

NASD.<sup>16</sup> To execute the same trade on an exchange, however, the exchange's systems might require the broker-dealer to enter matching buy and sell orders that are explicitly priced in a sub-penny increment that, absent an exemption, would not be permitted by Rule 612. The Commission does not believe that Rule 612 should preclude an immediate sub-penny execution on an exchange that results from the submission by a member of a cross order arranged by that member that otherwise is in accordance with exchange rules established consistent with Section 19(b) of the Exchange Act. The Commission believes, therefore, that this exemption is consistent with the public interest because it will level the playing field between the exchanges and the OTC market as venues for sub-penny crossing transactions.<sup>17</sup>

For these reasons, the Commission concludes that this limited exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

### III. Conclusion

*It is hereby ordered*, pursuant to Rule 612(c) of Regulation NMS, that a national securities exchange may accept cross orders priced in sub-penny increments, provided that:

- (1) The orders are immediately executed against each other; and
- (2) The cross transaction is effected in accordance with exchange rules approved or established pursuant to Section 19(b) of the Exchange Act.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

**Nancy M. Morris,**  
*Secretary.*

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<sup>16</sup> While a broker-dealer may execute a cross at a sub-penny price without violating Rule 612, the broker-dealer may not accept a sub-penny order. For example, the broker-dealer could accept a market order to buy, internalize it, and give the customer an execution at \$10.001 (assuming such execution is consistent with all applicable Commission and SRO rules including, for example, rules relating to best execution and order protection). Rule 612 prohibits the broker-dealer from accepting a limit order to buy that the customer has explicitly priced at \$10.001.

<sup>17</sup> However, as with sub-penny crosses arranged in the OTC market, nothing in this exemption permits a broker-dealer itself to accept a limit order that a customer has explicitly priced in an increment not permitted by Rule 612.

<sup>18</sup> 17 CFR 200.30-3(a)(83).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54715; File No. SR-NASD-2006-108]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving a Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 to a Proposed Rule Change Relating to an NASD Trade Reporting Facility Established in Conjunction With the National Stock Exchange, Inc.

November 6, 2006.

#### I. Introduction

On September 14, 2006, 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")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposal to establish an NASD trade reporting facility (the "NASD/NSX TRF") in conjunction with the National Stock Exchange, Inc. ("NSX"). The proposed rule change was published for comment in the *Federal Register* on September 27, 2006.<sup>3</sup> The Commission received one comment letter regarding the proposal.<sup>4</sup> The NASD filed Amendment No. 1 to the proposed rule change on November 2, 2006.<sup>5</sup> This order approves the proposal, as amended. In addition, the Commission is publishing notice to solicit comments on, and is simultaneously approving, on an accelerated basis, Amendment No. 1.

#### II. Description of the Proposal

##### A. NASD/NSX TRF

NASD proposes to establish a new trade reporting facility, the NASD/NSX TRF, that will provide NASD members with an additional facility for reporting transactions in NMS stocks, as defined

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

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

<sup>3</sup> See Securities Exchange Act Release No. 54479 (September 21, 2006), 71 FR 56573 ("Notice").

<sup>4</sup> See letter from Alden Adkins, Executive Vice President, Boston Stock Exchange, Inc. ("BSE"), to Nancy N. Morris, Secretary, Commission, dated October 17, 2006 ("BSE Letter").

<sup>5</sup> In Amendment No. 1, NASD proposes to: (1) Allow members to report transactions in all NMS stocks, as defined in Rule 600(b)(47) of Regulation NMS under the Act; (2) designate NASD Rule 5140 regarding multiple Market Participant Symbols ("MPIDs") as a pilot set to expire on January 26, 2007 and add language to IM-5140 regarding members' obligations when using multiple MPIDs for quoting and trade reporting purposes; (3) implement the NASD/NSX TRF in two phases; and (4) reflect final approval of the proposed rule change by the NASD Executive Committee of the Board of Governors.

in Rule 600(b)(47) of Regulation NMS under the Act,<sup>6</sup> that are effected otherwise than on an exchange. The NASD/NSX TRF will be operated by the NASD/NSX Trade Reporting Facility LLC ("NASD/NSX TRF LLC"). The NASD/NSX TRF structure and rules are substantially similar to the trade reporting facility established by the NASD and the Nasdaq Stock Market, Inc. (the "NASD/Nasdaq TRF"), which the Commission approved in June 2006.<sup>7</sup>

The NASD/NSX TRF will be a facility, as defined under the Act,<sup>8</sup> of the NASD, subject to regulation by the NASD and to the NASD's registration as a national securities association. NASD members<sup>9</sup> that match and/or execute orders internally or through proprietary systems may submit reports of these trades, with appropriate information and modifiers, to the NASD/NSX TRF, which will then report them to the appropriate exclusive securities information processor ("SIP").<sup>10</sup> NASD/NSX TRF transaction reports disseminated to the media will include a modifier indicating the source of the transactions that will distinguish them from transactions executed on or through the NSX. The NASD/NSX TRF will provide the NASD with a real-time copy of each trade report for regulatory review purposes. At the option of the participant, the NASD/NSX TRF may provide the necessary clearing information regarding transactions to

<sup>6</sup> See Amendment No. 1, *supra* note 5.

