

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-55346; File No. SR-NASD-2007-014)

February 26, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Make Conforming Changes to the Rules Relating to the NASD/NSX TRF, NASD/BSE TRF, and NASD/NYSE TRF Consistent with the New Requirements of Regulation NMS

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 February 12, 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, II, and III below, which Items have been substantially prepared by NASD. NASD has filed the proposal as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders it effective upon filing with the Commission. 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 proposes (1) amendments to the transaction reporting rules relating to the NASD/NSX Trade Reporting Facility (“NASD/NSX TRF”), the NASD/BSE Trade Reporting Facility (“NASD/BSE TRF”), and the NASD/NYSE Trade Reporting Facility (“NASD/NYSE TRF”) (collectively referred to herein as the “Subject TRFs”) consistent with the new

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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> 15 U.S.C. 78s(b)(3)(A).

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

requirements of Regulation NMS under the Act;<sup>5</sup> and (2) technical amendments to conform, to the extent practicable, the reporting rules of the Subject TRFs to the reporting rules of the NASD/Nasdaq Trade Reporting Facility (“NASD/Nasdaq TRF”) and NASD’s Alternative Display Facility (“ADF”). The text of the proposed rule change is available at 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, 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 such statements.

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

1. Purpose

Background

On June 29, 2005, the Commission published its release adopting Regulation NMS,<sup>6</sup> which established new substantive rules designed to modernize and strengthen the regulatory structure of the U.S. equities markets. Pursuant to Regulation NMS, the Commission, among other things, adopted Rule 611 (“Order Protection Rule”) to establish protection against trade-

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<sup>5</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (“Regulation NMS Adopting Release”).

<sup>6</sup> Id.

throughs for NMS stocks.<sup>7</sup>

In general, the Order Protection Rule requires a trading center (which includes national securities exchanges, self-regulatory organization (“SRO”) trading facilities, alternative trading systems, OTC market makers, and block positioners) to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs on that trading center of protected quotations and, if relying on an exception, that are reasonably designed to assure compliance with the terms of the exception. There currently are nine exceptions and two exemptions to the Order Protection Rule.<sup>8</sup> In addition, the Order Protection Rule requires trading centers to surveil regularly to ascertain the effectiveness of the policies and procedures adopted pursuant to Rule 611 of Regulation NMS and take prompt action to remedy deficiencies in such policies and procedures.

On November 6, 2006, the Commission approved the establishment of the NASD/NSX TRF.<sup>9</sup> On December 13, 2006, the Commission approved the establishment of the NASD/BSE

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<sup>7</sup> NMS stock is defined in Rule 600(b)(47) of Regulation NMS as “any NMS security other than an option.” Rule 600(b)(46) of Regulation NMS defines NMS security as “any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options.”

<sup>8</sup> See 17 CFR 242.611; Securities Exchange Act Release Nos. 54389 (August 31, 2006), 71 FR 52829 (September 7, 2006) (Order Granting an Exemption for Qualified Contingent Trades from Rule 611(a) of Regulation NMS) and 54678 (October 31, 2006), 71 FR 65018 (November 6, 2006) (Order Exempting Certain Sub-Penny Trade-Throughs from Rule 611 of Regulation NMS).

<sup>9</sup> See Securities Exchange Act Release No. 54715 (November 6, 2006), 71 FR 66354 (November 14, 2006) (SR-NASD-2006-108). The NASD/NSX TRF commenced operation for the reporting of over-the-counter trades in Nasdaq-listed securities on November 27, 2006 and is expected to expand to the reporting of over-the-counter trades in all exchange-listed securities in the first quarter of 2007.

TRF.<sup>10</sup> On February 1, 2007, NASD filed for immediate effectiveness a proposed rule change relating to the establishment of the NASD/NYSE TRF.<sup>11</sup> The Subject TRFs provide members additional mechanisms for reporting locked-in trades in exchange-listed securities executed otherwise than on an exchange.

