

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50898; File No. SR-NSX-2004-07)

December 21, 2004

Self-Regulatory Organizations; National Stock Exchange; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto Relating to Non-Member Give-Ups

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 31, 2004, the National Stock Exchange<sup>SM</sup> (“NSX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change, as described in Items I, II, and III below, which Items have been prepared by the Exchange. On December 3, 2004, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comment on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend the clearing requirements contained in Article II, Section 5.1 of the NSX By-Laws to permit members to give-up a non-member’s clearing number if certain conditions are satisfied. The text of the proposed rule change appears below. New language is in italics.

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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> The NSX submitted Amendment No. 1 in order to provide additional information in describing the manner in which the proposed rule change will operate. Amendment No. 1 replaces the original rule filing in its entirety. The Exchange notes that Amendment No. 1 does not alter the text of the proposed rule change as it appeared in the original rule filing.

CODE OF REGULATIONS (BY-LAWS)  
OF  
NATIONAL STOCK EXCHANGE

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ARTICLE II

Exchange Membership

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Section 5. Restrictions on Admittance to or Continuance in Membership and Association

5.1. General Restrictions

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Interpretations and Policies

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.03 An Exchange member may only give-up its own or another Exchange member's clearing number when executing a transaction on the Exchange; provided, however, that a member may give-up a non-member's clearing number when executing a transaction on the Exchange if (i) the non-member (a) is a registered broker-dealer and is a self-clearing member of the National Securities Clearing Corporation ("NSCC") and (b) consents to the disciplinary jurisdiction of the Exchange and agrees to adhere to all applicable Exchange By-Laws and Rules; and (ii) the executing member's guaranteeing clearing firm, who must be an Exchange member, agrees to accept financial responsibility for all transactions given-up to the non-member, including but not limited to, responsibility to

clear and settle the non-member's trades in the event that the non-member or the NSCC does not accept any such trades.

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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 NSX 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 NSX 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

Currently, to enter transactions on the NSX, an Exchange member must either be self-clearing or must have a clearing member agree to accept financial responsibility for all of its transactions. In turn, any Exchange member that wishes to self-clear or clear third party transactions on the Exchange must also be a member of the National Securities Clearing Corporation ("NSCC").

In addition, the Exchange By-Laws currently provide that, when a member executes a transaction on the Exchange, it may only give-up its own clearing number or the number of another Exchange member.<sup>4</sup> The Exchange notes that the provision limiting give-ups to Exchange members' clearing firms was originally put in place to ensure the Exchange's ability to exercise jurisdiction over all parties involved in the

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<sup>4</sup> See Interpretation .03 to Article II, Section 5.1 of the Exchange By-Laws.

execution and settlement of trades that occur on the Exchange. The Exchange proposes to expand the list of clearing firms eligible to be “given-up” to include non-member clearing firms,<sup>5</sup> if certain conditions are satisfied.

The conditions that would enable an NSX member to give-up a non-member’s clearing number are that (i) the non-member (a) be a registered broker-dealer and a self-clearing member of the NSCC and (b) consent to the disciplinary jurisdiction of the Exchange and agree to adhere to all applicable Exchange By-Laws and Rules; and (ii) the executing member’s clearing firm, who must be an Exchange member, agrees to accept financial responsibility for all transactions given-up to the non-member, including but not limited to, responsibility to clear and settle the non-member’s trades in the event that the non-member or the NSCC does not accept any such trades. The Exchange believes that this additional give-up alternative offers members more flexibility<sup>6</sup> and is consistent with the above-described intent of Interpretation .03 to Article II, Section 5.1 of the Exchange By-Laws in that it permits the Exchange to retain jurisdiction over the parties involved in executions and those responsible for guaranteeing transaction clearance and settlement.

