

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-51449; File No. SR-NASD-2005-034]

**Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. To Provide Limited Compensation for Losses Due to Malfunctions of the Order-Execution Systems of the Nasdaq Market Center or Nasdaq's Brut Facility**

March 30, 2005.

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 March 23, 2005, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in items I and II below, which items have been prepared by Nasdaq. On March 24, 2005, Nasdaq submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> Nasdaq has filed the proposal pursuant to section 19(b)(3)(A) of the Act<sup>4</sup> and Rule 19b-4(f)(6) thereunder,<sup>5</sup> which renders the proposal effective upon filing with the Commission. 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 Substance of the Proposed Rule Change**

Nasdaq proposes to provide limited compensation for losses due to malfunctions of the order-execution systems of the Nasdaq Market Center or Nasdaq's Brut facility. Nasdaq has designated this proposal as non-controversial and has requested that the Commission waive the 30-day pre-operative waiting period contained in Rule 19b-4(f)(6)(iii) under the Act.<sup>6</sup>

The text of the proposed rule change, as amended, is below. Proposed new language is *italicized*; proposed deletions are in [brackets].

\* \* \* \* \*

4705. Nasdaq Market Center Participant Registration

(a) through (h) No Change.

(i) *Except as provided for in paragraph (j) below, [T]the Association and its subsidiaries shall not be liable for any losses, damages, or other claims arising out of the Nasdaq Market Center or its use. Any losses, damages, or other claims, related to a failure of the Nasdaq Market Center to deliver, display, transmit, execute, compare, submit for clearance and settlement, adjust, retain priority for, or otherwise correctly process an order, Quote/Order, message, or other data entered into, or created by, the Nasdaq Market Center shall be absorbed by the member, or the member sponsoring the customer, that entered the order, Quote/Order, message, or other data into the Nasdaq Market Center.*

*(j) Nasdaq, subject to the express limits set forth below, may compensate users of the Nasdaq Market Center or Nasdaq's Brut order execution system for losses directly resulting from the systems' actual failure to correctly process an order, Quote/Order, message, or other data, provided the Nasdaq Market Center, or Brut system, as applicable, has acknowledged receipt of the order, Quote/Order, message, or data.*

*(1) For one or more claims made by a single market participant related to the use of the Nasdaq Market Center or Brut system on a single trading day, Nasdaq's liability shall not exceed the larger of \$100,000, or the amount of any recovery obtained by Nasdaq under any applicable insurance policy.*

*(2) For the aggregate of all claims made by all market participants related to the use of the Nasdaq Market Center or Brut system on a single trading day, Nasdaq's liability shall not exceed the larger of \$250,000, or the amount of the recovery obtained by Nasdaq under any applicable insurance policy.*

*(3) For the aggregate of all claims made by all market participants related to the use of the Nasdaq Market Center or Brut system during a single calendar month, Nasdaq's liability shall not exceed the larger of \$500,000, or the amount of the recovery obtained by Nasdaq under any applicable insurance policy.*

*(4) In the event all of the claims arising out of the use of the Nasdaq Market Center or Brut system cannot be fully satisfied because in the aggregate they exceed the maximum amount of liability provided for in this Rule, then the maximum amount will be proportionally allocated among all such claims arising on a single trading day,*

*or during a single calendar month, as applicable.*

*(5) All claims for compensation pursuant to this Rule shall be in writing and must be submitted no later than the opening of trading on the next business day following the day on which the use of the Nasdaq Market Center or the Brut system gave rise to the such claims. Nothing in this rule shall obligate Nasdaq or Brut to seek recovery under any applicable insurance policy.*

\* \* \* \* \*

4913. Limitation of Liability

*Except as provided for in Rule 4705(j), [T]the Association and its subsidiaries, as well as Nasdaq and Brut and their subsidiaries, shall not be liable for any losses, damages, or other claims arising out of the System or its use. Any losses, damages, or other claims, related to a failure of the System to deliver, display, transmit, execute, compare, submit for clearance and settlement, adjust, retain priority for, or otherwise correctly process an order, Quote/Order, message, or other data entered into, or created by, the System shall be absorbed by the member, or the member sponsoring the customer, that entered the order, Quote/Order, message, or other data into the System.*

\* \* \* \* \*

**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, as amended. 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 is proposing to provide a limited exception to its general limitation of liability rules to allow for payments of claims to users for order processing failures in the Nasdaq Market Center and Nasdaq's Brut system. Current limitation of liability rules provide that Nasdaq and Brut are not liable for any losses, damages, or claims arising out of the Nasdaq Market Center or the Brut system or their use

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

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

<sup>3</sup> Amendment No. 1 made technical corrections to the propose rule text of the proposed rule change.