Neither NASD, generally, nor any of the NASD Trade Reporting Facilities, specifically, qualifies as a trading center within the meaning of Regulation NMS. Thus, the provisions of the Order Protection Rule requiring trading centers to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs on that trading center of protected quotations in NMS stocks are not applicable to NASD. However, NASD has a responsibility to enforce requirements under the Act that apply to activity within its regulatory authority. Thus, unlike exchanges that have direct Regulation NMS obligations with respect to the SRO trading facilities, NASD has indirect Regulation NMS obligations with respect to all over-the-counter market activity, including post-trade regulation for compliance with the Order Protection Rule with respect to trading centers that trade report through an NASD Trade Reporting Facility. Such regulation includes monitoring for whether trading centers are reporting trades to an NASD Trade Reporting Facility that are trade-throughs of protected quotes and whether such trade-throughs are permissible under one of the specific exceptions and exemptions under the Order Protection Rule.

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<sup>10</sup> See Securities Exchange Act Release No. 54931 (December 13, 2006), 71 FR 76409 (December 20, 2006) (SR-NASD-2006-115). The NASD/BSE TRF will commence operation upon successful completion of system testing and certification (currently anticipated to be in the first quarter of 2007).

<sup>11</sup> See Securities Exchange Act Release No. 55325 (February 21, 2007) (SR-NASD-2007-011). The NASD/NYSE TRF will commence operation upon successful completion of system testing and certification (currently anticipated to be in the first quarter of 2007).

Proposed Amendments to Align the Rules of the Subject TRFs with Regulation NMS

NASD proposes to amend Rule 4632C relating to the NASD/NSX TRF, Rule 4632D relating to the NASD/BSE TRF, and Rule 4632E relating to the NASD/NYSE TRF to require reporting members to append applicable modifiers to last-sale transaction reports with respect to trades that fall within the exceptions and exemptions from Rule 611 of Regulation NMS. The proposed amendments are substantially similar to amendments to the transaction reporting requirements relating to the ADF, which were approved by the Commission on September 28, 2006,<sup>12</sup> and the NASD/Nasdaq TRF, which were filed for immediate effectiveness on January 8, 2007.<sup>13</sup>

Specifically, NASD proposes to adopt new paragraph (a)(5)(C) of Rule 4632C, paragraph (a)(5)(F) of Rule 4632D, and paragraph (a)(5)(I) of Rule 4632E to require members to append a unique modifier, specified by NASD, to indicate whether the trade would be a trade-through of a protected quotation but for the trade being qualified for an exception or exemption from Rule 611 of Regulation NMS. Further, NASD proposes to adopt new paragraph (a)(5)(D) of Rule 4632C, paragraph (a)(5)(G) of Rule 4632D, and paragraph (a)(5)(J) of Rule 4632E to require that, for any trade that would be a trade-through of a protected quotation but for the trade being qualified for an exception or exemption from Rule 611 of Regulation NMS, a member must append to the transaction report, in addition to the modifier required under new Rule

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<sup>12</sup> See Securities Exchange Act Release No. 54537 (September 28, 2006), 71 FR 59173 (October 6, 2006) (SR-NASD-2006-091). See also Securities Exchange Act Release No. 55088 (January 11, 2007), 72 FR 2573 (January 19, 2007) (SR-NASD-2007-001). Unlike the ADF, an NASD Trade Reporting Facility (e.g., the NASD/NSX TRF) is a trade reporting mechanism only; it does not permit quoting. As such, not all of the amendments to the ADF rules are applicable to the rules relating to the NASD Trade Reporting Facilities.

<sup>13</sup> See Securities Exchange Act Release No. 55101 (January 12, 2007), 72 FR 2568 (January 19, 2007) (SR-NASD-2007-002).

4632C(a)(5)(C), Rule 4632D(a)(5)(F), and Rule 4632E(a)(5)(I), respectively, a unique modifier, specified by NASD, that identifies the specific applicable exception or exemption from Rule 611 of Regulation NMS upon which the member is relying.<sup>14</sup> As stated in the proposed rules, these modifiers will be used in conformity with the specifications approved by the Operating Committee of the relevant National Market System Plans to identify trades executed pursuant to an exception or exemption from Rule 611 of Regulation NMS. NASD, along with the respective Subject TRFs, will publish technical specifications regarding the specific modifiers required under the proposed new rules.

