

system fails.<sup>3</sup> The Exchange believes that, under the current CBOE environment, these obligations are now both unnecessary and unduly burdensome on DPMs and, accordingly, should be repealed.

With regard to the non-Hybrid backup autoquote obligation, because the Exchange has converted all of its DPM option classes to the CBOE Hybrid System, there are no more non-Hybrid classes and, as such, CBOE Rule 8.85(a)(xi) no longer applies and should be deleted. Additionally, the Exchange believes that the recent adoption and implementation of the electronic DPM ("e-DPM") program<sup>4</sup> on the Exchange provides a more appropriate and cost effective safeguard against a DPM's inability to generate quotes in option classes traded on the Exchange in Hybrid classes and, as such, the Hybrid backup autoquote obligation under Rule 8.85(a)(xii) is no longer necessary.<sup>5</sup> The deletion of the backup autoquote rules would not affect a DPM's separate obligation to provide continuous market quotations for each of its allocated classes and respective series.<sup>6</sup>

Finally, the Exchange also proposes removing violations of the non-Hybrid backup autoquote rule (Rule 8.85(a)(xi)) and the Hybrid backup autoquote rule (Rule 8.85(a)(xii)) from the Exchange's Minor Rule Plan.<sup>7</sup>

## 2. Statutory Basis

Because the proposed rule change will refine and enhance the Exchange's rules relating to quoting obligations to make them more efficient and effective, the proposed rule change is consistent with Section 6(b) of the Act,<sup>8</sup> in general, and furthers the objectives of Sections 6(b)(5) and 6(b)(7) in particular,<sup>9</sup> in that it is designed to promote just and equitable principles of trade, to protect investors and the public interest, and enhances the effectiveness and fairness of the Exchange's disciplinary procedures.

<sup>3</sup> CBOE Rule 8.85(a)(xii) requires that the Hybrid backup autoquote system be independent from the DPM's proprietary autoquote system.

<sup>4</sup> See Exchange Act Release Nos. 49577 (April 19, 2004), 69 FR 22576 (April 26, 2004) (order approving the process for approving e-DPMs on the Exchange); 50003 (July 12, 2004), 69 FR 25647 (July 19, 2004) (order approving e-DPM trading rules).

<sup>5</sup> Exchange rules now allow CBOE to allocate an option class that is already allocated to a DPM to one or more e-DPMs. See *supra* note 4. See also CBOE Rules 8.92 and 8.93.

<sup>6</sup> See CBOE Rule 8.85(a)(i).

<sup>7</sup> See CBOE Rule 17.50(g)(10).

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

<sup>9</sup> 15 U.S.C. 78f(b)(5) and 78f(b)(7).

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

This proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

No written comments were solicited or received with respect to the proposed rule change.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which 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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2005-028 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-CBOE-2005-028. 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 CBOE. 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-CBOE-2005-028 and should be submitted by August 12, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

[FR Doc. E5-3916 Filed 7-21-05; 8:45 am]

**BILLING CODE 8010-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52049; File No. SR-NASD-2005-087]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change To Reflect Nasdaq's Separation From NASD Upon Nasdaq's Anticipated Approval as a National Securities Exchange

July 15, 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 July 11, 2005, the National Association of Securities Dealers, Inc. ("NASD") 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 NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

<sup>6</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.

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

NASD is proposing to: (1) Amend the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries ("Delegation Plan"), NASD By-Laws, NASD Regulation By-Laws, NASD Dispute Resolution By-Laws, and NASD rules to reflect the separation of The Nasdaq Stock Market, Inc. ("Nasdaq") from NASD upon Nasdaq's anticipated approval as a national securities exchange;<sup>3</sup> (2) to make certain changes to the rules that govern quoting and trading through the NASD Alternative Display Facility ("ADF"); and (3) to establish rules for the trade reporting of transactions otherwise than on an exchange through the new Trade Reporting Facility.<sup>4</sup> The text of the proposed rule is available on the NASD Web Site (<http://www.nasd.com>), on the Commission's Web Site at (<http://www.sec.gov>), at the NASD Office of Secretary and at the Commission's Public Reference Room. In the proposed rule text, proposed new language is underlined; proposed deletions are in brackets.