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A)

<sup>5</sup> 17 CFR 240.19b-4(f)(6).

<sup>6</sup> 17 CFR 240.19b-4(f)(6)(iii).

and that any such losses, damages, or claims related to a failure of the Nasdaq Market Center or the Brut system must be absorbed by the member that entered the order into the Nasdaq Market Center or Brut system or that sponsored that customer entering that order.<sup>7</sup>

Under the proposal, Nasdaq would compensate users of either the Nasdaq Market Center or Brut for failures of the order-execution portion of either system to correctly process an order, Quote/Order, message, or other data (Order) transmitted by a market participant into it, provided receipt of the entry has been acknowledged by that system. Payments under the proposal shall be subject to the following limits:

(1) For one or more claims made by a single market participant related to the use of the Nasdaq Market Center or Brut system on a single trading day, compensation would be limited to the larger of \$100,000, or the amount of any recovery obtained by Nasdaq under any applicable insurance policy;<sup>8</sup>

(2) For the aggregate of all claims made by all market participants related to the use of the Nasdaq Market Center or Brut system on a single trading day, compensation will be limited to the larger of \$250,000, or the amount of the recovery obtained by Nasdaq under any applicable insurance policy; and

(3) For the aggregate of all claims made by all market participants related to the use of the Nasdaq Market Center or Brut system during a single calendar month, compensation will be limited to the larger of \$500,000, or the amount of the recovery obtained by Nasdaq under any applicable insurance policy.

If all of the claims arising out of the use of the Nasdaq Market Center or Brut system cannot be fully satisfied because together they exceed the maximum amount of compensation dollars available, then available monies will be allocated on a proportional basis among all such claims arising on a single trading day or during a single calendar month, as applicable. All claims for compensation must be made in writing and submitted to Nasdaq no later than the opening of trading on the next business day after the day on which the use of Nasdaq's facilities gave rise to the compensation claim.

Nasdaq states that it will apply the proposed rule in a non-discriminatory manner, and believes that the proposed rule change provides a uniform non-discriminatory method to compensate

Nasdaq Market Center and Brut system users for losses arising from system malfunctions in the order execution process. Nasdaq believes that the potential availability of such compensation engenders confidence in Nasdaq market systems, and may encourage greater use of those systems thereby increasing beneficial liquidity for all system users. Finally, Nasdaq notes that another market center has a similar rule in place to likewise provide limited compensation for system malfunctions.<sup>9</sup>

## 2. Statutory Basis

Nasdaq believes that the proposed rule change, as amended, is consistent with the provisions of section 15A of the Act,<sup>10</sup> in general, and with section 15A(b)(6) of the Act,<sup>11</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to 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, as amended, will result in 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

Written comments were neither solicited nor received.

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

The foregoing proposed rule change, as amended, is subject to section 19(b)(3)(A)(iii) of the Act<sup>12</sup> and Rule 19b-4(f)(6) thereunder<sup>13</sup> because the proposal: (i) Does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative prior to 30 days after the date of filing or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that Nasdaq has given the Commission notice of its intent to file the proposed rule change, along with a brief description and text of the

proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

Nasdaq satisfied the five-day pre-filing requirement. In addition, Nasdaq has requested that the Commission waive the 30-day operative delay. Nasdaq believes that additional benefits and protections offered to users of Nasdaq and Brut, including public customers, impacted by system malfunctions should not be delayed. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because such waiver will permit users of the Nasdaq Market Center and Brut system to avail themselves of the benefits of these provisions immediately. In addition, the Commission notes that the proposed rule is substantially similar to a rule currently in place at another market center.<sup>14</sup> For these reasons, the Commission designates the proposal to be effective and operative upon filing with the Commission.<sup>15</sup>

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of the Act.<sup>16</sup>

## 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-NASD-2005-034 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission,

<sup>14</sup> See PCXE Rule 13.2.

<sup>15</sup> For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>16</sup> See Section 19(b)(3)(C) of the Act, 15 U.S.C. 78s(b)(3)(C).

<sup>7</sup> See NASD Rules 4705(i) and 4913.

<sup>8</sup> The decision to seek recovery under any applicable insurance policy for any claim shall be within Nasdaq's sole discretion. See NASD Rule 4705(j)(5).

<sup>9</sup> See PCXE Rule 13.2.

<sup>10</sup> 15 U.S.C. 78o-3.

<sup>11</sup> 15 U.S.C. 78o-3(b)(6).

<sup>12</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>13</sup> 17 CFR 240.19b-4(f)(6).

