

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54018; File No. SR-NSX-2006-06)

June 20, 2006

Self-Regulatory Organizations; National Stock Exchange; Notice of Filing of Proposed Rule Change to Allow the Primary Market Print Protection Rule to be Applied on an Optional Basis

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 April 12, 2006, the National Stock Exchange (“NSX” or “Exchange”) 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 the Exchange. 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

The Exchange proposes to amend NSX Rule 11.9(u), which pertains to the preferencing of public agency limit orders that a dealer represents as agent, to eliminate the specific requirement that a Designated Dealer execute eligible limit orders if certain conditions occur in the primary market (referred to as the “primary market print protection” or the “limit order protection” provision). Dealers and members would still be permitted, but not required, to guarantee the execution of a limit order as principal upon the occurrence of a transaction in another market. The text of the proposed rule change is set forth below. Proposed new language is in *italics*. Proposed deletions are in [brackets].

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Rule 11.9 National Securities Trading System

(a) – (u) No change.

Interpretations And Policies

.01 Limit Order Protection

Public agency limit orders in securities [other than Nasdaq/NNM Securities shall] may be filled if one of the following conditions occur:

(a) the bid or offering at the limit price has been exhausted in the primary market (NOTE: orders will be executed in whole or in part, based on the rules of priority and precedence, on a share for share basis with trades executed at the limit price in the primary market);

(b) there has been a price penetration of the limit in the primary market; or

(c) the issue is trading at the limit price on the primary market, unless it can be demonstrated that such order would not have been executed if it had been transmitted to the primary market or the customer and the Designated Dealer agree to a specific volume related or other criteria for requiring a fill.

(d) with respect to paragraph (c) above, if the issue has traded in a primary market's after-hours closing price trading session, the Designated Dealer shall fill limit orders designated as eligible for limit order protection based on volume that prints in a primary market's after-hours closing price trading session (a "GTX" order) at such limit price.

[In unusual trading situations, a Designated Dealer may seek relief from the above requirements from two Trading Practices Committee members or a designated member of the Exchange staff who would have the authority to set execution prices.]

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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, NSX included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it had received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NSX 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

The Exchange proposes to amend NSX Rule 11.9(u), which pertains to the preferencing of public agency limit orders that a dealer represents as agent, to eliminate the primary market print protection provision contained in Interpretation and Policy .01.³ However, dealers and other members would still be permitted, but not required, to execute orders pursuant to the limit order guarantee provisions in NSX Rule 11.9(a)(12), (k), (l), and (p).

NSX Rule 11.9(u), Interpretation and Policy .01 sets out specific primary market-related execution guarantees for non-Nasdaq-listed securities. Under the primary market print protection policy, a public agency limit order in an exchange-listed security routed to an NSX dealer for execution on NSX would be filled if the bid or offering at the limit price has been exhausted in the primary market; there has been a price penetration of the limit in the primary

³ Interpretation and Policy .01 to NSX Rule 11.9(u) was initially adopted as part of the Exchange's (then known as The Cincinnati Stock Exchange or "CSE") preferencing program in 1996. See Securities Exchange Act Release No. 37046 (March 29, 1996), 61 FR 15322 (April 5, 1996) (File No. SR-CSE-95-03).

market; or the issue is trading at the limit price on the primary market, unless it can be demonstrated that such order would not have been executed if it had been transmitted to the primary market or the customer and the Designated Dealers agree to a specific volume related or other criteria for requiring a fill.⁴ NSX states that, at the time this policy was adopted, the listing markets were generally the primary source of liquidity, the minimum price variation was 1/8 point, and more size was available at the national best bid or offer (“NBBO”). The larger spreads and quote sizes could create situations where a security might trade in the primary market all day at a customer limit price without an NSX dealer’s customer limit order being filled absent the requirement that Designated Dealers provide primary market print protection. The Exchange states that the primary market print protection thus provided a means to ensure that a customer limit order received as timely an execution as it would have received on the primary and was also a competitive tool to attract order flow to the NSX dealer units.

