

prohibiting sharing information about prior negotiated municipal securities business as well as current and planned solicitations between the dealer, its MFPs and any affiliated PAC is unrealistic because much of the information is public.

MSRB Response. The MSRB has revised the language relating to the municipal securities business information barrier to suggest that dealers prohibit the dealer and its MFPs from directly providing or coordinating information about prior negotiated municipal securities business as well as current and planned solicitations to any affiliated PAC.

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

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. Please include File Number SR-MSRB-2005-12 on the subject line.

Paper Comments

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

All submissions should refer to File Number SR-MSRB-2005-12. 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 MSRB's offices. 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-MSRB-2005-12 and should be submitted on or before September 6, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁴

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52226; File No. SR-NASD-2004-045]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 Thereto, and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 to the Proposed Rule Change, To Adopt NASD Rule 2111 to Prohibit Members From Trading Ahead of Customer Market Orders

August 9, 2005.

I. Introduction

On March 12, 2004, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt NASD Rule 2111 ("Manning for Market

Orders"). The proposal prohibits members from trading for their own account at prices that would satisfy a customer market order, unless the member immediately thereafter executes the customer market order. On February 16, 2005, NASD amended the proposed rule change.³ The proposed rule change, as modified by Amendment No. 1, was published for comment in the **Federal Register** on February 25, 2005.⁴ The Commission received one comment letter on the proposal.⁵ On August 3, 2005, NASD filed an amendment which incorporated its response to comments.⁶ This order approves the proposed rule change, as modified by Amendment No. 1, and provides notice of filing and grants accelerated approval of Amendment No. 2.⁷

II. Summary of Comments

The Commission received one comment letter on the proposed rule change.⁸ The commenter stated that it generally supported the concept of market order protection but cited a number of concerns with the proposal. The following is a summary of the concerns raised by the commenter.

- *The Rule Should Permit Additional Flexibility With Respect to the Requirement that Members Cross Standing Customer Market Orders*

The commenter stated that certain member firms' systems are not able to execute agency crosses if the order resides with the market maker, but the systems are able to proprietarily buy from the market seller and allocate to the market buyer at the same price (*i.e.* effect a riskless principal transaction).⁹ Thus, the commenter recommended that the proposed rule change be amended to allow a member that holds a customer market order that has not been immediately executed "to execute such order in any reasonable manner that meets the pricing requirements of the

³ See Amendment No. 1.

⁴ See Securities Exchange Act Release No. 51230 (February 18, 2005), 70 FR 9408.

⁵ See letter from Amal Aly, Vice President and Associate General Counsel, and Ann Vlcek, Vice President and Associate General Counsel, Securities Industry Association ("SIA") to Jonathan G. Katz, Secretary, Commission, dated March 18, 2005 ("SIA Letter").

⁶ See Amendment No. 2 modified the proposed rule text to state that a member could satisfy the proposal's crossing requirement by contemporaneously buying from the seller and selling to the buyer at the same price.

⁷ The Commission recently approved a related proposal, SR-NASD-2004-089, that requires members to provide price improvement to customer limit orders under certain circumstances. See Securities Exchange Act Release No. 52210 (August 4, 2005).

⁸ See footnote 5, *supra*.

⁹ See SIA Letter at 2.

²⁴ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

rule, and is consistent with the terms of the order.”¹⁰ The commenter pointed out that proposed NASD Rule 2111(c) allows a member that has not immediately executed a customer order, and holds multiple orders on both sides of the market that have not been executed, to cross or otherwise execute the order in a manner that is reasonable, and is consistent with the objectives of NASD Rule 2111(c) as well as with the terms and conditions of the order.¹¹ However, when a member does not hold multiple orders on both sides of the market, proposed NASD Rule 2111(c) requires that the member cross the order with any market order, marketable limit order, or non-marketable limit order priced better than the best bid or offer.¹²

Second, the commenter expressed concern that flickering quotes would create significant compliance and technological challenges for member firms because the rule requires member firms to cross marketable limit orders even if such limit orders were marketable only for a brief period of time.¹³ The commenter suggested that the proposed rule change should recognize some small period of time in which a given quote would not subject a marketable limit order to the rule’s protections.¹⁴