<sup>7</sup> See Securities Exchange Act Release No. 54084 (June 30, 2006), 71 FR 38935 (July 10, 2006) ("NASD/Nasdaq TRF Approval Order"). NASD has proposed to amend the NASD/Nasdaq TRF to permit NASD members to report transactions in NMS Stocks as defined in Rule 600 of Regulation NMS under the Act. Currently, the NASD/Nasdaq TRF only accepts transaction reports in Nasdaq Global Market and Nasdaq Capital Market securities and convertible bonds listed on The NASDAQ Stock Market LLC ("Nasdaq Exchange"). See Securities Exchange Act Release No. 54451 (September 15, 2006), 71 FR 55243 (September 21, 2006) ("Pending NASD/Nasdaq TRF Proposal").

<sup>8</sup> 15 U.S.C. 78c(a)(2).

<sup>9</sup> Only NASD members in good standing may participate in the NASD/NSX TRF. See NASD Rule 6120C(a)(1). NASD/NSX TRF participants also must meet the minimum requirements set forth in NASD Rule 6120C, including the execution of, and continuing compliance with, a Participant Application Agreement; membership in, or maintenance of, an effective clearing arrangement with a participant of a registered clearing agency registered pursuant to the Act; and the acceptance and settlement of each trade that the NASD/NSX TRF identifies as having been effected by the participant.

<sup>10</sup> The NASD/NSX TRF will have controls in place to ensure that transactions reported to the NASD/NSX TRF that are significantly away from the current market will not be submitted to the SIP. The NASD represented that this is consistent with current practice and noted that the Alternative Display Facility ("ADF") and the NASD/Nasdaq TRF currently do not submit such trades to the SIP.

the National Securities Clearing Corporation.

*B. Limited Liability Company Agreement of the NASD/NSX TRF LLC*

The NASD and NSX will jointly own the NASD/NSX TRF LLC, which will operate the NASD/NSX TRF. The NASD has filed the Limited Liability Company Agreement of the NASD/NSX TRF LLC (the "LLC Agreement") as part of the current proposal. The LLC Agreement recognizes the NASD as having sole regulatory responsibility for the NASD/NSX TRF. The NASD, as the "SRO Member" under the LLC Agreement, will perform the "SRO Responsibilities" <sup>11</sup> for the NASD/NSX TRF. The NSX, as the "Business Member" under the LLC Agreement, will be primarily responsible for the management of the facility's business affairs to the extent those activities are not inconsistent with the regulatory and oversight functions of the NASD. NSX will pay the cost of regulation and provide systems to enable NASD members to report trades to the NASD/NSX TRF. NSX will be entitled to the profits and losses, if any, derived from the operation of the NASD/NSX TRF. <sup>12</sup> Under Section 9(d) of the LLC Agreement, each Member agrees to comply with the federal securities laws and the rules and regulations thereunder and to cooperate with the Commission pursuant to its regulatory authority and the provisions of the LLC Agreement.

The NASD/NSX TRF LLC will be managed by, or under the direction of, a Board of Directors to be established by the NASD and NSX. The NASD will have the right to designate at least one Director, the SRO Member Director, to the NASD/NSX TRF LLC Board of Directors. The SRO Director must approve, by consent, all "Major Actions," as defined in Section 10(e) of the LLC Agreement. In addition, each Director agrees to comply with the federal securities laws and the rules and regulations thereunder and to cooperate with the Commission and the SRO Member pursuant to their regulatory authority. <sup>13</sup> Further, when discharging his or her duties as a member of the Board of Directors, each Director must take into consideration whether his or her actions as a Director would cause

<sup>11</sup> The LLC Agreement defines "SRO Responsibilities" as those duties or responsibilities of a self-regulatory organization ("SRO") pursuant to the Act and the rules promulgated thereunder, including but not limited to those set out in Section 9(a) of the LLC Agreement. See Schedule A of the LLC Agreement.

<sup>12</sup> See Section 15 of the LLC Agreement.

<sup>13</sup> See Section 10(b) of the LLC Agreement.

the NASD/NSX TRF or either Member to engage in conduct that would be inconsistent with the purposes of the Act. <sup>14</sup>

The initial term of the LLC Agreement is three years. During that time, until the NASD/NSX TRF reaches "Substantial Trade Volume" (defined as 250,000 trades or more per day for three consecutive months), NSX may terminate the arrangement for convenience. After the NASD/NSX TRF reaches Substantial Trade Volume, either Member may terminate the LLC Agreement by providing to the other Member prior written notice of at least one year. In addition, the NASD may terminate in the event its status or reputation as an SRO is called into jeopardy by the actions of NSX or the NASD/NSX TRF LLC. If the NASD/NSX TRF LLC arrangement is terminated, the NASD represented that it would be able to fulfill all of its regulatory obligations with respect to over-the-counter ("OTC") trade reporting through its other facilities, including the NASD/Nasdaq TRF and the ADF.