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

In its filing with the Commission, NASD 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. NASD 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 purpose of this proposed rule change is threefold: (1) To amend NASD rules to reflect the anticipated approval of Nasdaq as a national securities

<sup>3</sup> The Commission has not reached a decision on Nasdaq's exchange application. The Commission understands that Nasdaq will submit an amended Form 1 application. This amendment to Nasdaq's exchange application will be published for public comment before final action is taken.

<sup>4</sup> The facility has been named the "Trade Reporting Facility" for purposes of this proposed rule change. The official name of the entity, however, has not yet been determined.

exchange<sup>5</sup> and its resultant separation from NASD; (2) to make certain clarifying and conforming changes to the rules governing quoting and trading through the ADF; and (3) to establish rules for the trade reporting of transactions otherwise than on an exchange through the Trade Reporting Facility.<sup>6</sup>

#### *Proposed Changes Relating to the Separation of Nasdaq*

In 2000, NASD began restructuring its relationship with Nasdaq, which operates as an independent, for-profit company. As the result of a two-phase private placement of Nasdaq shares, a public offering recently completed in January 2005 and other dispositions of NASD shares, NASD's common stock ownership interest in Nasdaq has been reduced to a minority interest. Before Nasdaq can fully separate from NASD, it must become registered as a national securities exchange with the Commission. Nasdaq has submitted drafts of proposed additional amendments to its Form 1 previously filed with the Commission requesting exchange registration. NASD continues to maintain greater than 50% of the voting control through its ownership of one outstanding share of Series B Preferred Stock until exchange registration is granted. Once Nasdaq obtains exchange registration, the share of Series B Preferred Stock would automatically lose its voting rights and would be redeemed by Nasdaq for \$1.00.

Thus, upon Nasdaq's registration as a national securities exchange, Nasdaq and NASD would be unaffiliated corporate entities, and therefore each will need separate rules applicable to their respective members. To effectuate

<sup>5</sup> Securities Exchange Act Release No. 44396 (June 7, 2001), 66 FR 31952 (June 13, 2001) (File No. 10-131).

<sup>6</sup> On December 7, 2001, NASD filed with the Commission SR-NASD-2001-90, a proposed rule change to amend NASD rules to reflect Nasdaq's separation from NASD upon its approval as a national securities exchange and to establish rules governing trading otherwise than on an exchange, including transactions effected through the ADF. On July 24, 2002, the Commission approved SR-NASD-2002-97, which authorized NASD to operate the ADF on a pilot basis for nine months, pending the anticipated approval of SR-NASD-2001-90. See Securities Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49822 (July 31, 2002) (SR-NASD-2002-97). NASD subsequently filed for immediate effectiveness proposed rule changes to extend the pilot until July 26, 2005. See Exchange Act Release Nos. 47633 (April 10, 2003), 68 FR 19043 (April 17, 2003) (SR-NASD-2003-67); 49131 (January 27, 2004), 69 FR 5229 (February 3, 2004) (SR-NASD-2004-12); and 50601 (October 28, 2004), 69 FR 64611 (November 5, 2004) (SR-NASD-2004-160). NASD intends to withdraw SR-NASD-2001-90, and this proposed rule change is intended to replace and update that rule filing.

that change, NASD must modify existing NASD rules, effective upon Nasdaq's registration as an exchange, to reflect this separation of Nasdaq from NASD. These changes include removing references in the Delegation Plan to Nasdaq as a subsidiary and delegation of authority to Nasdaq; revising the NASD By-Laws, NASD Regulation, Inc. By-Laws and NASD Dispute Resolution, Inc. By-Laws to remove references to Nasdaq as a subsidiary of NASD; deleting Nasdaq-specific rules, such as listing and qualification requirements; replacing references to "Nasdaq" with "NASD" or "exchange," as applicable; and renaming and renumbering certain rules.<sup>7</sup> Provided below are descriptions of the more significant proposed rule changes to reflect Nasdaq's separation from NASD.