• *Certain Order Types Should be Excluded from the Rule*

The commenter stated that NASD should specifically exclude certain types of market orders from the rule’s protection.¹⁵ Specifically, the commenter said that orders that are (i) entered on a “not held” basis; (ii) executed on an agency basis where the customer specifically asks that the order be executed on an agency basis; and (iii) for accounts where the member is bound by another regulation limiting or prohibiting principal transactions, should be excluded from the protections of the rule.¹⁶ The commenter stated that “not held” orders should be exempted from the proposed rule change because a member is granted discretion in executing “not held” orders and requiring that a member execute such orders fully and promptly would not be consistent with the terms of the order.¹⁷

• *The Rule Should Only Apply to Orders Executed on Nasdaq or in the Over-the-Counter Market*

The commenter suggested that the proposed rule change should only apply

to orders executed on Nasdaq or in the over-the-counter (“OTC”) market because the New York Stock Exchange already has a similar rule.¹⁸ The commenter said that limiting the application of the proposed rule change would further recent industry efforts to discourage duplicative regulation.¹⁹

• *The Proposed Rule Change Should Allow Firms to More Fully Utilize Information Barriers to Segregate Non-Market Making Desks From Other Customer Order Flows*

The commenter stated that the proposed rule change should allow firms to more fully utilize information barriers to segregate non-market making desks from other customer order flows.²⁰ The commenter believes that where members are able to implement effective internal controls, such as information barriers, which operate “to prevent non-market making desks from obtaining knowledge of customer market orders held at the market making desk, those other non-market making desks * * * [should be able to] continue to trade in a principal capacity at prices that are the same as or inferior to the customer market orders held at market making desk.”²¹ Therefore, the commenter urged that in order for there to be consistent treatment of both market orders under NASD Rule 2111 and limit orders under IM-2110-2 (“Manning”), NASD should recognize the use of information barriers under the proposed rule change.²²

III. NASD Response to Comments

In response to the comments, the NASD amended the filing.²³ In response to the commenter’s statement that some of its members’ systems are not able to execute agency crosses when the order resides with the market maker, and thus so long as a customer’s market order is executed at the proper price, the rule should not mandate the manner in which the order is executed, NASD amended the proposal’s rule text. Specifically, Amendment No. 2 addresses the concern by allowing members to execute such orders on a riskless principal basis. As amended, the rule states that “a member can satisfy the crossing requirement by contemporaneously buying from the seller and selling to the buyer at the same price.”

Regarding the commenter’s concern that the proposal would require a

member to cross a marketable limit order even if that limit order were marketable only for a brief period of time due to flickering quotes, NASD responded that because the proposal would require the matching of both marketable and non-marketable limit orders that would meet the requirements of the pending market order, the changing marketability or non-marketability of a particular limit order as a result of flickering quotes is not an issue. The NASD recognized that flickering quotes may increase the difficulty in determining the appropriate price of a market order, but such quotes would not dictate whether a particular marketable or non-marketable limit order should be crossed pursuant to the proposed rule.

In response to the commenter’s suggestion that certain order types should be excluded from the rule’s protection, NASD clarified how NASD Rule 2111 would apply to the order types mentioned. First, regarding “not held” orders, NASD stated that for orders for which a customer has granted the member discretion with respect to time or price, those orders would not be considered market orders for the purposes of the rule. Second, regarding orders where the customer specifically asks that the order be handled on an agency basis, the NASD stated that, with regard to those orders where no other regulation limits or prohibits a principal transaction, the rule would apply. Third, with respect to orders for accounts where the member is bound by another regulation limiting or prohibiting principal transactions with customer orders, NASD noted that, consistent with prior interpretations of Manning, the obligation to execute a trade with a customer following a separate proprietary trade on the same side of the market does not apply if the orders subject to the restrictions are sent to another broker-dealer for execution; the obligations under NASD Rule 2111 apply, however, if such orders are not routed elsewhere for execution. NASD reiterated that these interpretations do not change a member’s best execution obligations under NASD Rule 2320.

Concerning the commenter’s argument that the proposal should apply only to orders executed on Nasdaq or in the OTC market, NASD stated that the proposal is based on a member’s obligations relating to just and equitable principles of trade with respect to the treatment of customer market orders, and therefore NASD believes that the proposed rule should apply to customer market orders regardless of where the orders are ultimately executed.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* at 2–3.

¹⁷ *Id.* at 2.

¹⁸ NYSE Rule 92.

¹⁹ See SIA Letter.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ See footnote 6, *supra*.