Additionally, NASD proposes to adopt new paragraph (a)(5)(E) of Rule 4632C, paragraph (a)(5)(H) of Rule 4632D, and paragraph (a)(5)(K) of Rule 4632E to require members to append “[a]ny other modifier as specified by NASD or the Securities and Exchange Commission.” An identical provision in the ADF rules was subject to notice and comment and approved by the Commission pursuant to SR-NASD-2006-091 and also was incorporated in Rule 4632 relating to the NASD/Nasdaq TRF pursuant to SR-NASD-2007-002. Under this proposed provision, NASD will have the authority to prescribe additional trade report modifiers by updating the Technical Specifications for the Subject TRFs without submitting a further proposed rule change for approval by the Commission. For example, such authority will be used to require additional modifiers to designate trades that qualify under two existing exemptions from the Order Protection Rule (qualified contingent trades and certain sub-penny trade-throughs)<sup>15</sup> as well as any other exemption that the Commission may grant in the future. This

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<sup>14</sup> A Member using the trade report modifiers under the proposed new rules is responsible for ensuring that the transaction meets the criteria of the specific exemption or exception set forth in Rule 611 of Regulation NMS.

<sup>15</sup> See supra note 8.

authority may also be used to capture additional regulatory information that NASD deems necessary (e.g., NASD will require more specific delineation of the Intermarket Sweep Order (“ISO”) exception than is required by the National Market System specifications).<sup>16</sup> To enable members to make the necessary systems changes, NASD would provide at least 30 days advance written notice relating to any new modifiers.

NASD also proposes to amend Rules 4632C, 4632D, and 4632E to expressly provide that, in the event that the rules require multiple modifiers on any given trade report, members are to report in accordance with guidance published by NASD regarding priorities among modifiers, if such guidance is provided. A Member that reports in accordance with such guidance would not be in violation of the trade reporting rules for failing to use a particular modifier.

NASD believes that the proposed rule change is necessary to ensure that there is transparency relating to trades that are exempt from the trade-through rule and to enhance NASD’s ability to examine for compliance with the Order Protection Rule.

Proposed Amendments to Rules of the Subject TRFs to Conform to NASD/Nasdaq TRF and ADF Rules

NASD proposes changes to conform, to the extent practicable, the reporting rules of the Subject TRFs to the NASD/Nasdaq TRF and ADF reporting rules. Specifically, NASD proposes to reorganize Rule 4632C relating to the NASD/NSX TRF, Rule 4632D relating to the NASD/BSE TRF, and Rule 4632E relating to the NASD/NYSE TRF and renumber paragraphs (a)(3) and (a)(5) of Rule 4632C, paragraphs (a)(3) and (a)(6) of Rule 4632D, and paragraphs (a)(3) and (a)(6) of Rule 4632E, without amending the text of those provisions. NASD also

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<sup>16</sup> The National Market System specifications identify both types of ISO orders with a single modifier. NASD, however, intends to distinguish between the ISO exceptions by requiring firms to use a separate modifier, as defined by NASD, in instances where the executing firm is responsible for sweeping the market.

proposes to renumber paragraphs (a)(4), (a)(6), and (a)(8) of Rule 4632C, paragraphs (a)(5), (a)(8), and (a)(10) of Rule 4632D and paragraphs (a)(5), (a)(8), and (a)(10) of Rule 4632E, and amend the text of those provisions to conform to the text of the equivalent provisions in Rule 4632 relating to the NASD/Nasdaq TRF.

Additionally, NASD proposes to adopt new Rules 4632C(a)(5), 4632D(a)(5), and 4632E(a)(5) to require members to use trade report modifiers designated by NASD for certain enumerated transactions. As with the NASD/Nasdaq TRF and ADF, members will be required to include such modifiers on all trade reports, including reports of “as/of” trades.<sup>17</sup> Consistent with SR-NASD-2007-001 and SR-NASD-2007-002, the proposed amendments to Rules 4632C, 4632D, and 4632E would delete the labels (e.g., .T or .W) for the modifiers that members are required to use when reporting the enumerated transactions. Thus, Rules 4632C, 4632D, and 4632E would identify the types of transactions that must have a unique identifier associated with them, and such modifiers would be labeled in the system technical specifications rather than in the rules.