#### *Deleted NASD Rules*

The following rules have been deleted by NASD in their entirety because they either relate exclusively to participation in, and operation of, the Nasdaq Stock Market or would no longer be applicable upon the separation of Nasdaq from NASD: NASD Rules 2852, 2854 and 2870 through 2885 related to Nasdaq Index Options; NASD Rules 5100 through 5113 and Rule 8212 related to the Nasdaq International Service; the NASD Rule 5200 Series related to Intermarket Trading System/Computer Assisted Execution System (ITS/CAES);<sup>8</sup> the NASD Rule 6300 Series related to the Consolidated Quotations Service (CQS);<sup>9</sup> the NASD Rule 6400 Series relating to reporting transactions in exchange-listed securities;<sup>10</sup> the NASD Rule 6800 Series related to the Mutual Fund Quotation Service; and NASD Rule 11890 related to Clearly Erroneous Transactions.

#### *NASD Rule 2840 Series Related to Trading in Index Warrants*

The proposed rule change would delete language in the NASD Rule 2840 Series related to index warrants listed on the Nasdaq Stock Market. The existing rule series was promulgated because Nasdaq intended to list such

<sup>7</sup> This proposed rule change also includes corrections of minor grammatical or typographical errors and other miscellaneous non-substantive changes.

<sup>8</sup> NASD is considering the appropriate quoting and trading structure and rules that would be applicable to exchange-listed securities other than Nasdaq securities. Its current intention is to permit quoting and trade reporting of these securities through the ADF and to permit trade reporting through the Trade Reporting Facility. Accordingly, proposed changes relating to quoting and trading in these securities will be addressed in a future submission with the Commission.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

index warrants. The remainder of NASD Rule 2840 Series remains unchanged, as it has continued applicability to NASD members that are not also members of an exchange on which they trade index warrants.

*NASD Rules 2850 Through 2885 Related to Position Limits and Options Trading*

To reflect Nasdaq's separation from NASD, the proposed rule change deletes from NASD Rules 2850 through 2885 all language related to position limits and transactions in index warrants and options traded on Nasdaq. However, the rule change retains all provisions related to options trading in the listed and over-the-counter ("OTC") markets.

*NASD Rule 5300 Series Related to PORTAL Securities*

The current NASD Rule 5300 Series provides qualification and transaction reporting requirements relating to PORTAL securities, which are foreign and domestic securities that are eligible for resale under Rule 144A under the Securities Act of 1933.<sup>11</sup> The proposed rule change deletes the PORTAL requirements relating to the qualification or designation of PORTAL securities, as that function would be performed by Nasdaq. Transactions in PORTAL securities, however, would be reported to NASD; therefore, the proposed rule change retains those rules and has relocated them to the NASD Rule 6700 Series.

*NASD Rules 6500 Through 6700 Series Related to OTC Equity Securities*

The proposed rule change would combine the existing NASD Rule 6600 and 6700 Series into a single NASD Rule 6600 Series that governs transactions in "OTC equity securities," as that term is defined in the rules. The proposed combination is intended to eliminate redundancies in the existing rules, while maintaining all of the regulatory requirements for trading and reporting transactions in such securities.

