

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55962; File No. SR-NASD-2007-040)

June 26, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Clearing Reports for Previously Executed Trades

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 22, 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 II below, which Items have been substantially prepared by NASD. NASD has designated the proposed rule change as “non-controversial” under Section 19(b)(3)(A)(iii)³ of the Act and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposal 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 is proposing to amend NASD Rules 6130, 6130A, 6130C, 6130D, and 6130E to prohibit members from submitting to an NASD Facility (i.e., the Alternative Display Facility (“ADF”) or a Trade Reporting Facility (“TRF”)) any report (including but not limited to a report of a step-out or a reversal) associated with a previously executed trade that was not reported to the NASD Facility, except where such report reflects the offsetting “riskless” portion of a riskless principal transaction. NASD is also proposing to amend NASD Rules 4632(d),

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(iii).

⁴ 17 CFR 240.19b-4(f)(6).

4632A(e), 4632C(d), 4632D(e), and 4632E(e) to clarify that, where the first leg of a riskless principal transaction is reported to NASD, the second leg must also be reported to NASD; however, in such circumstance, the member is not required to report both legs of the transaction to the same NASD Facility.

The text of the proposed rule change is available at NASD, from the Commission's Public Reference Room, and on the NASD's Web site (<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

Proposed Changes Relating to Reports Associated With Previously Executed Trades

Currently, members can use the ADF and the NASD/Nasdaq TRF to submit non-tape reports (i.e., the transaction is not reported to the tape for publication) and clearing-only reports (i.e., the transaction is not reported to the tape but may be submitted for clearing purposes) for a variety of reasons, including to reallocate or cancel transactions previously executed and reported to the tape by an exchange. For example, Firm A buys 1000 shares of ABC security on the Nasdaq Exchange and then submits a clearing-only report to the ADF or NASD/Nasdaq TRF

to allocate those shares to Firm B (referred to as a “step-out”).⁵ Similarly, a “reversal” is a clearing-only entry that allows a participant to cancel the effects of a prior submission to the National Securities Clearing Corporation.⁶ Such functionality is not prescribed by rule, but rather has been offered as a service to members using the ADF and Nasdaq’s Automated Confirmation Transaction Service (“ACT”).⁷ Such functionality is not supported by any other NASD Facility.

NASD believes that members’ ability to submit non-tape reports should be limited across NASD Facilities for several reasons. First, where the previously executed transaction associated with a non-tape report is reported to an exchange, NASD’s audit trail will not include the original transaction report. The inclusion of a non-tape report that is not related to an NASD transaction report can create confusion and impair NASD staff’s ability to produce a complete and accurate audit trail.

Second, certain non-tape or clearing-only reports that provide for the re-allocation or cancellation of a previously reported transaction can make it more difficult for NASD to tabulate

⁵ A step-out allows a member to allocate all or part of a previously executed trade to another broker-dealer. In other words, a step-out functions as a position transfer, rather than a trade; the parties are not exchanging shares and funds. The step-out function was designed and implemented to facilitate the clearing process for members involved in these types of transactions. See, e.g., NASD Notice to Members 05-11 (February 2005) and NASD Notice to Members 98-40 (May 1998).

⁶ If a participant wants to cancel a previously submitted sell trade, it would have to submit a reversal as a buy to effectively unwind the position at clearing.

⁷ ACT has been licensed for use for trade reporting and clearing and comparison services through the NASD/Nasdaq TRF and also serves as the mechanism for reporting trades that are automatically executed through the Nasdaq Market Center. Nasdaq has advised NASD that it will submit a proposed rule change proposing to allow step-outs on ACT under Nasdaq rules with respect to any trade to which a Nasdaq member is a party, regardless of where it originated.

accurately the aggregate dollar amount of its covered sales for purposes of Section 31 fees.⁸

Entry of such a transactions in an NASD Facility, when the original transaction was reported and assessed a Section 31 fee by an exchange, can result in the misalignment of Section 31 fees with the appropriate market and market participants.

Thus, NASD is proposing to amend NASD Rules 6130 (relating to the NASD/Nasdaq TRF), 6130A (relating to the ADF), 6130C (relating to the NASD/NSX TRF), 6130D (relating to the NASD/BSE TRF), and 6130E (relating to the NASD/NYSE TRF) to provide that a member shall not submit to an NASD Facility any report (including but not limited to a report of a step-out or reversal) associated with a previously executed trade that was not reported to that NASD Facility. For example, a clearing-only entry for a step-out relating to a trade reported to the Nasdaq Exchange may not be submitted to the NASD/Nasdaq TRF. This proposed rule language also clarifies that a member is not permitted to report a trade to an NASD Facility for submission to the National Securities Clearing Corporation for clearance and settlement purposes, if the trade was not reported to that same NASD Facility for public dissemination purposes. Thus, for example, a member may not tape report a trade to the NASD/NYSE TRF and use the NASD/Nasdaq TRF to clear that same trade.

