

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51278; File No. SR-NASD-2005-027)

February 28, 2005

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of
Proposed Rule Change by the National Association of Securities Dealers, Inc. Clarifying
Members' Obligations to Report Cancelled 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 February 14, 2005, 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. 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 the Substance of the Proposed Rule Change Regarding Reporting of Cancelled Trades

Nasdaq proposes to clarify members' obligations to report the cancellation of trades previously submitted to the Nasdaq Market Center. Pursuant to Section 19(b)(3)(A)(i) of the Act³ and Rule 19b-4(f)(6)⁴ thereunder, Nasdaq has designated this proposal as effecting a change that does not significantly affect the protection of investors or the public interest, and does not impose any significant burden on competition. Nasdaq is proposing to make the change operative 60 days after the date of filing.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(i).

⁴ 17 CFR 240.19b-4(f)(6).

Nasdaq has provided the Commission the pre-filing notification as required by subparagraph (iii) of Rule 19b-4(f)(6).

The text of the proposed rule change is below. Proposed new language is italicized; proposed deletions are in brackets.⁵

* * * * *

4630. Reporting Transactions in Nasdaq National Market Securities

* * * * *

4632. Transaction Reporting

* * * * *

(g) Reporting Cancelled Trades

(1) Obligation and Party Responsible for Reporting Cancelled Trades

With the exception of trades cancelled by Nasdaq staff in accordance with Rule 11890, members shall report to the Nasdaq Market Center the cancellation of any trade previously submitted to the Nasdaq Market Center. The member responsible under Rule 5430(b) for submitting the original trade report shall submit the cancellation report in accordance with the procedures set forth in paragraph (g)(2). For trades executed through a Nasdaq system that automatically reports trades to the Nasdaq Market Center, the member that would have been required by Rule 5430(b) to report the trade (but for the trade being reported automatically by the Nasdaq system) shall submit the cancellation report in accordance with the procedures set forth in paragraph (g)(2).

⁵ The proposed rule change is marked to show changes from the rule as it appears in the electronic NASD Manual available at www.nasd.com.

(2) Deadlines for Reporting Cancelled Trades

(A) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] before 5:13:30 p.m. on the date of execution, the member responsible under paragraph (g)(1) shall report the cancellation within 90 seconds of the time the trade is cancelled [decision to cancel the trade].

(B) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 5:13:30 p.m., but before 5:15 p.m. on the date of execution, the member responsible under paragraph (g)(1) shall use its best efforts to report the cancellation not later than 5:15 p.m. on the date of execution, and otherwise it shall report the cancellation on the following business day by 6:30 p.m.

(C) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 5:15 p.m. on the date of execution, the member responsible under paragraph (g)(1) shall report the cancellation on the following business day by 6:30 p.m.

(D) For trades executed outside the hours of 9:30 a.m. to 4:00 p.m. Eastern Time and cancelled [for which a decision to cancel is made] prior to 6:30 p.m. on the date of execution, the member responsible for reporting under paragraph (g)(1) shall report the cancellation by 6:30 p.m.

(E) For trades executed outside the hours of 9:30 a.m. to 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 6:30 p.m. on the date of execution, the member responsible under paragraph (g)(1) shall report the cancellation on the following business day by 6:30 p.m.

(F) For any trade cancelled [for which the decision to cancel occurs] on any date after the date of execution, the member responsible under paragraph (g)(1) shall report the cancellation (i) [if the decision to cancel occurs before 6:30 p.m., then] by 6:30 p.m. on the date of cancellation if the trade is cancelled before 6:30 p.m. [when the decision to cancel occurs], or (ii) [if the decision to cancel occurs at or after 6:30 p.m., then] by 6:30 p.m. on the following business day if the trade is cancelled at or after 6:30 p.m.