*C. NASD/NSX TRF Rules*

1. NASD Rule 4000C and 6000C Series

The NASD proposes to adopt the NASD Rule 4000C Series, "The NASD/NSX Trade Reporting Facility," and 6000C Series, "NASD/NSX Trade Reporting Facility Systems and Programs," to establish, respectively, trade reporting and clearing and comparison rules for the NASD/NSX TRF. <sup>15</sup> The NASD Rule 4000C and 6000C Series are substantially similar to the NASD Rule 4000 and 6000 Series governing the NASD/Nasdaq TRF. <sup>16</sup>

The NASD also proposes to adopt a new rule relating to give up agreements and provisions designed to clarify the reporting of riskless principal transactions. <sup>17</sup> Specifically, the NASD proposes to adopt NASD Rule 4632C(g),

<sup>14</sup> *Id.*

<sup>15</sup> The NASD notes that all other NASD rules that apply to OTC trading generally will apply to trades reported to the NASD/NSX TRF.

<sup>16</sup> Some differences between the rules governing the NASD/NSX TRF and the NASD/Nasdaq TRF result from differences between the trade reporting systems of the facilities. For example, because the NASD/NSX TRF has no trade comparison functionality, the rules governing the NASD/NSX TRF contain no provisions relating to trade matching, trade acceptance, or aggregate volume matching. Similarly, because the NASD/NSX TRF will not be able to support trade reporting for certain transactions on its first day of operation, NASD Rules 4632C(a)(2) and (a)(7) indicate that certain types of transactions may not be reported through the NASD/NSX TRF and must be reported to the NASD via an alternative electronic mechanism.

<sup>17</sup> The NASD has proposed similar provisions for the NASD/Nasdaq TRF. See Pending NASD/Nasdaq TRF Proposal, *supra* note 7.

which states that a member may agree to allow an NASD/NSX TRF participant to report trades on its behalf, provided that both parties have completed an agreement to that effect (a "give up agreement") and submitted the agreement to the NASD/NSX TRF. The NASD also proposes to adopt NASD Rule 4632C(d)(3)(B), which sets forth the procedures for reporting riskless principal transactions. Specifically, NASD Rule 4632C(d)(3)(B) provides that when the media leg of a riskless principal transaction is reported to the NASD/NSX TRF, the second, non-media leg also must be reported to the NASD/NSX TRF. When the media leg of the riskless principal transaction has been reported previously by an exchange, a member would be permitted, but not required to report the second, non-media leg to the NASD/NSX TRF. To avoid double reporting of the same transaction, NASD Rule 4632C(e)(6) provides that transactions reported on or through an exchange shall not be reported to the NASD/NSX TRF for purposes of publication.

In Amendment No. 1, NASD proposes additional changes to its rules to reflect that the NASD/NSX will also accept trade reports in non-Nasdaq exchange-listed securities. Specifically, NASD proposes to amend (e) of Rule 4632C to prohibit members from reporting the following transactions: (1) The acquisition of securities by a member as principal in anticipation of making an immediate exchange distribution or exchange offering on an exchange; and (2) purchases of securities off the floor of an exchange pursuant to a tender offer. <sup>18</sup> These exclusions are currently set forth in NASD Rule 6420(e)(6) and (7). In addition, NASD made some clarifying changes to reflect that the NASD/NSX TRF will accept certain trade reports in bonds.

2. Amendments to Existing NASD Rules

The NASD proposes to amend certain NASD rules to reflect the operation of more than one trade reporting facility. Specifically, the NASD proposes to amend NASD Rule 5100, "Short Sale Rule," and IM-5100, "Short Sale Rule," to refer to "a" trade reporting facility, rather than "the" trade reporting facility to clarify that the rules apply to trades reported to any trade reporting facility established by the NASD.

In addition, the NASD proposes to amend NASD Rule 6120, "Trade Reporting Participation Requirements," to provide that participation in the

<sup>18</sup> *Id.*

System<sup>19</sup> is mandatory for any member with an obligation to report OTC trades to the NASD, unless the member has an alternative electronic mechanism pursuant to NASD rules for reporting and clearing the transaction. Thus, for example, participation in the System would not be mandatory for purposes of reporting OTC trades in exchange-listed securities for a member that is a participant in the NASD/NSX TRF.

### 3. New NASD Rule 5140 and IM-5140

The NASD proposes to adopt NASD Rule 5140 and accompanying IM-5140 on a pilot basis through January 26, 2007.<sup>20</sup> NASD Rule 5140 and IM-5140 will allow participants in any NASD trade reporting facility to request the use of more than one MPID for purposes of reporting trades to a trade reporting facility.<sup>21</sup> The NASD will require members to provide bona fide business and/or regulatory reasons for requesting an additional MPID, and the NASD will carefully consider such reasons in determining whether to issue additional MPIDs to a member.<sup>22</sup> The NASD stated that it believes that the proposed rules are important to ensure that the NASD has a consolidated process for issuing and tracking the MPIDs used for each NASD trade reporting facility.

