

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-55870; File No. SR-NASDAQ-2007-037]

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change To Modify Order Audit Trail System Rules To Provide an Exemption From Transmission Requirements for Proprietary Orders and Amendment No. 1 Thereto

June 6, 2007.

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 April 3, 2007, The NASDAQ Stock Market LLC (“Nasdaq”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by Nasdaq. On June 4, 2007, Nasdaq filed Amendment No. 1, which replaced the text of the original filing in its entirety. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

Nasdaq proposes to modify its Order Audit Trail System (“OATS”) rules to provide an exemption from OATS transmission requirements for certain proprietary orders. The text of the proposed rule change is available at <http://www.nasdaq.com>, at Nasdaq, 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, Nasdaq 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. Nasdaq 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

Nasdaq proposes to modify its OATS rules to adopt a limited exemption from OATS order data transmission requirements for proprietary trading firms. OATS is an integrated audit trail of order, quote, and trade information for Nasdaq securities used to recreate events in the life cycle of orders and more completely monitor the trading practices of member firms.

A “Proprietary Trading Firm” is proposed to be defined as meaning a Nasdaq member that trades its own capital with all the trading being done in the firm’s accounts by traders that are owners of, employees of, or contractors to the firm. Additionally, a Proprietary Trading Firm does not have “customers,” as that term is defined in Nasdaq Rule 0120(g) and is not a member of the National Association of Securities Dealers, Inc. (“NASD”). At present, there are no Proprietary Trading Firms that are also market makers.

Nasdaq also proposes to revise Nasdaq Rule 6955 to add that a Proprietary Trading Firm, and persons associated with a Proprietary Trading Firm, only upon request would be required to transmit order data information for specific time periods stated in a request to Nasdaq Regulation.<sup>3</sup> Although a Proprietary Trading Firm would not be required to transmit the order data information to Nasdaq Regulation unless requested, it still would be held responsible for maintaining and retaining the information in a format that could be easily integrated into the NASD’s OATS system in the event Nasdaq Regulation makes a request for such information.

The current requirement for Proprietary Trading Firms to transmit all data order information is onerous and not offset by an equivalent regulatory benefit. It is very expensive for firms to develop and maintain the compliance systems and compliance staff required to continuously monitor the daily transmission of OATS data. Additionally, the transmission of OATS

<sup>3</sup> Rule 0130 provides that the term Nasdaq Regulation should be understood as also referring to NASD staff, NASD Regulation staff, and NASD departments acting on behalf of Nasdaq pursuant to the Regulatory Contract. NASD Regulation has agreed to perform certain functions on behalf of Nasdaq pursuant to a regulatory services agreement.

data often results in either rejections or mismatches.<sup>4</sup>

Errors can result from a programming error even if it just a misplaced semicolon. To cure these issues, members may need to spend an inordinate amount of time correcting a minor glitch with NASD. Mismatches occur when NASD reconstitutes the order and any discrepancies exist between the order origination and order execution, which may be different entities.<sup>5</sup> Often times the discrepancy is of very minor consequence, but triage efforts are overly burdensome.

The basis for OATS is customer protection through the transparency of the executions of customer orders. The proposed rule change does not impact this, since by definition, Proprietary Trading Firms do not handle customer orders. OATS was designed to provide an accurate, time-sequenced record of orders and transactions, beginning with the receipt of an order at the first point of contact between the broker-dealer and the customer or counterparty and further documenting the life of the order through the process of execution. This requirement only came into effect during the later stages of the OATS implementation. Also, as mentioned below, no other exchange has a daily transmission requirement for this category of customer.

This approach parallels, in a much more limited manner, the approach undertaken by the New York Stock Exchange (“NYSE”) in NYSE Rule 132C, which requires NYSE members, upon request, to transmit order tracking data to the NYSE.<sup>6</sup> The NYSE has stated that it has been its experience that “submission of data by request has proven to be effective and efficient”<sup>7</sup> from both the NYSE’s and its members’ perspective.