(G) For purposes of determining the deadline by which a trade cancellation must be reported to Nasdaq pursuant to subparagraph (g) of this rule the term “cancelled” shall mean the time at which (i) the member with the reporting responsibility informs its contra party, or is informed by its contra party, that a trade is being cancelled, (ii) the member with the reporting responsibility and its contra party agree to cancel a trade if neither party can unilaterally cancel the trade, or (iii) the member with the reporting responsibility takes an action to cancel the trade on its books and records, whichever event occurs first.

* * * * *

4640. Reporting Transactions in Nasdaq SmallCapSM Market Securities

* * * * *

4642. Transaction Reporting

* * * * *

(g) Reporting Cancelled Trades

(1) Obligation and Party Responsible for Reporting Cancelled Trades

With the exception of trades cancelled by Nasdaq staff in accordance with Rule 11890, members shall report to the Nasdaq Market Center the cancellation of any trade previously submitted to the Nasdaq Market Center. The member responsible under Rule 5430(b) for submitting the original trade report shall submit the cancellation report in accordance with the procedures set forth in paragraph (g)(2). For trades executed through a Nasdaq system that automatically reports trades to the Nasdaq Market Center, the member that would have been required by Rule 5430(b) to report the trade (but for the trade being reported automatically by the Nasdaq system) shall submit the cancellation report in accordance with the procedures set forth in paragraph (g)(2).

(2) Deadlines for Reporting Cancelled Trades

(A) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] before 5:13:30 p.m. on the date of execution, the member responsible under paragraph (g)(1) shall report the cancellation within 90 seconds of the time the trade is cancelled [decision to cancel the trade].

(B) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 5:13:30 p.m., but before 5:15 p.m. on the date of execution, the member responsible under

paragraph (g)(1) shall use its best efforts to report the cancellation not later than 5:15 p.m. on the date of execution, and otherwise it shall report the cancellation on the following business day by 6:30 p.m.

(C) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 5:15 p.m. on the date of execution, the member responsible under paragraph (g)(1) shall report the cancellation on the following business day by 6:30 p.m.

(D) For trades executed outside the hours of 9:30 a.m. to 4:00 p.m. Eastern Time and cancelled [for which a decision to cancel is made] prior to 6:30 p.m. on the date of execution, the member responsible for reporting under paragraph (g)(1) shall report the cancellation by 6:30 p.m.

(E) For trades executed outside the hours of 9:30 a.m. to 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 6:30 p.m. on the date of execution, the member responsible under paragraph (g)(1) shall report the cancellation on the following business day by 6:30 p.m.

(F) For any trade cancelled [for which the decision to cancel occurs] on any date after the date of execution, the member responsible under paragraph (g)(1) shall report the cancellation (i) [if the decision to cancel occurs before 6:30 p.m., then] by 6:30 p.m. on the date of cancellation if the trade is cancelled before 6:30 p.m. [when the decision to cancel occurs], or (ii) [if the decision to cancel

occurs at or after 6:30 p.m., then] by 6:30 p.m. on the following business day if the trade is cancelled at or after 6:30 p.m.

(G) For purposes of determining the deadline by which a trade cancellation must be reported to Nasdaq pursuant to subparagraph (g) of this rule the term “cancelled” shall mean the time at which (i) the member with the reporting responsibility informs its contra party, or is informed by its contra party, that a trade is being cancelled, (ii) the member with the reporting responsibility and its contra party agree to cancel a trade if neither party can unilaterally cancel the trade, or (iii) the member with the reporting responsibility takes an action to cancel the trade on its books and records, whichever event occurs first.

* * * * *

4650. Reporting Transactions in Nasdaq Convertible Debt Securities

* * * * *

4652. Transaction Reporting

* * * * *

(g) Reporting Cancelled Trades

(1) Obligation and Party Responsible for Reporting Cancelled Trades

With the exception of trades cancelled by Nasdaq staff in accordance with Rule 11890, members shall report to the Nasdaq Market Center the cancellation of any trade previously submitted to the Nasdaq Market Center. The member responsible under Rule 5430(b) for submitting the original trade report shall submit the cancellation report in accordance with the procedures set forth in

paragraph (g)(2). For trades executed through a Nasdaq system that automatically reports trades to the Nasdaq Market Center, the member that would have been required by Rule 5430(b) to report the trade (but for the trade being reported automatically by the Nasdaq system) shall submit the cancellation report in accordance with the procedures set forth in paragraph (g)(2).

