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2007-046. 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 will also be available for inspection and copying at the principal office of the NASD. 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-2007-046 and should be submitted on or before [insert date 21 days from date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).