The proposed rule change also includes separate definitions for a "non-exchange listed security" and "OTC Equity Security," with the latter including certain exchange-listed securities that do not otherwise qualify for real-time reporting. NASD believes this is necessary given that the trade reporting obligations under the NASD Rule 6600 Series apply to certain exchange-listed securities that do not otherwise qualify for real-time trade reporting, while other NASD requirements, such as current NASD Rule 6740, do not apply to such

securities. In addition, because NASD would continue to operate the OTC Bulletin Board, the proposed rule change retains the NASD Rule 6500 Series. Throughout these rules, references to Nasdaq and Nasdaq systems have been replaced with NASD, NASD systems or the OTC Reporting Facility<sup>12</sup> as appropriate.

*NASD Rule 6900 Series Related to Direct Participation Programs (DPPs)*

The NASD Rule 6900 Series governs trade reporting of secondary market transactions by members in DPP securities other than transactions executed on a national securities exchange. The proposed rule change amends the NASD Rule 6900 Series to reflect the fact that, upon the separation of Nasdaq and NASD, DPPs would no longer be reported to the Nasdaq Market Center, but would be reported to NASD.

*NASD Rule 6950 Series Related to Order Audit Trail System (OATS) Requirements*

Upon Nasdaq's registration as an exchange, orders routed by members to Nasdaq would be subject to the OATS order transmittal requirements in NASD Rule 6954(c)(6), relating to routes to non-members, including national securities exchanges. To ensure that NASD continues to receive from its members the same OATS data and linkage information that it receives today, the proposed rule change amends NASD Rule 6954(c)(6) to require that members record the routed order identifier or other unique identifier required by the non-member receiving the order, as applicable. As a result, it is our understanding that Nasdaq's exchange rules would require that orders transmitted to the Nasdaq Market Center continue to provide a routed order identifier. As such, the proposed rule change would require that members record that same routed order identifier in their transmittal reports, as they do today.

The proposed rule change also clarifies existing requirements related to routed order identifiers, specifically that members are permitted to use a routed order identifier that is different from the order identifier used for order origination purposes and that a member transmitting an order to another member must provide the routed order identifier to the member receiving the order.<sup>13</sup>

<sup>12</sup> The service by which members can trade report OTC equity securities has been named the "OTC Reporting Facility" for purposes of this proposed rule change. The official name of that system, however, has not yet been determined.

<sup>13</sup> The Commission notes that NASD has also proposed to require members to identify the

*NASD Rule 9700 Series Related to Grievances Concerning Automated Systems*

NASD is proposing to delete in its entirety the NASD Rule 9700 Series, which sets forth procedures to address unspecified general grievances related to any automated quotation, execution or communication system operated by NASD or Nasdaq. Several of the provisions relate to the authority of the Nasdaq Listing and Review Council, which no longer would be part of NASD upon Nasdaq exchange registration. Moreover, this rule series is very general in nature, as it ostensibly is a "catch-all" for all potential grievances not otherwise provided for in NASD rules, including the Code of Procedure (NASD Rule 9000 Series) and the Uniform Practice Code (NASD Rule 11000 Series). NASD believes that whatever residual application this rule series may have served at some point, it has since been superceded by additional rules that provide redress for specific grievances, such as denial of access to services under NASD Rule 9555 and denial of access complaints related to the ADF under NASD Rule 4400A.

*Proposed Changes Related to the Alternative Display Facility*

The ADF is a quotation collection, trade comparison, and trade reporting facility developed by NASD in accordance with the Commission's SuperMontage Approval Order<sup>14</sup> and in conjunction with Nasdaq's anticipated registration as a national securities exchange. The ADF, which currently is operating on a pilot basis, provides ADF market participants (market makers and ECNs) the ability to post quotations in Nasdaq securities and provides all members that participate in the ADF the ability to view quotations and report transactions in Nasdaq securities to the exclusive securities information processor ("SIP") for Nasdaq-listed issues for consolidation and dissemination of data to vendors and ADF market participants. The facility provides for trade comparison through the Trade Reporting and Comparison Service ("TRACS") and further provides for real-time data delivery to NASD for

national securities exchange or registered securities association to which an order is transmitted. See proposed NASD Rule 6954(c)(6)(I). In its submission, NASD inadvertently neglected to underline the proposed rule text to indicate that it was new language. Telephone call between Stephanie Dumont, Vice President, Associate General Counsel, NASD and Kelly M. Riley, Assistant Director, Division of Market Regulation ("Division"), Commission on July 15, 2005.