In response to the commenter's suggestion that the proposal should allow firms to more fully utilize information barriers to segregate non-market making desks from other customer order flows, NASD stated that it has issued guidance in connection with Manning concerning the extent to which a trading desk other than the firm's market-making desk could trade for its own account while the market-making desk held protected customer limit orders on its books.²⁴ NASD states that the same guidance would apply for the instant proposal.

IV. Discussion and Commission Findings

The Commission has reviewed carefully the proposed rule change, the comment letter, and NASD's response, and finds that the proposed rule change, as amended, is consistent with the requirements of the Act and rules and regulations thereunder applicable to a national securities association²⁵ and, in particular, the requirements of section 15A(b)(6) of the Act,²⁶ which requires, among other things, that the rules of a national securities association 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. The Commission believes that the proposal is reasonably designed to ensure that customer market orders are executed quickly and fairly. Indeed, paragraph (a) of the rule requires a member to "make every effort to execute a customer market order that it receives fully and promptly."

Regarding the commenter's concerns that so long as a customer's market orders are executed at the proper price under the rule, the proposed rule change should not mandate that the orders be crossed, the NASD amended NASD Rule 2111(c) to allow for members to execute a customer order as a riskless principal to satisfy the crossing requirement. Regarding the commenter's concern that under the rule a firm must cross a marketable limit order even if the order were only marketable for a brief period of time, the NASD recognized that flickering quotes may increase the difficulty in determining the appropriate price of a market order, but such quotes would not dictate whether a particular marketable

or non-marketable limit order should be crossed pursuant to the proposed rule. The Commission believes that the proposed rule change reasonably addresses the manner in which member firms need to execute customer market orders under various market conditions. The requirements of the rule are only triggered if the member fails to execute a market order fully and promptly.

The Commission agrees with the NASD's analysis with respect to whether certain types of market orders should be excluded from the rule. The Commission believes that the proposed rule change allows sufficient flexibility to accommodate those order types by, for example, not considering a "not held" order to be a "market" order for purposes of the proposed rule change.

Concerning the commenter's argument that the rule should only apply to orders executed on Nasdaq or in the OTC market, the Commission agrees with NASD that applying the proposed rule change to NASD members executing customer market orders across all equities markets will help better assure that customer orders receive the protections of the rule, regardless of where the orders ultimately are executed. The commenter did not state that the NASD rule is inconsistent with the NYSE's rule.

In response to the commenter's assertion that the proposed rule change should permit firms to more fully utilize information barriers to segregate non-market making desks from other customer order flows, the Commission believes the NASD's position—that its existing Manning guidance with respect to information barriers will apply to the proposed rule change—adequately addresses the commenter's concern.

The Commission finds good cause to approve Amendment No. 2 before the 30th day after the date of publication of notice of filing in the **Federal Register**. NASD filed Amendment No. 2 in response to comments it received after the publication of the notice of filing of the proposed rule change.²⁷ Because Amendment No. 2 is responsive to the commenter's concerns and explains how the rule applies, the Commission finds good cause for accelerating approval of Amendment No. 2.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether Amendment No. 2 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-2004-045 on the subject line.

Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2004-045. 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 the 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-2004-045 and should be submitted on or before September 6, 2005.

VI. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,²⁸ that the proposed rule change (SR-NASD-2004-045), as modified by Amendment No. 1 thereto, be, and it hereby is, approved and that Amendment No. 2 be, and hereby is, approved on an accelerated basis.

²⁴ See *Notice to Members* 95-43 (June 1995) and *Notice to Members* 03-74 (November 2003).

²⁵ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

²⁶ 15 U.S.C. 78o-3(b)(6).

²⁷ See footnote 6, *supra*.

²⁸ 15 U.S.C. 78s(b)(2).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁹

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52221; File No. SR-PCX-2005-74]

Self-Regulatory Organizations; Pacific Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 Thereto To Trade Shares of Certain Vanguard International Equity Index Funds Pursuant to Unlisted Trading Privileges

August 8, 2005.