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<sup>5</sup> The Exchange notes that use of the term “non-member” refers to the fact that a “non-member” firm does not have certain voting and ownership rights that other NSX members have. However, as described in the proposed rule text, a “non-member” firm that has entered into a give-up arrangement under Interpretation .03 to Article II, Section 5.1 of the Exchange By-Laws is subject to the Exchange’s jurisdiction and the requirement to adhere to all applicable Exchange By-Laws and Rules, just as any other member of the Exchange.

<sup>6</sup> For example, under the NSX’s current requirements, an NSX member can execute a transaction on behalf of a non-member. However, for purposes of reporting by NSX to the NSCC for clearing and settlement, the NSX member cannot give-up the non-member’s clearing account to NSX. Instead, the clearing and settlement information must be processed directly with the NSCC. Under the proposed rule change, an NSX member would have the option of giving up the non-member’s clearing number to the NSX for reporting by NSX to the NSCC. This gives the NSX member the flexibility to process a non-member’s order in the same manner in which it is permitted to process other NSX members’ orders.

In order to evidence the satisfaction of the above-referenced requirements, and thus for a member to be eligible to give-up a non-member's clearing number, an access authorization agreement in a form prescribed by the Exchange must be completed and signed by the member, its NSX member clearing firm, and the non-member clearing firm.<sup>7</sup> The agreement will specify that the conditions of Interpretation .03 have been satisfied, including that the non-member consents to the disciplinary jurisdiction of the Exchange and agrees to adhere to all applicable Exchange By-Laws and Rules. The agreement will also specify that the executing member's clearing firm agrees to accept financial responsibility for all transactions given-up to the non-member.

The Exchange believes the proposal provides adequate controls regarding non-member give-ups. For operational purposes, the Exchange requires the non-member be a self-clearing member of NSCC, thus requiring NSCC clearing membership for Exchange transactions given-up to non-members, as is currently required for Exchange transactions given-up to NSX members.<sup>8</sup> For disciplinary jurisdiction and compliance purposes, the requirements that the non-member consent to the disciplinary jurisdiction of the Exchange and agree to adhere to all applicable Exchange By-Laws and Rules, provide an adequate level of Exchange control over the non-member give-up transaction. The Exchange believes that these controls provide a jurisdictional basis for disciplinary action against the non-member, allowing the Exchange to enforce its rules with respect to the non-member to the same degree as if the non-member were itself a member.

Additionally, the NSX requires that the member clearing firm accept financial

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<sup>7</sup> The access authorization agreement is attached to Form 19b-4 as Exhibit 3.

<sup>8</sup> Telephone conversation between Jennifer M. Lamie, Assistant General Counsel and Secretary, NSX and Marisol Rubecindo, Attorney, Division of Market Regulation, Commission.

responsibility for all transactions given-up to the non-member. The Exchange believes that this guarantees the financial obligations incurred with respect to non-member give-up transactions. As is currently the case for give-ups to member clearing firms, the Exchange will assess the executing member with the relevant fees on all transactions given-up to non-members.

## 2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with the provisions of Section 6(b) of the Act,<sup>9</sup> in general, and Section 6(b)(5) of the Act,<sup>10</sup> in particular, which requires, among other things, that the rules of the Exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, to foster cooperation and coordination with persons engaged in clearing and settling transactions, and, in general, to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change, as amended, will impose any inappropriate burden on competition.

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

No written comments were solicited or received in connection with the proposed rule change, as amended.

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

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<sup>9</sup> 15 U.S.C. 78f(b).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

Within 35 days of the publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 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 organizations consents, the Commission will:

- A. by order approve the 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-NSX-2004-07 on the subject line.

##### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, D.C. 20549-0609.

All submissions should refer to File No. SR-NSX-2004-07. This file number should be included in the subject line if e-mail is used. To help the Commission process and review 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. Copies of such filings will also 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-NSX-2004-07 and should be submitted on before [insert date 21 days from publication in the Federal Register].

For the Commission by the Division of Market Regulation, pursuant to the delegated authority.<sup>11</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>11</sup> 17 CFR 200.30-3(a)(12).