<sup>14</sup> Securities Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001) (SR-NASD-99-53).

<sup>11</sup> 17 CFR 230.144A.

regulatory purposes, including enforcement of firm quote and related rules.

NASD is proposing several clarifying and conforming changes to the ADF rules including: (1) Clarification that certain ADF requirements apply not only to Registered Reporting ADF market makers, but to Registered Reporting ADF ECNs as well; (2) amendments to the ADF trade reporting requirements to make them more consistent with current Nasdaq trade reporting rules, including requiring that execution time be included in all ADF trade reports; (3) clarification that all applicable trade modifiers must be included in "as/of" trades; (4) amendments to the trade halt rule to include halt authority if there is extraordinary market activity in a security; and (5) deletion of the provisions in the ADF rules relating to passive market making, since passive market making would not be available on the ADF.

*Proposed Changes Related to the Trade Reporting Facility*

*Establishment of the Trade Reporting Facility*

NASD is proposing to establish the Trade Reporting Facility, which would provide members another mechanism for reporting transactions effected otherwise than on an exchange. In this regard, Nasdaq and NASD propose to enter into a Limited Liability Company Agreement of The Trade Reporting Facility LLC between Nasdaq and NASD ("the LLC Agreement"), a copy of which is available on the NASD's Web Site (<http://www.nasd.com>) and the Commission's Web Site (<http://www.sec.gov>). The Trade Reporting Facility would be a facility of NASD and subject to NASD's registration as a national securities association. Trades by members in Nasdaq-listed and other exchange-listed securities<sup>15</sup> executed otherwise than on an exchange ("Non-System Trading") may be reported to the Trade Reporting Facility. NASD would continue to have regulatory responsibility for the Non-System Trading reported to the Trade Reporting Facility, while Nasdaq agrees to pay the cost of regulation and would provide systems to enable broker-dealers to report trades to the Trade Reporting Facility. Nasdaq would be entitled to the economic interests derived from the Non-System Trading reported to the Trade Reporting Facility. This proposed structure would be in place for at least three years.

Pursuant to the LLC Agreement, NASD, as the "SRO Member" of the Trade Reporting Facility, would have the sole regulatory responsibility for the activities of the Trade Reporting Facility. The SRO Member would perform SRO Responsibilities including, but not limited to:

(1) Adoption, amendment and interpretation of policies arising out of and regarding the operation of the facilities of the SRO, or regarding the meaning, administration, or enforcement of an existing rule of the SRO, including any generally applicable exemption from such a rule;

(2) Approval of rule filings of the SRO prior to filing with the Commission;

(3) Regulation of the Trade Reporting Facility's activities, including the right to review and approve the regulatory budget for the Trade Reporting Facility;

(4) Securities regulation and any other matter implicating SRO Responsibilities; and

(5) Real-time market surveillance (Nasdaq Marketwatch).

Nasdaq, as the "Business Member," would be primarily responsible for the management of the Trade Reporting Facility's business affairs to the extent those activities are not inconsistent with the regulatory and oversight functions of NASD. 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.