#### D. Implementation

In light of the systems changes necessary for the NASD to implement the NASD/NSX TRF for non-Nasdaq exchange-listed securities, the NASD proposes to implement the proposal in two phases.<sup>23</sup> Specifically, the NASD proposes to implement the proposed

rule change with respect to Nasdaq-listed equity securities on the first day of operation of the NASD/NSX TRF, and to implement the proposed rule change with respect to non-Nasdaq exchange-listed securities at a later date.

The NASD will announce the implementation of the first phase of the proposed rule change no later than 30 days following Commission approval of the proposal, and the second phase no later than 90 days following Commission approval.<sup>24</sup>

### III. Summary of Comments

The Commission received one comment letter regarding the proposal.<sup>25</sup> The commenter supports the proposal and noted that it has proposed to develop a trade reporting facility with the NASD.<sup>26</sup> The commenter, however, argues that the Commission needs to consider the fair competition requirements of Section 11A(a)(1)(C)(ii) of the Act<sup>27</sup> when deciding whether and on what terms and conditions to approve the NASD/NSX TRF proposal. The commenter believes that this section of the Act requires the Commission to approve multiple trade reporting facilities, assuming the facilities are otherwise consistent with the Act.<sup>28</sup>

The commenter argues that the Commission should delay the effectiveness of the NASD/NSX TRF to allow the Commission to determine whether Section 11A(a)(1)(C)(ii) of the Act requires multiple non-Nasdaq trade reporting facilities.<sup>29</sup> Even if the Commission does decide to permit multiple non-Nasdaq trade reporting facilities, the commenter argues that the Commission should delay effectiveness of the NASD/NSX TRF because the commenter believes that the NASD/NSX TRF would obtain a competitive advantage if it were able to begin operating prior to the NASD/BSE TRF.<sup>30</sup> The commenter recommends that the Commission approve the NASD/NSX TRF but delay the effectiveness of its approval until the Commission has determined whether, and on what terms, multiple non-Nasdaq trade reporting facilities are appropriate and consistent with the Act.<sup>31</sup>

### IV. Discussion

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.<sup>32</sup> In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 15A(b)(6) of the Act<sup>33</sup> in that it is designed to prevent fraudulent and manipulative acts and practices, 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 mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

The NASD/NSX TRF will provide NASD members with an additional mechanism for reporting transactions in exchange-listed securities effected otherwise than on an exchange. Rule 601 of Regulation NMS requires the NASD to file a transaction reporting plan regarding transactions in listed equity and Nasdaq securities that are executed by its members otherwise than on a national securities exchange.<sup>34</sup> Under Rule 603 of Regulation NMS,<sup>35</sup> national securities exchanges and national securities associations act jointly pursuant to an effective national market system plan to disseminate consolidated information, including a national best bid and offer, and quotations for and transactions in NMS stocks. Today, NASD operates the ADF,<sup>36</sup> NASD/Nasdaq TRF<sup>37</sup> and the

<sup>19</sup> NASD Rule 6110(m) defines "System" to mean the NASD/Nasdaq Trade Reporting Facility, the trade reporting service of the ITS/CAES System, and the OTC Reporting Facility.

<sup>20</sup> The NASD also has established a pilot program through January 26, 2007, to allow electronic communications networks ("ECNs") to use multiple MPIDs for purposes of quoting and trade reporting on the ADF. See Securities Exchange Act Release No. 54307 (August 11, 2006), 71 FR 47551 (August 17, 2006) (notice of filing and immediate effectiveness of File No. SR-NASD-2006-096).

<sup>21</sup> Although the NASD trade reporting facilities are mechanisms used solely for trade reporting and do not permit quoting, a member could report a trade to a trade reporting facility as the result of a quotation posted on a NASD facility such as the ADF. In that instance, the member would be required to use the same MPID for quoting and trade reporting purposes (e.g., a member that is both a trade reporting facility participant and a Registered Reporting ADF ECN would be required to use the same MPID when reporting a trade that resulted from its posted quotation on the ADF). See IM-5140 and Amendment No. 1, *supra* note 5.

<sup>22</sup> The NASD noted that one bona fide reason for using multiple MPIDs would be to facilitate back office operations. For example, a member might have multiple MPIDs for trade reporting purposes if it clears trades through multiple clearing firms. See Amendment No. 1, *supra* note 5.

<sup>23</sup> See Amendment No. 1, *supra* note 5.

<sup>24</sup> See Amendment No. 1, *supra* note 5.

<sup>25</sup> See BSE Letter, *supra* note 4.