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, 2005, the Pacific Exchange, Inc. (“PCX” or “Exchange”), through its wholly owned subsidiary PCX Equities, Inc. (“PCXE” or “Corporation”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been substantially prepared by the Exchange. PCX amended the proposed rule change on July 28, 2005.³ The Commission is publishing this notice and order to solicit comments on the proposal, as amended, from interested persons and to approve the proposal, as amended, on an accelerated basis.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange, through its wholly owned subsidiary PCXE, proposes to trade shares of the following exchange traded funds (“ETFs”) based on three Vanguard International Equity Indices pursuant to unlisted trading privileges (“UTP”) based on PCXE Rule 5.5(j)(3):

- Morgan Stanley Capital International Inc. (“MSCI”) Europe Index (ticker symbol: VGK)
- MSCI Pacific Index (ticker symbol: VPL); and
- MSCI Emerging Markets Select Index (ticker symbol: VWO).

The text of the proposed rule change is available from the Exchange’s Web site (<http://www.pacificex.com>), at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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

In its filing with the Commission, the Exchange 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 III below. The Exchange 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 trade, pursuant to UTP, Vanguard Index Participation Equity Receipts, which are securities issued by the three funds (“VIPER Shares”). The MSCI Europe Index and the MSCI Pacific Index are market-capitalization-weighted indices that are designed to measure developed market equity performance in Europe and the Pacific region, respectively. Each MSCI country index is created separately and then aggregated, without change, into the larger regional index. The MSCI Europe Index is comprised of securities from 16 of 50 countries for which MSCI has indices.⁴ The MSCI Pacific Index is comprised of securities from 5 of the 50 countries for which MSCI has indices.⁵ The MSCI Emerging Markets Select Index is comprised of securities from 18 of the 50 countries for which MSCI has indices.⁶ The Commission previously approved the

⁴ Currently, the MSCI Europe Index includes Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

⁵ Currently, the MSCI Pacific Index includes Australia, Hong Kong, Japan, New Zealand, and Singapore.

⁶ Currently, the MSCI Emerging Markets Select Index includes Argentina, Brazil, Chile, China, Czech Republic, Hungary, India, Indonesia, Israel, Korea, Mexico, Peru, Philippines, Poland, South Africa, Taiwan, Thailand, and Turkey. This information on countries represented in the indices is current as of February 25, 2005. Telephone conversation between Tania J.C. Blanford, Staff Attorney, PCX, and Natasha Cowen, Attorney, Division of Market Regulation, Commission, on July 13, 2005.

original listing and trading of the VGK, VPL, and VWO on the American Stock Exchange (“Amex”).⁷

The Exchange deems these VIPER Shares to be equity securities, thus rendering trading in these securities subject to the Exchange’s existing rules governing the trading of equity securities. PCX will trade these ETFs during the hours that the Intraday Indicative Value (“IIV”) is disseminated.⁸

The Exchange understands that the listing exchange, Amex, will disseminate the following information for each ETF on a daily basis through the facilities of the Consolidated Tape Association (“CTA”): Recent net asset value (“NAV”), shares outstanding, and estimated cash amount and total cash amount per creation unit. In addition, the Exchange understands that Amex will make the following information available on its Web site: Daily trading volume, closing price, NAV, and final dividend amounts to be paid for each VIPER Share. The closing prices of the deposit securities are readily available from, as applicable, the relevant exchanges, automated quotation systems, published or other public sources in the relevant country, or on-line information services such as Bloomberg or Reuters. The exchange rate information required to convert such information into U.S. dollars is also readily available in newspapers and other publications and from a variety of on-line services.

To provide updated information relating to each ETF for use by investors, professionals, and persons wishing to create or redeem the VIPER Shares, Amex disseminates through the facilities of the CTA: (1) continuously throughout the trading day, last sale information for each ETF; and (2) every 15 seconds throughout the trading a day, the estimated IIV of each ETF as calculated by a third party.

The IIV may not reflect the value of all securities included in the applicable underlying index. In addition, the IIV does not necessarily reflect the precise composition of each index at a particular point in time. Therefore, the IIV on a per-share basis disseminated during Amex’s regular trading hours should not be viewed as a real-time

⁷ See Securities Exchange Act Release No. 50189 (August 12, 2004), 69 FR 51723 (August 20, 2004) (SR-Amex-2004-05) (“Original Listing Order”).

⁸ The IIV is the estimated net asset value, which is disseminated by Amex every 15 seconds throughout the trading day. The IIV is designed to give investors a sense of the relationship between a basket of securities that are representative of those owned in the ETF and the share price of the ETF on an intraday basis.

²⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, the Exchange modified the trading hours in which it proposes to trade these exchange traded funds.