The Trade Reporting Facility would be managed by or under the direction of a Board of Directors to be established by the parties. NASD would have the right to designate at least one Director, the SRO Member Director, who may be a member of NASD's Board of Governors or an officer or employee of NASD designated by the NASD Board of Governors. The SRO Member Director would have veto power over all major actions of the LLC Board. Major actions are defined in Section 10(e) of the LLC Agreement to include:

(1) Approving pricing decisions that are subject to the Commission filing process;

(2) Approving contracts between the Trade Reporting Facility and the Business Member, any of its affiliates, directors, officers or employees;

(3) Approving Director compensation;

(4) Selling, licensing, leasing or otherwise transferring material assets used in the operation of the Trade Reporting Facility's business outside of the ordinary course of business with an aggregate value in excess of \$3 million;

(5) Approving or undertaking a merger, consolidation or reorganization of the Trade Reporting Facility with any other entity;

(6) Entering into any partnership, joint venture or other similar joint business undertaking;

(7) Making any fundamental change in the market structure of the Trade Reporting Facility from that contemplated by the Members as of the date of the LLC Agreement;

(8) To the fullest extent permitted by law, taking any action to effect the voluntary, or which would precipitate an involuntary, dissolution or winding up of the Company, other than as contemplated by Section 20 of the LLC Agreement;

(9) Conversion of the Trade Reporting Facility from a Delaware limited liability company into any other type of entity;

(10) Expansion of or modification to the business which results in the Trade Reporting Facility engaging in material business unrelated to the business of Non-System Trading;

(11) Changing the number of Directors on or composition of the Board; and

(12) Adopting or amending policies regarding access and credit matters affecting the Trade Reporting Facility.

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.

Either Member may dissolve the Trade Reporting Facility LLC by providing to the other Member prior written notice of at least one year. Neither Member may deliver such notice before the second anniversary of the effective date of the LLC Agreement. After notice, the Members must negotiate in good faith to (i) allow the Business Member to continue to operate the LLC under NASD's SRO registration, (ii) restructure the LLC to allow the Business Member to operate the facility under Nasdaq's SRO registration, or (iii) sell the LLC or the business of the LLC to the SRO Member based on an agreed valuation. If the parties cannot agree on any of (i), (ii) or (iii), the LLC Agreement provides in Section 20(b) a mechanism for an appraisal process.

*Proposed Rules Relating to the Trade Reporting Facility*

NASD also is proposing rules relating to the use and operation of the Trade Reporting Facility. Members now would have the option of trade reporting transactions executed otherwise than on an exchange either to the Trade

<sup>15</sup> See *supra* note 7.

Reporting Facility or the ADF.<sup>16</sup> For purposes of these requirements, the proposed rule change would define the term “otherwise than on an exchange” to mean a trade effected by an NASD member in an exchange-listed security otherwise than on or through the facilities of a national securities exchange. The determination of what constitutes a trade “on or through” a national securities exchange would be left to the respective exchanges and applicable statutes, rules and regulations, as approved by the Commission.

The proposed rule change replaces the existing Nasdaq trade reporting rules in the Rule 4000 and 6100 Series in their entirety with rules applicable to the Trade Reporting Facility.<sup>17</sup> However, the proposed rules relating to the Trade Reporting Facility track, with certain limited exceptions, the requirements and general organization of the current Nasdaq trade reporting rules.

The proposed rule change combines the trade reporting requirements in the current NASD Rule 4630, 4640 and 4650 Series (Nasdaq National Market, Nasdaq SmallCap and Nasdaq Convertible Debt Securities, respectively) into one rule series (proposed NASD Rule 4630 Series), which then applies the proposed trade reporting requirements uniformly to all securities listed on Nasdaq. Because no quoting or issuer listing and qualifications activities would occur on or through the Trade Reporting Facility, all rules in the current NASD Rule 4000 Series pertaining to such activities have not been included. In addition, the current rule relating to customer confirmations for transactions in Nasdaq SmallCap securities (NASD Rule 4643) has not been included because it is duplicative of Rule 10b-10 under the Act.<sup>18</sup> Finally, the proposed rule change does not include rules relating to the risk management functionality currently provided through Nasdaq’s ACT, as that service would not be provided through the Trade Reporting Facility.