<sup>26</sup> See Securities Exchange Act Release No. 54591 (October 12, 2006), 71 FR 61519 (October 18, 2006) ("NASD/BSE TRF Proposal").

<sup>27</sup> 15 U.S.C. 78k-1(a)(1)(C)(ii).

<sup>28</sup> See BSE Letter, *supra* note 4.

<sup>29</sup> See BSE Letter, *supra* note 4.

<sup>30</sup> See BSE Letter, *supra* note 4.

<sup>31</sup> See BSE Letter, *supra* note 4.

<sup>32</sup> In approving this proposed rule change, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>33</sup> 15 U.S.C. 78o-3(b)(6).

<sup>34</sup> Under Rule 601(b) of Regulation NMS, broker-dealers are prohibited from executing a transaction otherwise than on a national securities exchange unless there is an effective transaction reporting plan. NASD Rule 5000 requires NASD members to report transactions in exchange-listed securities effected otherwise than on an exchange to NASD.

<sup>35</sup> 17 CFR 242.603.

<sup>36</sup> Currently, the ADF only accepts quotes and trades in Nasdaq-listed securities. The Commission recently approved a proposal to extend the ADF to non-Nasdaq exchange-listed securities. See Securities Exchange Act Release No. 54537 (September 28, 2006), 71 FR 59173 (October 6, 2006).

<sup>37</sup> Currently, the NASD/Nasdaq TRF only accepts trade reports in Nasdaq-listed securities. As noted above, the NASD has proposed to amend the NASD/Nasdaq TRF to accept transaction reports in non-Nasdaq exchange-listed securities. See Pending NASD/Nasdaq TRF Proposal, *supra* note 7.

ITS/CAES System<sup>38</sup> for collecting transaction reports. In addition, NASD is a participant in the Nasdaq UTP Plan<sup>39</sup> with regard to transaction reports in Nasdaq-listed securities, and the CTA Plan<sup>40</sup> with regard to securities listed on exchanges other than Nasdaq.

Upon approval of the NASD/NSX TRF, the NASD will operate another facility for the purposes of accepting transaction reports from its members. The Commission has previously recognized that the Act does not prohibit the NASD from establishing multiple facilities for fulfilling its regulatory purposes.<sup>41</sup> Indeed, as noted above, the NASD currently operates multiple facilities for fulfilling its regulatory obligations. Therefore, the Commission believes that it is consistent with the Act for the NASD to establish the NASD/NSX TRF for purposes of fulfilling its regulatory obligations. The NASD represented that if the NASD/NSX TRF LLC arrangement is terminated, the NASD will be able to fulfill all of its regulatory obligations with respect to OTC trade reporting through its other facilities, including the NASD/Nasdaq TRF and the ADF.

The NASD represented that it will have an integrated audit trail of all trade reporting facilities, ADF, and ITS/CAES System transactions, and will have integrated surveillance capabilities.<sup>42</sup> NASD has represented that it expects to automate its integrated audit trail and surveillance by the end of the fourth quarter of 2006 for Nasdaq-listed securities and by the end of the first quarter of 2007 for non-Nasdaq exchange-listed securities. The Commission believes that an integrated audit trail and integrated surveillance capabilities are important to the NASD's ability to conduct effective surveillance of OTC trading in exchange-listed securities when transactions in those securities can be reported to one of the

NASD's trade reporting facilities, the ADF, or the ITS/CAES System.

A commenter suggested that the Commission approve the current proposal but delay the effectiveness of its approval until the Commission has determined whether multiple non-Nasdaq trade reporting facilities are appropriate and consistent with the Act.<sup>43</sup> In the NASD/Nasdaq TRF Approval Order, the Commission noted that the NASD/Nasdaq LLC Agreement specifically contemplated that the NASD could enter into similar arrangements with other national securities exchanges. In addition, the Commission noted that the NASD has represented that it was prepared to implement a trade reporting facility with any exchange based on technology available to the exchange. The Commission noted this provision and representation when addressing competitive concerns raised by commenters to the NASD/Nasdaq TRF. The Commission specifically found that the NASD/Nasdaq TRF did not impose an unfair burden on competition and that the " \* \* \* Act does not prevent any other party, including an exchange, from developing similar technology for use as a NASD facility." Accordingly, the Commission does not require additional time to determine whether multiple non-Nasdaq trade reporting facilities are consistent with the Act and thus declines to delay the effectiveness of the NASD/NSX TRF.

The commenter also argues that NASD/NSX TRF could obtain a competitive advantage if it commences operations prior to the NASD/BSE TRF, with the potential to "permanently lessen the likelihood of multiple Trade Reporting Facilities having a fair chance to obtain enough initial print volume to allow them to survive long enough to offer the competitive benefits that presumably would underlie any Commission decision to allow multiple non-Nasdaq Trade Reporting Facilities."<sup>44</sup> The Commission does not believe that it should delay the operation of the NASD/NSX TRF until other trade reporting facilities are ready to operate. The Commission believes that approving the NASD/NSX TRF and allowing it to begin operations immediately could enhance competition by providing a new facility, in addition to those that are operating currently, for reporting OTC trades in exchange-listed securities.

