

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-49556; File No. SR-NASD-2004-059)

April 12, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change by the National Association of Securities Dealers, Inc. Regarding an Interpretation to its Trade Through Rule for Exchange-Listed Securities

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 April 2, 2004, the National Association of Securities Dealers, Inc. (“NASD”), through its subsidiary, The Nasdaq Stock Market, Inc. (“Nasdaq”), 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 Nasdaq. Nasdaq has designated this proposal as a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule pursuant to Section 19(b)(3)(A) of the Act,<sup>3</sup> and Rule 19b-4(f)(1)<sup>4</sup> thereunder, 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

Nasdaq proposes an interpretation to Rule 5262 (“Trade-Throughs”) establishing that certain executions in exchange-listed securities will not be considered trade-throughs if a commitment to trade is sent contemporaneously via the Intermarket Trading System (“ITS”) with the execution to another market center to fully satisfy that other market’s quotation.

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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)(1).

The text of the proposed rule change is below. Proposed new language is underlined; proposed deletions are in brackets.

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**Rule 5262. Trade-Throughs**

(a) – (c) No Change.

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IM 5262-1. Contemporaneous Sending Of Commitments

The terms “trade-through” and “third participating market center trade-through” do not include the situation where a member who initiates the purchase (sale) of an ITS Security, at a price which is higher (lower) than the price at which the security is being offered (bid) in another ITS participating market, sends contemporaneously through ITS to such ITS participating market a commitment to trade at such offer (bid) price or better and for at least the number of shares displayed with that market center’s better-priced offer (bid). A trade-through complaint sent in these circumstances is not valid, even if the commitment sent in satisfaction cancels or expires, and even if there is more stock behind the quote in the other market.

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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, Nasdaq 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. Nasdaq 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Nasdaq market center operates facilities for quoting and trading exchange-listed securities. Nasdaq’s facilities are linked with exchanges that trade these securities via the Intermarket Trading System (“ITS”), which is governed by a national market system plan (“ITS Plan”).<sup>5</sup> The ITS Plan requires each participant, including Nasdaq, to adopt a rule—Rule 5262—prohibiting participants from trading ITS securities at a price which is lower than the bid or higher than the offer displayed from an ITS Participant Exchange or ITS/CAES Market Maker.<sup>6</sup> The rationale for the so-called “Trade-Through Rule” is that superior priced quotations in a security displayed from other participant markets should be protected or satisfied if, in another participant market, an execution in the security occurs at an inferior price. Under Rule 5262, one remedy for a trade-through is that, upon a valid complaint of a trade-through, a commitment to trade, at the price and for the number of shares in the disseminated quotation, must be sent to the other participant market to fully satisfy such quotation.

The proposed interpretation of Rule 5262 recognizes that superior quotations are fully protected/satisfied if an ITS commitment is sent to trade with a bid/offer that would otherwise appear to have been traded through. That is, a trade will not be considered a trade-through if an ITS commitment is sent contemporaneously from the participant executing the trade for the

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<sup>5</sup> The ITS Plan was approved on a permanent basis on January 27, 1983. See Securities Exchange Act Release No. 19456 (January 27, 1983), 48 FR 4938. Signatories to the ITS Plan include the American Stock Exchange, LLC, the Boston Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., the Chicago Stock Exchange, Inc., the Cincinnati Stock Exchange, Inc. (now known as the National Securities Exchange), the NASD, the New York Stock Exchange, Inc. (“NYSE”), the Pacific Exchange, Inc., and the Philadelphia Stock Exchange, Inc.

<sup>6</sup> Capitalized terms are defined in NASD Rule 5210.

purpose of being executed against the better-priced displayed bid or offer. A complaint is not valid even if a commitment cancels or expires and even if there is more stock behind the quote in the other market. Furthermore, the interpretation recognizes the impracticality of having to wait for the other market to revise its quotation as a result of trading with a satisfying commitment before trading activity may occur in other markets.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the Act, including Section 15A(b)(6)<sup>7</sup> of the Act, which requires, among other things, that a registered national securities association's rules be designed 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 and perfect the mechanisms of a free and open market and a national market system, and to protect investors and the public interest. Nasdaq believes that the proposed rule change is consistent with these requirements because it will facilitate transactions in securities, remove impediments to a free and open market, and protect investors by improving the transparency and efficiency of transactions.

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

Nasdaq 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>7</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 rule change has become effective pursuant to Section 19(b)(3)(A)(i)<sup>8</sup> of the Act, and subparagraph (f)(1) of Rule 19b-4 thereunder,<sup>9</sup> because it is concerned solely with the interpretation of the meaning, administration or enforcement of existing NASD Rule 5262.

At any time within 60 days of the filing of a rule change pursuant to Section 19(b)(3)(A) of the Act, the Commission may summarily abrogate the 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
- Send an E-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2004-059 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, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2004-059. 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

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<sup>8</sup> 15 U.S.C 78s(b)(3)(A)(i).

<sup>9</sup> 17 CFR 240.19b-4(f)(1).

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, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the 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-2004-059 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>10</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>10</sup> 17 CFR 200.30-3(a)(12).