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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-56639; File No. SR-NASD-2007-035)

October 11, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc. (n/k/a Financial Industry Regulatory Authority, Inc.); Notice of Filing of Proposed Rule Change Related to Mandated Use of an Automated Liability Notification System

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 May 25, 2007, the National Association of Securities Dealers (“NASD”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change described in Items I, II, and III below, which items have been prepared primarily by the NASD.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

NASD is proposing to amend Rule 11810(i) to mandate the use of the automated liability notification system of a registered clearing agency when issuing liability notices in connection with certain securities transactions provided both parties to the contract are participants in a registered clearing agency that has such an automated system.<sup>4</sup>

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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> On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD/s Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Exchange Act Release No. 56146 (July 26, 2007); 72 FR 42190 (Aug. 1, 2007).

<sup>4</sup> Proposed new rule text is attached to NASD’s filing as Exhibit 1 and can be found at <http://www.finra.org/RulesRegulation/RuleFilings/index.htm>.

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.

NASD has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>5</sup>

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(1) Purpose

NASD Rule 11810(i) sets forth the procedures that must be followed when a party is owed securities that have become the subject of a voluntary corporate action, such as a tender or exchange offer. Under Rule 11810(i), the owed party delivers a liability notice to the owing or failing party. The liability notice sets a cut off date for the delivery of the securities by the owing party and provides notice to the owing party that the counterparty will be held liable for any damages caused by its failure to deliver the securities in time for the owed party to participate in the voluntary corporate action.

If the owing party delivers the securities in response to the liability notice, it has met its delivery obligation. If the owing party fails to deliver the securities in sufficient time for the owed party to participate in the voluntary corporate action, it will be liable for any damages that may accrue thereby (i.e., in lieu of delivering the securities the owing party must deliver proceeds equivalent to the proceeds that the owed party would have received if it had been able

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<sup>5</sup> The Commission has modified portions of the text of the summaries prepared by the NASD.

to participate in the offer). The owed party has the responsibility to communicate its intentions to the owing party and to prove, if necessary, that the owing party received the liability notice.

Rule 11810(i) currently requires broker-dealers to send liability notices using “electronic media having immediate receipt capabilities.” Although there is currently no one acceptable means for sending and tracking liability notices, NASD members have advised that it is industry practice to send liability notices by fax to the failing counterparty. Sending liability notices by fax is a manual, paper-intensive process that is subject to error. For example, the fax may be directed to the wrong department and not timely received by the correct department, or sent to the correct department but overlooked by the responsible person(s). In other cases, the receiver may not notify the sender that the fax has been received, and the sender must follow up with another fax or telephone call or both. The financial risk to an owing firm that misses or incorrectly processes a liability notice relating to a voluntary corporate action can be considerable, since the corporate action may involve hundreds of shareholders.

In response to industry need for a reliable and uniform method of transmitting liability notices, The Depository Trust Company (“DTC”) developed SMART/Track for Corporate Action Liability Notification Service (“SMART/Track”). SMART/Track is a web-based system for the communication of corporate action liability notices that allows DTC participants and the clearing members of the National Securities Clearing Corporation to create, send, process and track such notices.<sup>6</sup> Transmitting liability notices through SMART/Track eliminates paper liability notices and provides firms with an electronic, centralized system for the distribution, management and control of liability notices and helps reduce the risks, costs, and delays resulting from missing or inaccurate information associated with paper corporate action liability notices.

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<sup>6</sup> Currently DTC is the only registered clearing agency operating an automated corporate liability notification service.

Specifically, SMART/Track provides participants with (1) more timely receipt and distribution of corporation action liability notifications; (2) a centralized system to manage and control all liability notifications on all issues; (3) immediate identification of the security affected by a corporate action liability notification; (4) detailed disclosure and clearer explanation of the terms and conditions of the corporate action; and (5) an audit trail with a complete record of actions taken regarding a liability notice.

As proposed, NASD Rule 11810(i) will mandate the use of the automated liability notification system of a registered clearing agency when the parties to a contract are both participants in a registered clearing agency that has an automated service for corporate action liability notices. When either or both parties to a contract are not participants in a registered clearing agency that has an automated service for corporate action liability notices, Rule 11810(i) will continue to require the liability notice to be issued using written or comparable electronic media having immediate receipt capabilities.

NASD proposes to announce the effective date of the proposed rule change in a “Notice to Members” that will be published no later than sixty days following the date of approval of the proposed rule change by the Commission. The NASD anticipates that the effective date of the proposed rule change will be thirty days following publication of the Notice to Members announcing the Commission’s approval of the proposed rule change.

(2) Statutory Basis

The statutory basis under the Act for this proposed rule change is the requirement under Section 15A of the Act, which requires, among other things, that the rules of a national securities association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons

engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to perfect the mechanism of a free and open market and a national market system, and in general to protect investors and the public interest.<sup>7</sup> NASD believes that the proposed rule change is consistent with the provisions of the Act in that SMART/Track will eliminate the use of paper corporate action liability notices and will provide firms with an electronic, centralized system to distribute, manage, and control liability notices. In addition to reducing the risks, costs, and delays resulting from missing or inaccurate information associated with paper corporate action liability notices, SMART/Track gives firms detailed disclosure of the terms and conditions of the corporate action, enables firms to more timely receive and distribute corporate action liability notices, and provides an audit trail with a complete record of actions taken regarding a liability notice.

(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

Written comments were neither solicited nor received.

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

Within thirty-five days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

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<sup>7</sup> 15 U.S.C. 78f(b)(5).

- (A) by order approve such proposed rule change or
- (B) institute proceedings to determine whether the proposed rule change should be

disapproved.

#### 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 an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2007-035 in 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-2007-035. 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 Section, 100 F

Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings also will be available for inspection and copying at the principal office of the NASD and on NASD's Web site, <http://www.finra.org/RulesRegulation/RuleFilings/index.htm>. 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-2007-035 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>8</sup> 17 CFR 200.30-3(a)(12).