#### A. NASD/NSX TRF Rules

Most of the provisions in the new NASD Rule 4000C and 6000C Rule Series, which establish the trade reporting and clearing and comparison rules for the NASD/NSX TRF, are substantially similar to the NASD Rule 4000 and 6000 Series that the Commission approved for the NASD/Nasdaq TRF,<sup>45</sup> or to existing NASD Rules.<sup>46</sup> Accordingly, the Commission finds that the NASD Rule 4000C and 6000C Series are consistent with Act. In addition, the Commission finds that new NASD Rule 4632C(g), relating to give up agreements, and NASD Rule 4632C(d)(3)(B), regarding the reporting of riskless principal transactions, are consistent with the Act because they clarify the requirements for and operation of these procedures. In this regard, NASD Rule 4632C(g) requires, among other things, that give up agreements be filed with NASD. In addition, NASD Rule 4632C(g) notes that both the member with the reporting obligation and the member submitting the trade to the NASD/NSX TRF are responsible for ensuring that the information submitted is in compliance with all applicable rules and regulations.

Similarly, NASD Rule 4632C(d)(3)(B) clarifies the procedures for reporting riskless principal transactions and should facilitate the accurate reporting of these transactions. Specifically, NASD Rule 4632C(d)(3)(B) provides that when the media leg of a riskless principal transaction is reported to the NASD/NSX TRF, the second, non-media leg also must be reported to the NASD/NSX TRF. When the media leg of the riskless principal transaction has been reported previously by an exchange, a member would be permitted, but not required to report the second, non-media leg to the NASD/NSX TRF. In addition, to avoid double reporting of the same transaction, NASD Rule 4632C(e)(6) prohibits the reporting of transactions reported on or through an exchange to the NASD/NSX TRF for purposes of publication.

<sup>45</sup> See NASD/Nasdaq TRF Approval Order, *supra* note 7.

<sup>46</sup> In this regard, the NASD proposes in Amendment No. 1 to adopt NASD Rule 4632C(e)(7) and (e)(8), which will provide that the following categories of transactions may not be reported to the NASD/NSX TRF for purposes of publication: (1) The acquisition of securities by a member as principal in anticipation of making an immediate exchange distribution or exchange offering on an exchange; and (2) purchases of securities off the floor of an exchange pursuant to a tender offer. These provisions are identical to current NASD Rule 6420(e)(6) and (e)(7). In addition, NASD has proposed to add the same provision to the NASD/Nasdaq TRF rules. See Pending NASD/Nasdaq TRF Proposal, *supra* note 7.

<sup>38</sup> The ITS/CAES System provides a means by which NASD and its members can comply with the terms of the Intermarket Trading System Plan ("ITS Plan"). The ITS/CAES System reports trades in non-Nasdaq exchange-listed securities that are effected in the ITS/CAES System or in NASD members' proprietary systems. The NASD has proposed to amend the ITS/CAES System to reflect the operation of the Nasdaq Exchange as a national securities exchange. See Pending NASD/Nasdaq TRF Proposal, *supra* note 7.

<sup>39</sup> Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis ("Nasdaq UTP Plan").

<sup>40</sup> Consolidated Tape Association Plan ("CTA Plan").

<sup>41</sup> See NASD/Nasdaq TRF Approval Order, *supra* note 7.

<sup>42</sup> See Amendment No. 1, *supra* note 5.

<sup>43</sup> See BSE Letter, *supra* note 4.

<sup>44</sup> See BSE Letter, *supra* note 4.

The Commission finds that the amendments to NASD Rule 5100 and IM-5100 and NASD Rule 6120 are consistent with the Act because they revise the NASD's rules to reflect the operation of multiple trade reporting facilities. In this regard, the amendments to NASD Rule 5100 and IM-5100 make clear that these provisions apply to trades reported to any trade reporting facility established by the NASD. Similarly, the amendments to NASD Rule 6120 clarify that a member with an obligation to report an OTC transaction to the NASD must participate in the System<sup>47</sup> unless the member has an alternative electronic mechanism pursuant to NASD rules for reporting and clearing such a transaction. Thus, participation in the System under NASD Rule 6120 for purposes of reporting transactions in exchange-listed securities would not be mandatory for a member that is a participant in the NASD/NSX TRF.