As a result of these rule deletions, there are several gaps in the numbering of proposed rules (e.g. NASD Rule 4200 is followed by NASD Rule 4616). However, NASD believes it is preferable at this time to have these “gaps in

numbering” to maintain consistency with the ADF trade reporting rules and to retain continuity with respect to prior guidance that has been disseminated relating to Nasdaq trade reporting rules. In this regard, NASD intends to interpret and apply the Trade Reporting Facility rules in the same manner in which the Nasdaq trade reporting rules currently are interpreted and applied.

In addition, NASD is proposing NASD Rule 4633, which would give NASD the authority to halt trading otherwise than on an exchange reported to the Trade Reporting Facility. The proposed trading halt rule would impose mandatory trade halts when a primary market halts for certain defined regulatory reasons and grants NASD discretion to halt when there is extraordinary market activity in a security or the primary market halts for operational reasons. The proposal also provides NASD the authority to halt trading in the event that the facility cannot transmit real-time trade reporting information to the SIP. NASD believes it must have this authority to ensure that necessary and reliable information would be disseminated from the Trade Reporting Facility to the marketplace. However, the proposal would not necessarily restrict, in the event of a halt due to operational problems limited only to the Trade Reporting Facility, continued trading otherwise than on an exchange outside of the Trade Reporting Facility, for example, through the ADF. This is similar in application to the ADF trading halt rule.<sup>19</sup>

NASD also is proposing a new NASD Rule 5000 Series relating to trading otherwise than on an exchange. In the new NASD Rule 5000 Series, NASD is proposing rules that would apply uniformly to trading in the ADF and the Trade Reporting Facility.<sup>20</sup> First, proposed NASD Rule 5000 provides that members are required to report transactions effected otherwise than on or through a national securities exchange to NASD through either the Trade Reporting Facility, pursuant to the NASD Rule 4000 and 6000 Series, or the ADF, pursuant to the NASD Rule 4000A and 6000A Series.

Second, NASD is proposing to renumber current NASD Rule 3350 (the “Short Sale Rule”) as NASD Rule 5100 and apply its requirements to

transactions reported to either the ADF or the Trade Reporting Facility. Similar to the current application of NASD Rule 3350 to trades reported to the ADF, the proposed rule change would require members to comply with the Short Sale Rule based on the national best bid for Nasdaq National Market Securities.<sup>21</sup> In all other respects, the Short Sale Rule would be consistent with the current short sale rule, including an exemption for registered market makers engaged in bona fide market making activity. The proposed rule change also clarifies that the term “customer” as used in the Short Sale Rule applies to non-member broker-dealers and makes other conforming changes in light of the Commission’s adoption of Regulation SHO.

Finally, NASD is proposing NASD Rule 5200 that would prohibit members from executing a transaction otherwise than on an exchange in a security subject to an initial public offering until such security has first opened for trading on the national securities exchange listing the security, as indicated by the dissemination of an opening transaction in the security by the listing exchange. This is similar to the requirement currently in NASD Rule 6440(g), applicable to OTC transactions in exchange-listed securities.

Based on discussions with Commission staff, NASD also is noting that it intends to work with the appropriate parties to ensure that Trade Reporting Facility and ADF transactions are disseminated to the media with a modifier indicating the source of such transactions that would distinguish them from transactions executed on or through the Nasdaq Stock Market.

This rule proposal does not include any proposed fees or assessments specifically related to the Trade Reporting Facility. Fees or assessments with respect to the Trade Reporting Facility will be the subject of a future submission with the Commission.

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,<sup>22</sup> in general, and Section 15A(b)(6) of the Act,<sup>23</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, and, in general, to protect investors and the public interest. NASD

<sup>16</sup> NASD will have an integrated audit trail of Trade Reporting Facility and ADF transactions and will have integrated surveillance capabilities.

<sup>17</sup> The clearing and comparison requirements in the NASD Rule 6100 Series apply both to the Trade Reporting Facility and the NASD system that would be used for purposes of transaction reporting of OTC equity securities and DPPs.