(2) Deadlines for Reporting Cancelled Trades

(A) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] before 5:13:30 p.m. on the date of execution, the member responsible under paragraph (g)(1) shall report the cancellation within 90 seconds of the time the trade is cancelled [decision to cancel the trade].

(B) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 5:13:30 p.m., but before 5:15 p.m. on the date of execution, the member responsible under paragraph (g)(1) shall use its best efforts to report the cancellation not later than 5:15 p.m. on the date of execution, and otherwise it shall report the cancellation on the following business day by 6:30 p.m.

(C) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 5:15 p.m. on the date of execution, the member responsible under paragraph (g)(1) shall report the cancellation on the following business day by 6:30 p.m.

(D) For trades executed outside the hours of 9:30 a.m. to 4:00 p.m. Eastern Time and cancelled [for which a decision to cancel is made] prior to 6:30 p.m. on the date of execution, the member responsible for reporting under paragraph (g)(1) shall report the cancellation by 6:30 p.m.

(E) For trades executed outside the hours of 9:30 a.m. to 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 6:30 p.m. on the date of execution, the member responsible under paragraph (g)(1) shall report the cancellation on the following business day by 6:30 p.m.

(F) For any trade cancelled [for which the decision to cancel occurs] on any date after the date of execution, the member responsible under paragraph (g)(1) shall report the cancellation (i) [if the decision to cancel occurs before 6:30 p.m., then] by 6:30 p.m. on the date of cancellation if the trade is cancelled before 6:30 p.m. [when the decision to cancel occurs], or (ii) [if the decision to cancel occurs at or after 6:30 p.m., then] by 6:30 p.m. on the following business day if the trade is cancelled at or after 6:30 p.m.

(G) For purposes of determining the deadline by which a trade cancellation must be reported to Nasdaq pursuant to subparagraph (g) of this rule the term “cancelled” shall mean the time at which (i) the member with the reporting responsibility informs its contra party, or is informed by its contra party, that a trade is being cancelled, (ii) the member with the reporting responsibility and its contra party agree to cancel a trade if neither party can unilaterally cancel

the trade, or (iii) the member with the reporting responsibility takes an action to cancel the trade on its books and records, whichever event occurs first.

* * * * *

6420. Transaction Reporting

* * * * *

(f) Reporting Cancelled Trades

(1) Obligation and Party Responsible for Reporting Cancelled Trades

With the exception of trades cancelled by Nasdaq staff in accordance with Rule 11890, members shall report to the Nasdaq Market Center the cancellation of any trade previously submitted to the Nasdaq Market Center. The member responsible under Rule 6420 for submitting the original trade report shall submit the cancellation report in accordance with the procedures set forth in paragraph (f)(2). For trades executed through a Nasdaq system that automatically reports trades to the Nasdaq Market Center, the member that would have been required by Rule 6420 to report the trade (but for the trade being reported automatically by the Nasdaq system) shall submit the cancellation report in accordance with the procedures set forth in paragraph (f)(2).

(2) Deadlines for Reporting Cancelled Trades

(A) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] before 5:13:30 p.m. on the date of execution, the member responsible under paragraph (f)(1) shall report the cancellation within 90 seconds of the time the trade is cancelled [decision to cancel the trade].

(B) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 5:13:30 p.m., but before 5:15 p.m. on the date of execution, the member responsible under paragraph (f)(1) shall use its best efforts to report the cancellation not later than 5:15 p.m. on the date of execution, and otherwise it shall report the cancellation on the following business day by 6:30 p.m.