The NASD proposes to adopt NASD Rule 5140 and accompanying IM-5140 on a pilot basis through January 26, 2007. NASD Rule 5140 and IM-5140 will allow participants in any NASD trade reporting facility to request the use of more than one MPID for purposes of reporting trades to a trade reporting facility so long as the participant has a bona fide business and/or regulatory reason for using multiple MPIDs.<sup>48</sup>

The Commission finds that NASD Rule 5140 and IM-5140 are consistent with Section 15A(b)(6) of the Act because they will permit the use of multiple MPIDs for bona fide business and/or regulatory reasons while providing safeguards designed to address potential misuse of multiple MPIDs. In this regard, trade reporting facility participants must submit written requests and obtain NASD approval for the use of multiple MPIDs. Trade reporting facility participants must identify the purpose(s) and system(s) for which the multiple MPIDs will be used.<sup>49</sup> If the NASD determines that the

use of multiple MPIDs is detrimental to the marketplace, or that a trade reporting facility participant is using one or more additional MPIDs improperly or for other than the purpose(s) identified by the participant, the NASD retains the discretion to limit or withdraw its grant of the additional MPIDs to the participant.<sup>50</sup> Similarly, if a participant misuses its MPID on one NASD facility, including the ADF, or on the facility of another SRO, the NASD retains the discretion to limit or withdraw the grant of the MPID for trade reporting purposes through any NASD trade reporting facility.<sup>51</sup> Finally, the NASD would consider the misuse of an MPID for quoting purposes through another system to be grounds for withdrawal of the MPID for trade reporting through a trade reporting facility.<sup>52</sup>

#### B. NASD/NSX TRF LLC

The NASD and NSX will jointly own the NASD/NSX TRF LLC, which will operate the NASD/NSX TRF. The NASD has filed the LLC Agreement as part of the current proposal.<sup>53</sup> The LLC Agreement is substantially similar to the limited liability company agreement of the NASD/Nasdaq TRF LLC ("NASD/Nasdaq TRF LLC Agreement") that the Commission approved in the NASD/Nasdaq TRF Approval Order.<sup>54</sup> Accordingly, for the reasons discussed in the NASD/Nasdaq TRF Approval Order with respect to the NASD/Nasdaq TRF LLC Agreement, the Commission finds that the LLC Agreement is consistent with the Act.<sup>55</sup>

The Commission notes that the NASD/NSX TRF LLC, as the operator of an NASD facility, is an integral part of a SRO registered pursuant to the Act and, as such, is subject to obligations imposed by the Act. The Commission underscores that these obligations endure so long as the NASD/NSX TRF LLC operates an NASD facility.

The Commission believes that the LLC Agreement makes clear that the

NASD will have sole regulatory responsibility for the activities of NASD members related to the facility operated by the NASD/NSX TRF LLC and provides the NASD with certain rights that are intended to preserve its regulatory authority and control.<sup>56</sup> The Commission believes that the provisions of the LLC Agreement will allow the NASD to carry out its self-regulatory responsibilities with respect to its facility and that both the Commission and the NASD will have sufficient regulatory jurisdiction over the controlling parties of the NASD/NSX TRF LLC to carry out their responsibilities under the Act.

For example, under the LLC Agreement, each Member and each director of the NASD/NSX TRF LLC agrees to comply with the federal securities laws and rules and regulations thereunder and to cooperate with the Commission pursuant to its regulatory authority and the provisions of the LLC Agreement. In addition, the NASD and NSX acknowledge in the LLC Agreement that—to the extent directly related to the NASD/NSX TRF LLC's activities—their books, records, premises, officers, directors, governors, agents, and employees will be deemed to be the books, records, premises, officers, directors, governors, agents, and employees of the NASD itself and its affiliates for the purposes of, and subject to oversight pursuant to, the Act. This provision will reinforce the Commission's ability to exercise its authority under Section 19(h)(4) of the Act<sup>57</sup> with respect to the officers and directors of the NASD/NSX TRF LLC because all such officers and directors—to the extent that they are acting in matters related to the NASD/NSX TRF LLC's activities—would be deemed to be the officers and directors of the NASD itself. Furthermore, under the LLC Agreement, the records of the NASD and NSX, to the extent that they are related to the NASD/NSX TRF LLC's activities, are deemed to be records of the NASD itself and are subject to the

<sup>47</sup> See *supra* note 19.

<sup>48</sup> The NASD notes that one bona fide reason for using multiple MPIDs would be to facilitate back office operations. For example, a member might have multiple MPIDs for trade reporting purposes if it clears trades through multiple clearing firms. See Amendment No. 1, *supra* note 5.

<sup>49</sup> See IM-5140. The NASD contemplates that a member that participates in more than one trade reporting facility would use the same MPIDs across trade reporting facilities as well as the ADF, if the member is also a participant in the ADF. However, the NASD believes that it could be appropriate for a member to obtain, for example, one MPID for exclusive use on the NASD/Nasdaq TRF and another MPID for exclusive use on the NASD/NSX TRF. As part of the NASD Rule 5140 process, the member would be required to specify the system(s) for which the MPIDs would be used and the NASD

would determine whether such use of multiple MPIDs was appropriate under the facts and circumstances. See Amendment No. 1, *supra* note 5.

<sup>50</sup> See IM-5140.

<sup>51</sup> See Amendment No. 1, *supra* note 5.

<sup>52</sup> See Amendment No. 1, *supra* note 5.