<sup>18</sup> 17 CFR 240.10b-10.

<sup>19</sup> As such, under the proposal, NASD Rule 3340 would not prohibit a member from quoting or trading through another market if NASD closes trading pursuant to its authority under proposed NASD Rule 4633(a)(3) or NASD Rule 4120A(a)(3).

<sup>20</sup> Rules that previously resided in the NASD Rule 5000 Series, and have not otherwise been deleted, have been moved.

<sup>21</sup> Telephone call between Phil Shaikun, Associate General Counsel, NASD and Kelly M. Riley, Division, Commission on July 15, 2005.

<sup>22</sup> 15 U.S.C. 78o-3.

<sup>23</sup> 15 U.S.C. 78o-3(b)(6).

believes that the proposed rule change will provide an effective mechanism and regulatory framework for quoting and trading activities otherwise than on an exchange upon Nasdaq's separation from NASD.

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

NASD believes that the proposed rule change will not 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 on this proposed rule change 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 NASD 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](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2005-087 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-2005-087. 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 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 the File Number SR-NASD-2005-087 and should be submitted on or before August 12, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>24</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

[FR Doc. E5-3912 Filed 7-21-05; 8:45 am]

**BILLING CODE 8010-01-P**

## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-52035; File No. SR-OCC-2002-16]

### **Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of a Proposed Rule Change Relating to Unsegregation of Long Option Positions**

July 14, 2005.

#### **I. Introduction**

On July 9, 2002, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-OCC-2002-16 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> On December 12, 2002, and January 11, 2005, OCC amended the proposed rule change. Notice of the proposal was published in the **Federal Register** on March 14,

2005.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

#### **II. Description**

OCC Rule 611 permits a clearing member to issue instructions to OCC to release from segregation a long position in options contracts carried in a customers' account or firm non-lien account provided that the clearing member is simultaneously carrying in such account for such customer a short position in option contracts and the margin requirement of the customer has been reduced as a result of carrying the long option position. The proposed rule change amends Rule 611(c) to permit a clearing member to issue such instructions where one leg of the spread is a long option position and the other is a long or short position in a security futures contract.

The proposed rule change was submitted in light of joint margin rules that were adopted by the Commission and by the Commodity Futures Trading Commission ("CFTC") on August 1, 2002,<sup>3</sup> pursuant to Section 7(c)(2) of the Act and related provisions of the Commodity Exchange Act governing the setting of margin requirements for security futures. The proposed rule is drafted in such a way that its operation is dependent on the joint margin rules and the rules of the exchanges and security futures markets adopted thereunder. Only if a particular spread position involving a long option qualifies for reduced margin treatment under those rules could the option be unsegregated pursuant to Rule 611. With approval of this proposed rule change, consistency between the joint margin rules and Rule 611(c) will be assured.<sup>4</sup>

Section 7(c)(2)(B) of the Act requires that the margin requirements for security futures products be consistent with the margin requirements for comparable options contracts traded on any exchange registered pursuant to section 6(a) of the Act.<sup>5</sup> Clearing members are permitted under the joint margin rules<sup>6</sup> and exchange and

<sup>2</sup> Securities Exchange Act Release No. 51331, (March 8, 2005), 70 FR 12525.

<sup>3</sup> Securities Exchange Act Release No. 46292, 67 FR 53146 (August 14, 2002) [File No. S7-16-01].

<sup>4</sup> OCC has requested a no action position from the Commission's Division of Market Regulation that a clearing member that gives an instruction to unsegregate long option positions pursuant to this amended rule will not be deemed to be in violation of Rules 15c3-3, 8c-1, and 15c2-1 under the Act. *Supra*, note 12.

<sup>5</sup> 15 U.S.C. 78g(c)(2)(B)(iii)(I).

<sup>6</sup> *Supra*, note 3.

<sup>24</sup> 17 CFR 200.30-3(a)(12).

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