Additionally, much of the information retained by a Proprietary Trading Firm is otherwise available to the Nasdaq

<sup>4</sup> OATS rejections may occur for a multitude of reasons including: Incorrect symbol; duplicate order event; cancelled time stamp prior to order timestamp; canceled timestamp greater than current date and time; issue is not reportable to OATS; issue symbol invalid for order event date; missing or invalid shares quantity or Buy/Sell code; missing or invalid member type code or issue symbol ID; missing or invalid cancel quantity; missing time in force code; missing or invalid firm order ID; and missing or invalid expiration time.

<sup>5</sup> Common causes of mismatches include: missing branch/sequence numbers; improperly formatted branch/sequence numbers on one of the reports; differing execution timestamps; missing reporting exception codes and late reporting of OATS execution reports.

<sup>6</sup> See Securities Exchange Act Release No. 47689 (April 17, 2003), 68 FR 20200 (April 24, 2003) (SR-NYSE-99-51).

<sup>7</sup> *Id.* at 20202.

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

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

Regulation through Nasdaq's systems, and Nasdaq can use such information and supply it to the NASD, upon request, as well. This information includes trade reporting data, including order time and sales data captured by the Nasdaq system.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>8</sup> in general, and with Section 6(b)(5) of the Act,<sup>9</sup> in particular, in that the proposal 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.

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

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments were neither solicited nor received.

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

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:

- By order approve such proposed rule change, or
- 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, as amended, 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-NASDAQ-2007-037 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-NASDAQ-2007-037. 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 the Nasdaq. 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-NASDAQ-2007-037 and should be submitted on or before July 5, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority,<sup>10</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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**BILLING CODE 8010-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-55872; File No. SR-OCC-2007-01]

### Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of a Proposed Rule Change Relating to Credit Default Options

June 6, 2007.

## I. Introduction

On February 13, 2007, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") proposed rule change File No. SR-OCC-2007-01 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> On March 7, 2007, OCC filed an amendment to the proposed rule change.<sup>2</sup> Notice of the proposal was published in the **Federal Register** on March 5, 2007.<sup>3</sup> No comment letters were received. This order approves the proposed rule change as amended.

## II. Description

The purpose of the proposed rule change is to permit OCC to clear and settle credit default options ("CDOs"), which are options related to the creditworthiness of an issuer or guarantor ("reference entity") of one or more specified debt securities ("reference obligation(s)"). CDOs are "binary" options that pay a fixed amount to the holder of the option upon the occurrence of a "credit event" affecting the reference obligations.<sup>4</sup> CDOs will be traded by the Chicago Board Options Exchange ("CBOE").<sup>5</sup>

### Description of Credit Default Options

CDOs are structured as binary options that are automatically exercised and the exercise settlement amount payable if a "credit event" occurs at any time prior to the last day of trading. A "credit event" is generally defined as any failure to pay on any of the reference

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

<sup>2</sup> The March 7, 2007, amendment reflects OCC's determination to seek approval for the credit default option product only and not for binary options in general. Because Amendment No. 1 is technical in nature, the Commission is not republishing the notice of filing for public comment.

<sup>3</sup> Securities Exchange Act Release No. 55362 (February 27, 2007), 72 FR 9826.

<sup>4</sup> "Binary" options (also sometimes referred to as "digital" options) are "all-or-nothing" options that pay a fixed amount if automatically exercised and otherwise pay nothing.

<sup>5</sup> Securities Exchange Act Release Nos. 55251 (February 7, 2007), 72 FR 7091 (February 14, 2007) (notice of filing of proposed rule change); 55871 (June 6, 2007) (order approving proposed rule change) [File No. SR-CBOE-2006-84].

<sup>8</sup> 15 U.S.C. 78f.

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> 17 CFR 200.30-3(a)(12).