<sup>53</sup> The Commission notes that any changes to the LLC Agreement that are stated policies, practices, or interpretations of the NASD, as defined in Rule 19b-4 under the Act, must be filed with the Commission pursuant to Section 19(b) of the Act and Rule 19b-4 thereunder.

<sup>54</sup> See *supra* note 7.

<sup>55</sup> The Commission incorporates by reference the discussion and analysis of the NASD/Nasdaq TRF LLC and NASD/Nasdaq TRF LLC Agreement set forth in the NASD/Nasdaq TRF Approval Order, *supra* note 7.

<sup>56</sup> For example, pursuant to the LLC Agreement, the NASD must consent before certain "Major Actions," as defined in the LLC Agreement, with respect to the NASD/NSX TRF LLC are effective.

<sup>57</sup> 15 U.S.C. 78s(h)(4). Section 19(h)(4) of the Act authorizes the Commission, by order, to remove from office or censure any officer or director of an SRO if it finds after notice and an opportunity for hearing that such officer or director has: (1) Willfully violated any provision of the Act or the rules and regulations thereunder, or the rules of such SRO; (2) willfully abused his or her authority; or (3) without reasonable justification or excuse, has failed to enforce compliance with any such provision by a member or person associated with a member of the SRO.

Commission's examination authority under Section 17(b)(1) of the Act.<sup>58</sup>

The LLC Agreement also provides that the NASD and NSX, and each officer, director, agent, and employee thereof, irrevocably submits to the jurisdiction of the U.S. federal courts, the Commission, and the NASD for the purpose of any suit, action, or proceeding pursuant to the U.S. federal securities laws and the rules and regulations thereunder arising from, or relating to, the NASD/NSX TRF LLC's activities.

The Commission also believes that the requirements of Section 19(b) of the Act and Rule 19b-4 thereunder provide the Commission with sufficient authority over changes in control of the NASD/NSX TRF LLC to enable the Commission to carry out its regulatory oversight responsibilities with respect to the NASD and its facilities.

The Commission notes that the NASD is required to enforce compliance with the provisions of the LLC Agreement because they are "rules of the association" within the meaning of Section 3(a)(27) of the Act.<sup>59</sup> A failure on the part of the NASD to enforce its rules could result in a suspension or revocation of its registration pursuant to Section 19(h)(1) of the Act.<sup>60</sup>

### C. Accelerated Approval of Amendment No. 1

The Commission finds good cause for approving Amendment No. 1 prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. In Amendment No. 1, the NASD proposes to expand the NASD/NSX TRF to accept transaction reports in non-Nasdaq exchange-listed securities. The NASD had noted its intention to accept for these trades in the NASD/NSX TRF in its Notice. Because the NASD is obligated to collect these transaction reports, and allowing the NASD/NSX TRF to accept these trade reports may increase competition among the trade reporting facilities operated by the NASD, the Commission believes there is good cause to accelerate approval of this change to the NASD/NSX TRF. Second, the NASD proposes to implement the NASD/NSX TRF in two phases to allow it to make necessary systems changes. The Commission finds that good cause exists to accelerate approval of this implementation schedule as it will allow NASD to incrementally begin operations of this new trade reporting facility, as its systems are ready. The

Commission notes that NASD stated that it expects to announce the implementation date of the first phase no later than 30 days following approval and the second phase no later than 90 days following approval. Finally, NASD proposes to designate its Rule 5140 and IM-5140 regarding multiple MPIDs as a pilot that would expire on January 26, 2007 and to add language to clarify that members that use an MPID for quoting purposes must use the same MPID for trade reporting purposes for transactions that result from the member's quotation. Because the changes to its Rule 5140 and IM-5140 are designed to prevent potential misuse of MPIDs, the Commission believes that good cause exists to accelerate approval of the changes proposed in Amendment No. 1. Accordingly, the Commission finds that it is consistent with Sections 6(b)(5) and 19(b) of the Act to approve Amendment No. 1 on an accelerated basis.

### V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether Amendment No. 1 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-2006-108 on the subject line.

#### Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2006-108. 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 Exchange. 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-2006-108 and should be submitted on or before December 5, 2006.

### VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>61</sup> that the proposed rule change (SR-NASD-2006-108), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>62</sup>

Nancy M. Morris,  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54713; File No. SR-NYSE-2006-98]

### Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of a Proposed Rule Change Regarding the Amendment of NYSE Rule 300 Relating to Trading Licenses and the Deletion of NYSE Rule 300T

November 6, 2006.

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 November 3, 2006, the New York Stock Exchange LLC ("NYSE" 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 NYSE. 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 NYSE Rule 300 relating to trading

<sup>61</sup> 15 U.S.C. 78s(b)(2).

<sup>62</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>58</sup> See Section 17(c) of the LLC Agreement.

<sup>59</sup> 15 U.S.C. 78c(a)(27).

<sup>60</sup> 15 U.S.C. 78s(h)(1).