450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2005-034. 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-2005-034 and should be submitted on or before April 27, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

[FR Doc. E5-1555 Filed 4-5-05; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51458; File No. SR-NSCC-2004-09]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change To Establish a Comprehensive Standard of Care and Limitation of Liability to Its Members

March 31, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on December 8, 2004, the National Securities Clearing Corporation ("NSCC") filed with the Securities and

Exchange Commission ("Commission") and on March 15, 2005, amended the proposed rule change described in Items I, II, and III below, which items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

NSCC is seeking to establish a comprehensive standard of care and limitation of liability with respect to its members.

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

In its filing with the Commission, NSCC 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. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>2</sup>

##### (A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

NSCC is seeking to establish a comprehensive standard of care and limitation of liability with respect to its members. Historically, the Commission has left to user-governed clearing agencies the question of how to allocate losses associated with, among other things, clearing agency functions.<sup>3</sup> The Commission has reviewed clearing agency services on a case-by-case basis and in determining the appropriate standard of care has balanced the need for a high degree of clearing agency care with the effect the resulting liabilities may have on clearing agency operations, costs, and safekeeping of securities and funds.<sup>4</sup> Because standards of care represent an allocation of rights and liabilities between a clearing agency and its members, which are sophisticated financial entities, the Commission has refrained from establishing a unique federal standard of care and generally has allowed clearing agencies and other self-regulatory organizations and their members to establish their own standard

of care.<sup>5</sup> In addition, the Commission has recognized that a gross negligence standard of care is appropriate for certain noncustodial functions where a clearing agency, its board of directors, and its members determine to allocate risk to individual service users.<sup>6</sup>

NSCC believes that adopting a uniform rule<sup>7</sup> limiting NSCC's liability

<sup>5</sup> *Id.*

<sup>6</sup> Securities Exchange Act Release No. 26154 (October 3, 1988), 53 FR 39556. NSCC's services provided to members are noncustodial in that, other than clearing fund deposits, it does not hold its members' funds or securities.

<sup>7</sup> The proposed language of new Section 2 of Rule 58 is as follows:

SEC. 2. Notwithstanding any other provision in the Rules:

(a) The Corporation will not be liable for any action taken, or any delay or failure to take any action, hereunder or otherwise to fulfill the Corporation's obligations to its Members including Settling Members, Settling Bank Only Members, Municipal Comparison Only Members, Insurance Carrier Members, TPA Members, Mutual Fund/ Insurance Services Members, Non-Clearing Members, Fund Members and Data Services Only Members, other than for losses caused directly by the Corporation's gross negligence, willful misconduct, or violation of Federal securities laws for which there is a private right of action. Under no circumstances will the Corporation be liable for the acts, delays, omissions, bankruptcy, or insolvency, of any third party, including, without limitation, any depository, custodian, sub-custodian, clearing or settlement system, transfer agent, registrar, data communication service or delivery service ("Third Party"), unless the Corporation was grossly negligent, engaged in willful misconduct, or in violation of Federal securities laws for which there is a private right of action in selecting such Third Party.

(b) Under no circumstances will the Corporation be liable for any indirect, consequential, incidental, special, punitive or exemplary loss or damage (including, but not limited to, loss of business, loss of profits, trading losses, loss of opportunity and loss of use) howsoever suffered or incurred, regardless of whether the Corporation has been advised of the possibility of such damages or whether such damages otherwise could have been foreseen or prevented.

(c) With respect to instructions given to the Corporation by a Special Representative/Index Recipient Agent, the Corporation shall have no responsibility or liability for any errors which may occur in the course of transmissions or recording of any transmissions or which may exist in any magnetic tape, document or other media so delivered to the Corporation.

(d) With respect to the Corporation's distribution facilities, the Corporation assumes no responsibility whatever for the form or content of any tickets, checks, papers, documents or other material (other than items prepared by it) placed in the boxes in its distribution facilities assigned to each Settling Member, Municipal Comparison Only Member, Insurance Carrier Member, TPA Member, Fund Member and Data Services Only Member, or otherwise handled by the Corporation; nor does the Corporation assume any responsibility for any improper or unauthorized removal from such boxes or from the Corporation's facilities of any such tickets, checks, papers, documents or other material, including items prepared by the Corporation.

(e) With respect to Fund/Serv transactions, the Corporation will not be responsible for the completeness or accuracy of any transaction or instruction received from or transmitted to a

<sup>2</sup> The Commission has modified the text of the summaries prepared by NSCC.

<sup>3</sup> Securities Exchange Act Release Nos. 20221 (September 23, 1983), 48 FR 45167 and 22940 (February 24, 1986), 51 FR 7169.

<sup>4</sup> *Id.*

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

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