However, NASD is proposing an exception to this prohibition for reports that reflect the offsetting “riskless” portion of a riskless principal transaction. For purposes of over-the-counter trade reporting requirements applicable to equity securities, a “riskless principal” transaction is a transaction in which a member, after having received an order to buy (sell) a security, purchases (sells) the security as principal and satisfies the original order by selling (buying) as principal at

⁸ For example, as explained in NASD Notice to Members 05-11 (February 2005), as part of the step-out function, ACT provides the ability to move the obligation to pay the transaction fee associated with the trade to the ultimate seller of the security when the trade is allocated.

the same price (the offsetting, “riskless” leg). A riskless principal transaction can be submitted to NASD as a single trade report properly marked as riskless principal, or by submitting two separate reports: (1) a report that is submitted to the tape to reflect the initial leg of the transaction; and (2) a non-tape (or clearing-only) report to reflect the offsetting, “riskless” leg of the transaction. Where a member chooses to report a riskless principal transaction to NASD by submitting two separate reports, both the tape report and non-tape (or clearing-only) report must be submitted to an NASD Facility. Where the initial leg of the transaction is executed on and reported through an exchange, a tape report would not be submitted to an NASD Facility to reflect the initial leg; however, a member is permitted, but not required, to submit a non-tape (or clearing-only) report for the second leg of the transaction to an NASD Facility.

NASD believes it is appropriate to continue to permit a member to submit a non-tape (or clearing-only) report for the second leg of a riskless principal transaction to an NASD Facility, even where the first leg of the transaction has been reported to the tape by an exchange, in light of the unique nature of riskless principal transactions. A riskless principal transaction is the economic equivalent of a single agency trade and therefore the second riskless principal report is suppressed from the tape to avoid double reporting and overstatement of volume, notwithstanding that, technically, it is a separate trade. In addition, the second leg, if appropriately reported pursuant to NASD rules, is not subject to Section 31 fees. Accordingly, the proposed rule language includes an express carve-out to permit a report of an offsetting second leg of a riskless principal transaction submitted to an NASD Facility in connection with a first leg executed on and reported to an exchange.

The proposed rule change will ensure consistency across NASD Facilities, promote a more complete and accurate audit trail, and enable NASD to properly assess applicable

transaction-related fees. As noted above, currently only the ADF and NASD/Nasdaq TRF offer the above-described functionality relating to step-outs and reversals and, thus, the proposed rule change would require a systems change only for certain members using those facilities. With respect to the other NASD Facilities, the proposed rule change would merely codify current functionality.

Clarifying Changes to Riskless Principal Reporting Requirements

Currently, the rules relating to NASD's TRFs require that, where the initial leg of a riskless principal transaction was reported to a TRF, the second leg must also be reported to that same TRF.⁹ NASD is proposing to revise these rules to clarify that, where the first leg of a riskless principal transaction was reported to NASD, the second leg must also be reported to NASD; however, in that circumstance, the member is not required to report both legs to the same TRF. NASD believes that the current provisions are too restrictive and could have the unintended consequence of requiring members to be participants in all TRFs in order to comply with NASD rules.¹⁰ NASD expects that, where possible, a member will report both legs of a riskless principal transaction to the same NASD Facility. NASD also is proposing conforming changes to NASD Rule 4632A(e)(1)(C)(ii) relating to the ADF.

⁹ See NASD Rules 4632(d)(3)(B), 4632C(d)(3)(B), 4632D(e)(3)(B), and 4632E(e)(3)(B).

¹⁰ For example, assume Firm A is only a participant of TRF A and it executes the first leg of a riskless principal transaction otherwise than on exchange with Firm B, which is only a participant of TRF B. Assume further that Firm B has the reporting obligation under NASD rules. The initial leg of the riskless principal transaction will be reported by Firm B to TRF B. Firm A must report the second leg of the riskless principal transaction to NASD, but because it is not a participant of TRF B, it cannot report the second leg to TRF B. The proposed changes would allow Firm A to report the second leg of the transaction to TRF A.

NASD is filing the proposed rule change for immediate effectiveness. The proposed rule change will not become operative prior to the thirtieth day after the date of filing. NASD will announce the operative date on its Web site.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹¹ 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 will promote a more complete and accurate audit trail and enable NASD to properly assess applicable transaction-related fees.

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.

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

Because the proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 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, the proposed

¹¹ 15 U.S.C. 78q-3(b)(6).

rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹² and subparagraph (f)(6) of Rule 19b-4 thereunder.¹³

At any time within 60 days of the filing of the 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 the 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
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2007-040 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-2007-040. 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

¹² 15 U.S.C. 78s(b)(3)(A).

¹³ 17 CFR 240.19b-4(f)(6).

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 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-2007-040 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.¹⁴

Florence E. Harmon
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).