

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56972; File No. SR-NASD-2007-035)

December 14, 2007

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

I. Introduction

On May 25, 2007, the National Association of Securities Dealers, Inc. (“NASD”)¹ filed with the Securities and Exchange Commission (“Commission”) a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).² Notice of the proposal was published in the Federal Register on October 17, 2007.³ For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

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 is seeking delivery of those securities. 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 it

¹ 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. (“FINRA”) in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. Exchange Act Release No. 56146 (July 26, 2007); 72 FR 42190 (Aug. 1, 2007).

² 15 U.S.C. 78s(b)(1).

³ Securities Exchange Act Release No. 56639 (October 11, 2007), 72 FR 58918 (October 17, 2007) [File No. SR-NASD-2007-035].

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., the owing party must deliver proceeds equivalent to the proceeds that the owed party would have received if it had been able 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.

Prior to this proposed rule change, Rule 11810(i) required broker-dealers to send liability notices using “electronic media having immediate receipt capabilities.” Although there was no one acceptable means for sending and tracking liability notices, NASD members advised the NASD that it was industry practice to send liability notices by fax. However, sending liability notices by fax is a manual, paper-intensive process that is subject to error. The financial risk to an owing firm that misses or incorrectly processes a liability notice relating to a voluntary corporate action can be considerable.

In response to industry need for a reliable and uniform method of transmitting liability notices, The Depository Trust Company (“DTC”) developed the 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 National Securities Clearing Corporation clearing members to create, send, process, and track such notices. 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. Use of SMART/Track helps reduce the risks, costs, and delays resulting from missing or inaccurate information associated with paper corporate action liability notices. Specifically, 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 amended, NASD Rule 11810(i) mandates the use of the automated liability notification system of a registered clearing agency when the parties to a failed contract involving securities that have become the subject of a voluntary corporate action are both participant in a clearing agency that has an automated service for corporate action liability notices.⁴ When either or both parties to such a contract are not participants in a registered clearing agency that has an automated service for corporate action liability notices, Rule 11810(i) continues to require the liability notice to be issued using written or comparable electronic media having immediate receipt capabilities.

NASD will announce the effective date of the proposed rule change in a “Notice to Members” that will be published no later than sixty days from the date of approval of this rule

⁴ Currently DTC is the only registered clearing agency operating an automated corporate liability notification service.

change. The NASD anticipates that the effective date of the rule change will be thirty days following publication of the Notice to Members announcing the Commission's approval.

III. Discussion

Section 15A(b)(6) of the Act requires, among other things, that the rules of a securities association be designed 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.⁵ The proposed rule change is consistent with the provisions of the Act because by eliminating the use of paper corporate action liability notices and requiring the use of a registered clearing agency's automated service for corporate action liability notices where available, the proposed rule change should help reduce the risks, costs, and delays resulting from missing or inaccurate information associated with paper corporate action liability notices.

Accordingly, for the reasons stated above the Commission finds that the rule change, is consistent with FINRA's obligation under Section 15A(b)(6) of the Act 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.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with the requirements of Section 15a(b)(6) of the Act and the rules and regulations thereunder.

⁵ 15 U.S.C. 78o-3(b)(6).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-NASD-2007-035) be and hereby is approved.

For the Commission by the Division of Trading and Practices, pursuant to delegated authority.⁶

Florence E. Harmon
Deputy Secretary

⁶ 17 CFR 200.30-3(a)(12).