

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-53132; File No. SR-NASD-2005-144)

January 17, 2006

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change Relating to Order Entry and Execution Practices

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 December 8, 2005, 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 prepared by NASD. 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 add Rule 3380 to prohibit members and associated persons from splitting any order into multiple smaller orders for execution or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind payment to the member or associated persons as a result of the execution of such orders or the transaction reporting of such executions. The text of the proposed rule change appears below. Additions are underlined.

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**3380. Order Entry and Execution Practices**

No member or associated person may engage in conduct that has the intent or effect of splitting any order into multiple smaller orders for execution or any execution into multiple

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind amount to be received by the member or associated person as a result of the execution of such orders or the transaction reporting of such executions. For purposes of this rule, “monetary or in-kind amount” shall be defined to include, but not be limited to, any credits, commissions, gratuities, payments for or rebates of fees, or any other payments of value to the member or associated person.

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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, 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

“Trade shredding” is a term used to describe the practice of splitting customer orders for securities into multiple smaller orders (e.g., a 1,000 share order is split into 10 100 share orders) for the primary purpose of maximizing payments or rebates to the member. Among other things, concerns have been raised about market participants increasingly engaging in the practice of trade shredding as a means to increase their share of market data revenues under the joint industry plans (“Plans”),<sup>3</sup> where the Plan participant has adopted a practice of sharing its Plan

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<sup>3</sup> The three joint-industry plans are (1) the CTA Plan, which is operated by the Consolidated Tape Association and disseminates transaction information for exchange-listed securities, (2)

revenues with market participants who send it orders. Specifically, because the current allocation formulas for distributing Plan income heavily emphasize the number of trades, no matter how small the size of the trade, an incentive can exist for market participants to engage in distortive behavior, such as trade shredding, as a means to increase their share of market data revenues.

To address these concerns, among others, the Commission adopted Regulation NMS, which contains amendments to the current Plan formulas used to allocate Plan income.<sup>4</sup> These modifications incorporate a more broad-based measure of a self-regulatory organization's ("SRO") contribution to the consolidated trade stream, including both an SRO's quotes and trades, intended to reduce the incentives for trade shredding.

Although these modifications in Plan formulas should reduce the incentives for trade shredding, the Commission continues to believe that SRO rules prohibiting trade shredding are necessary and appropriate and has requested that all SROs implement rule changes to inhibit the practice of trade shredding. In response to the Commission's request, NASD is proposing to adopt new Rule 3380, which would prohibit such practices. Specifically, new Rule 3380 would prohibit members and associated persons from splitting any order into multiple smaller orders for execution or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind payment to the member or associated persons as a result of the execution of such orders or the transaction reporting of such executions. For purposes of the proposed new rule, "monetary or in-kind amount" shall be defined to

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the CQ Plan, which disseminates consolidated quotation information for exchange-listed securities, and (3) the Nasdaq UTP Plan, which disseminates consolidated transaction and quotation information for Nasdaq-listed securities.

<sup>4</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

include, but not be limited to credits, commissions, gratuities, payments for or rebates of fees, or any other payments of value to the member or associated person.

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act,<sup>5</sup> which requires, among other things, that NASD rules must 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 further the goal of preventing manipulative acts and practices by prohibiting this potentially distortive practice.

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

NASD believes that the proposed rule change will impose no 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

NASD has neither solicited nor received comments on this proposal.

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

Within 35 days of the date of 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 organization consents, the Commission will:

(A) by order approve such proposed rule change, or

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<sup>5</sup> 15 U.S.C. 78q-3(b)(6).

(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-NASD-2005-144 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2005-144. 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 such filing also will be available for inspection and copying at the principal offices 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-2005-144 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>6</sup>

Nancy M. Morris  
Secretary

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<sup>6</sup> 17 CFR 200.30-3(a)(12).