The Exchange proposes to eliminate the requirement for Designated Dealers to provide primary market print protection in light of changes in the industry that have occurred since the requirement was first adopted in 1996. Since that time, the industry has converted to decimal trading and the availability of liquidity at the NBBO price point has declined, in many cases significantly. NSX states that, as a result, a dealer that may choose to offset his position in the primary market may often encounter great difficulty in accessing liquidity at the primary market

⁴ With respect to paragraph (c), the rule provides that, if the issue has traded in a primary market’s after-hours closing price trading session, the Designated Dealer shall fill limit orders designated as eligible for limit order protection based on volume that prints in a primary market’s after-hours closing trading session (a “GTX” order) at such limit price. The interpretation also provides that dealers may seek relief from the limit order protection requirements in unusual trading situations.

price that it is obligated to provide. This is particularly true in the case of manually-executed orders, given the associated time latency and the frequency with which quotes in markets change.

In addition to decimalization, the Commission has adopted the order handling rules, including the limit order display requirements of Rule 604 of Regulation NMS under the Act.⁵ The display of a limit order, in conjunction with the requirements that other markets not trade-through that price, makes it more likely that the limit order will be executed. NSX states that there is also increased competition between the various markets, and the primary market may not necessarily be the best source for liquidity. Electronic communication networks have also formed as alternative liquidity providers to the markets, and automated order routing system capabilities to the various markets have been enhanced. The Exchange also notes that, in contrast to the environment when NSX enacted its rule provisions mandating primary market print protection for exchange-listed issues, NSX order-sending firms now have access to comprehensive order execution quality statistics.

These changes make it such that the mandatory aspects of the primary market print protection policy are no longer necessary to ensure timely executions or as a “front-end” execution price guarantee to attract order flow. The Exchange notes that many dealers believe that it is no longer appropriate to mandate they guarantee the execution of resting limit orders for exchange-listed issues based on activity in the primary market. NSX states that they believe that, in today’s trading environment, the exchange-listed primary market print protection exposes them to unwarranted liability, which they often have no ability to mitigate.

⁵ 17 CFR 242.604.

Accordingly, the Exchange believes that the primary market print protection provisions of its Rules should be eliminated. In making this proposal, the Exchange notes that under separate provisions of the NSX Rules, dealers and other members are currently permitted, but not required, to guarantee the execution of a limit order as principal upon the occurrence of a transaction in another market, not just the primary markets, at the price of such order.⁶ Dealers and other members will continue to have this ability after the elimination of the primary market print protection rule. Accordingly, NSX dealers can continue to execute resting limit orders voluntarily when executions at the limit price occur in other markets as a means of satisfying their best execution obligations and maintaining superior execution quality statistics, but they now have more flexibility to determine how best to service those orders.

Importantly, the Exchange notes that these revisions do not affect the trading ahead prohibitions of NSX Rule 12.6, the best execution obligations of NSX Rule 12.10, or any other dealer obligations. The Exchange states that its Regulatory Services Division will continue its surveillance of order executions to ensure that NSX dealers meet their obligations to each order.

⁶ Under the Exchange's priority principles, dealers and members are permitted to effect the execution of a public agency limit order on NSX pursuant to a limit order guarantee. The execution of an order pursuant to a limit order guarantee takes priority over orders and bids or offers in the Exchange's trading system (known as the National Securities Trading System or "NSTS") and is deemed to be a transaction effected on NSX in the same manner as if the transaction were executed through NSTS and must be reported to the Exchange as promptly as possible and in any event within one minute of execution. See NSX Rules 11.9(a)(12), (k), (l) and (p).

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,⁷ in general, and furthers the objectives of Section 6(b)(5) of the Act,⁸ in particular, in that it is designed to promote just and equitable principles of trade; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change would impose 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

The Exchange has neither solicited nor received written comments on the proposed rule change.

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 NSX consents, the Commission will:

- (A) by order approve such proposed rule change; or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

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-NSX-2006-06 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 20549-1090.

All submissions should refer to File Number SR-NSX-2006-06. 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 office of NSX. 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 publicly available. All submissions should refer to File Number SR-NSX-2006-06 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.⁹

Nancy M. Morris
Secretary

⁹ 17 CFR 200.30-3(a)(12).