(C) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 5:15 p.m. on the date of execution, the member responsible under paragraph (f)(1) shall report the cancellation on the following business day by 6:30 p.m.

(D) For trades executed outside the hours of 9:30 a.m. to 4:00 p.m. Eastern Time and cancelled [for which a decision to cancel is made] prior to 6:30 p.m. on the date of execution, the member responsible for reporting under paragraph (f)(1) shall report the cancellation by 6:30 p.m.

(E) For trades executed outside the hours of 9:30 a.m. to 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 6:30 p.m. on the date of execution, the member responsible under paragraph (f)(1) shall report the cancellation on the following business day by 6:30 p.m.

(F) For any trade cancelled [for which the decision to cancel occurs] on any date after the date of execution, the member responsible under paragraph (f)(1) shall report the cancellation (i) [if the decision to cancel occurs before 6:30

p.m., then] by 6:30 p.m. on the date of cancellation if the trade is cancelled before 6:30 p.m. [when the decision to cancel occurs], or (ii) [if the decision to cancel occurs at or after 6:30 p.m., then] by 6:30 p.m. on the following business day if the trade is cancelled at or after 6:30 p.m.

(G) For purposes of determining the deadline by which a trade cancellation must be reported to Nasdaq pursuant to subparagraph (f) of this rule the term “cancelled” shall mean the time at which (i) the member with the reporting responsibility informs its contra party, or is informed by its contra party, that a trade is being cancelled, (ii) the member with the reporting responsibility and its contra party agree to cancel a trade if neither party can unilaterally cancel the trade, or (iii) the member with the reporting responsibility takes an action to cancel the trade on its books and records, whichever event occurs first.

* * * * *

6600. REPORTING TRANSACTIONS IN OVER-THE-COUNTER EQUITY SECURITIES

* * * * *

6620. Transaction Reporting

* * * * *

(f) Reporting Cancelled Trades

(1) Obligation and Party Responsible for Reporting Cancelled Trades

With the exception of trades cancelled by Nasdaq staff in accordance with Rule 11890, members shall report to the Nasdaq Market Center the cancellation of any trade previously submitted to the Nasdaq Market Center. The member

responsible under Rule 6620 for submitting the original trade report shall submit the cancellation report in accordance with the procedures set forth in paragraph (f)(2). For trades executed through a Nasdaq system that automatically reports trades to the Nasdaq Market Center, the member that would have been required by Rule 6620 to report the trade (but for the trade being reported automatically by the Nasdaq system) shall submit the cancellation report in accordance with the procedures set forth in paragraph (f)(2).

(2) Deadlines for Reporting Cancelled Trades

(A) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] before 5:13:30 p.m. on the date of execution, the member responsible under paragraph (f)(1) shall report the cancellation within 90 seconds of the time the trade is cancelled [decision to cancel the trade].

(B) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 5:13:30 p.m., but before 5:15 p.m. on the date of execution, the member responsible under paragraph (f)(1) shall use its best efforts to report the cancellation not later than 5:15 p.m. on the date of execution, and otherwise it shall report the cancellation on the following business day by 6:30 p.m.

(C) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 5:15 p.m. on the date

of execution, the member responsible under paragraph (f)(1) shall report the cancellation on the following business day by 6:30 p.m.

(D) For trades executed outside the hours of 9:30 a.m. to 4:00 p.m. Eastern Time and cancelled [for which a decision to cancel is made] prior to 6:30 p.m. on the date of execution, the member responsible for reporting under paragraph (f)(1) shall report the cancellation by 6:30 p.m.

(E) For trades executed outside the hours of 9:30 a.m. to 4:00 p.m. Eastern Time and cancelled [for which the decision to cancel occurs] after 6:30 p.m. on the date of execution, the member responsible under paragraph (f)(1) shall report the cancellation on the following business day by 6:30 p.m.