It should be noted that, because of differences in functionality, not all of the rules relating to NASD’s Trade Reporting Facilities are identical. For example, unlike the NASD/Nasdaq TRF, the NASD/BSE TRF, and the NASD/NYSE TRF, pursuant to current Rule 4632C(a)(7), the NASD/NSX TRF does not accept trade reports for Stop Stock Transactions (as such term is

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<sup>17</sup> The NASD/NSX TRF currently does not accept “as/of” trade reports and the rules for the NASD/BSE TRF, which have been approved by the Commission but are not yet effective, also do not permit the submission of “as/of” trade reports. NASD will file a separate proposed rule change to reflect the reporting of “as/of” trades to the NASD/NSX TRF and NASD/BSE TRF. Thus, upon the operative date of this proposed rule change, members will be required to append all applicable trade report modifiers to “as/of” trade reports submitted to the NASD/NSX TRF and the NASD/BSE TRF. NASD reminds members that they should mark any “as/of” trade report for publication if that trade would have been for publication had it been reported on trade date.

defined in Rule 4200C), transactions occurring at prices based on average-weighting or other special pricing formulae, or transactions that reflect a price different from the current market when the execution price is based on a prior reference point in time. In this proposed rule change, NASD proposes to renumber Rule 4632C(a)(7) as 4632C(a)(8) without amending the text of the rule.

In addition, neither the NASD/NSX TRF nor the NASD/BSE TRF will accept trades reported as other than regular way settlement (see Rules 6130C(a) and 6130D(a), respectively). Thus, unlike Rule 4632(a)(5) relating to the NASD/Nasdaq TRF and Rule 4632E(a)(5) relating to the NASD/NYSE TRF, proposed Rules 4632C(a)(5) and 4632D(a)(5) do not include provisions pertaining to trade report modifiers for Seller's Option, Cash, or Next Day transactions.

As discussed in footnote 17 above, the NASD/NSX TRF and NASD/BSE TRF rules currently do not provide for the submission of "as/of" trade reports; however, once the necessary system changes have been made, NASD will file a separate proposed rule change proposing amendments to Rules 4632C(a)(2)(B) and (D) and 4632D(a)(2)(B) and (D) that are consistent with Rule 4632(a)(2)(B) and (D) and proposed Rule 4632E(a)(2)(B) and (D).

NASD has filed the proposed rule change for immediate effectiveness. In accordance with the Regulation NMS compliance dates established by the Commission,<sup>18</sup> NASD proposes to make the proposed rule change operative on the Pilot Stocks Phase Date, which is currently anticipated to be July 9, 2007. However, members may begin submitting trade reports to the Subject TRFs in compliance with the proposed rule change after the Trading Phase Date, which

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<sup>18</sup> See Securities Exchange Act Release No. 55160 (January 24, 2007), 72 FR 4202 (January 30, 2007).

is currently anticipated to be March 5, 2007. This does not change in any way a member's responsibilities under the Regulation NMS compliance dates.<sup>19</sup>

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>20</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 the proposed rule change facilitates the goals articulated in Regulation NMS, including providing an effective mechanism and regulatory framework for reporting over-the-counter transactions to NASD.

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

NASD does not believe that the proposed rule change will result in 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.

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<sup>19</sup> NASD notes that, although the proposed rule change will not be operative until the Pilot Stocks Phase Date, members may be required to meet the Regulation NMS message format requirements for reporting to the Subject TRFs prior to that date. NASD will notify members of the date of mandatory compliance with Regulation NMS message formatting requirements for the Subject TRFs and on such date, members will be required to report in accordance with the new systems requirements, although the specific new modifiers proposed herein would continue to be voluntary until the Pilot Stocks Phase Date.

<sup>20</sup> 15 U.S.C. 78o-3(b)(6).

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

The foregoing proposed rule change is subject to Section 19(b)(3)(A)(iii) of the Act<sup>21</sup> and Rule 19b-4(f)(6) thereunder<sup>22</sup> because the proposal: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative prior to 30 days after the date of filing or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that NASD has given the Commission notice of its intent to file the proposed rule change, along with a 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.<sup>23</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.

### 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

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<sup>21</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>22</sup> 17 CFR 240.19b-4(f)(6).

<sup>23</sup> NASD has satisfied the five-day pre-filing requirement.

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2007-014 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-2007-014. 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. Copies of the filing also will be available for inspection and copying at the principal office of 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-2007-014 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>24</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>24</sup> 17 CFR 200.30-3(a)(12).