(F) For any trade cancelled [for which the decision to cancel occurs] on any date after the date of execution, the member responsible under paragraph (f)(1) shall report the cancellation (i) [if the decision to cancel occurs before 6:30 p.m., then] by 6:30 p.m. on the date of cancellation if the trade is cancelled before 6:30 p.m. [when the decision to cancel occurs], or (ii) [if the decision to cancel occurs at or after 6:30 p.m., then] by 6:30 p.m. on the following business day if the trade is cancelled at or after 6:30 p.m.

(G) For purposes of determining the deadline by which a trade cancellation must be reported to Nasdaq pursuant to subparagraph (f) of this rule the term “cancelled” shall mean the time at which (i) the member with the reporting responsibility informs its contra party, or is informed by its contra party,

that a trade is being cancelled, (ii) the member with the reporting responsibility and its contra party agree to cancel a trade if neither party can unilaterally cancel the trade, or (iii) the member with the reporting responsibility takes an action to cancel the trade on its books and records, whichever event occurs first.

* * * * *

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

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

1. Purpose

On July 22, 2004, the Commission approved a proposed rule change requiring members to report to Nasdaq the cancellation of any trade previously reported to Nasdaq, unless the trade is cancelled by Nasdaq staff.⁶ Soon after Commission approval, questions were raised about the meaning of certain text in the new rules. Specifically, the rule requires trades executed and cancelled during normal market hours to be reported within 90 seconds of “the decision to cancel the trade.” Trades cancelled outside normal market hours also must be reported by certain specified times. Because the phrase “the decision to cancel the trade” is susceptible to multiple legitimate interpretations, thus making it difficult to impose a uniform standard against which compliance with the rule can be judged, Nasdaq is proposing new language to clarify the events that trigger the reporting obligation. The events are as follows: (1) when the member with the reporting obligation informs its contra party, or is informed by its contra party, that a trade is being cancelled, (2) when the member and its contra party agree to cancel a trade if neither

⁶ See Securities Exchange Act Release No. 50059 (July 22, 2004), 69 FR 45103 (July 28, 2004).

party has the ability to unilaterally cancel it, or (3) the member takes an action to cancel the trade on its books and records. The new language also makes it clear that the earliest occurrence of any one of three specified events triggers the reporting obligation. For example, if a member and its contra party decide at 11:00 a.m. that a trade executed that same day (after 9:30 a.m.) should be cancelled, the member with the reporting obligation must report the cancellation to Nasdaq by 11:01:30 a.m., even if the member does not take action to remove the trade from its books and records until some time later that day. Requiring the trigger to be the earliest of the three events is designed to ensure the reporting of the cancellation as soon as possible.⁷

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,⁸ in general, and with Section 15A(b)(6) of the Act,⁹ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, and to protect investors and the public interest. The proposed rule change will establish clear standards for determining when the obligation to report a cancelled trade is triggered, and thus it assists members in complying with the reporting obligation. The clear standards also will make it easier for the NASD to audit for compliance with the rule.

⁷ The original proposed rule change and this current filing only establish an obligation to report cancellations and do not establish rules governing the circumstance in which it is permissible to cancel trades.

⁸ 15 U.S.C. 78o-3.

⁹ 15 U.S.C. 78o-3(b)(6).

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, as amended.

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 foregoing 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 from the date on which it was filed,¹⁰ or such

shorter time as the Commission may designate, it has become effective pursuant to 19(b)(3)(A) of the Act¹¹ and Rule 19b-4(f)(6)¹² thereunder.

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.¹³

¹⁰ Nasdaq has provided the Commission the pre-filing notification as required by subparagraph (iii) of Rule 19b-4(f)(6), and intends to make the change operative 60 days after the date of filing.

¹¹ 15 U.S.C. 78s(b)(3)(A).

¹² 17 CFR 240.19b-4(f)(6).

¹³ 15 U.S.C. 78s(b)(3)(C).

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-2005-027 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-2005-027. 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 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-2005-027 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

Margaret H. McFarland
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).