

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57784; File No. SR-FINRA-2007-039)

May 6, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change as Modified by Amendment Nos. 1 and 2 Thereto to Establish an Exemption for Certain Regulation NMS-Compliant Intermarket Sweep Orders from the Requirements in IM-2110-2 (Trading Ahead of Customer Limit Order) and Rule 2111 (Trading Ahead of Customer Market Orders)

I. Introduction

On December 21, 2007, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)), filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to establish an exemption for certain Regulation NMS-compliant Intermarket Sweep Orders (“ISOs”) from the requirements governing trading ahead of customer limit orders and customer market orders. On February 11, 2008, FINRA filed Amendment No. 1 to the proposed rule change. The proposed rule change, as amended, was published for comment in the Federal Register on March 5, 2008.³ The Commission received one comment letter regarding the proposal.⁴ FINRA responded to the comment letter on March 26, 2008.⁵ On April 30, 2008, FINRA filed Amendment No. 2 to the proposed rule change.⁶

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 57388 (February 27, 2008), 73 FR 11963.

⁴ See submission via SEC WebForm from Craig Carlino, Monroe Securities, dated March 13, 2008.

⁵ See letter from Andrea D. Orr, Assistant General Counsel, FINRA, to Nancy M. Morris, Secretary, Commission, dated March 26, 2008 (“FINRA letter”).

⁶ In Amendment No. 2, FINRA deleted definitions that were either unnecessary or duplicative from the proposed rule text. Because the Amendment is technical in nature, it is not subject to notice and comment.

This order approves the proposed rule change, as modified by Amendment Nos. 1 and 2.

II. Description of the Proposed Rule Change

FINRA is proposing to establish an exemption for certain Regulation NMS-compliant ISOs⁷ from the Rule and the Interpretive Material (“IM”) that govern trading ahead of customer limit orders and customer market orders. Under the proposed rule, a member will be exempt from its obligations with respect to trading for its own account if an ISO is routed in compliance with Rule 600(b)(30)(ii) of Regulation NMS, and the customer limit order or market order is received after the member routed the ISO. The exemption will also apply if the member executes an ISO to facilitate a customer limit order or market order, and the customer has consented to not receiving the better prices obtained by the ISO.

In its filing with the Commission, FINRA stated that the proposed exemption is similar to an exemption adopted by the New York Stock Exchange LLC to its Rule 92 (Limitations on Members’ Trading Because of Customers’ Orders). The ISO exemption to Rule 92 was approved by the Commission on July 5, 2007.⁸

⁷ Regulation NMS defines an ISO as a limit order for an NMS stock that meets the following requirements: (i) when routed to a trading center, the limit order is identified as an intermarket sweep order; and (ii) simultaneously with the routing of the limit order identified as an intermarket sweep order, one or more additional limit orders, as necessary, are routed to execute against the full displayed size of any protected bid, in the case of a limit order to sell, or the full displayed size of any protected offer, in the case of a limit order to buy, for the NMS stock with a price that is superior to the limit price of the limit order identified as an intermarket sweep order. These additional routed orders also must be marked as intermarket sweep orders. See 17 CFR 242.600(b)(30).

⁸ See Securities Exchange Release No. 56017 (July 5, 2007), 72 FR 38110 (July 12, 2007) (SR-NYSE-2007-21).

III. Summary of Comments

The Commission received one comment letter in response to the proposed rule change.⁹ The commenter stated that the implementation of IM-2110-2 will reduce liquidity and result in inferior executions for public investors who own non-penny stock OTC securities.¹⁰ The commenter also objected to the change to the definition of the size of the order on which terms and conditions may be negotiated.¹¹

FINRA responded to the comment letter on March 26, 2008.¹² FINRA stated that the comment letter was not germane to the proposed rule change, as it did not pertain to the proposed ISO exemption.¹³ According to FINRA, the comments related to a rule change, previously approved by the Commission,¹⁴ which expanded IM-2110-2 to apply to OTC equity securities.¹⁵

IV. Discussion and Commission Findings

The Commission has carefully reviewed the proposed rule change, the comment letter, and FINRA's response to the comment letter, and finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association¹⁶ and, in particular, Section 15A(b)(6) of the Act,¹⁷ which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and

⁹ Supra note 4.

¹⁰ Id. at 1-2.

¹¹ Id. at 2.

¹² Supra note 5.

¹³ Id. at 1.

¹⁴ See Securities Exchange Act Release No. 55351 (February 26, 2007), 72 FR 09810 (March 5, 2007) (SR-NASD-2005-146).

¹⁵ FINRA letter at 2.

¹⁶ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁷ 15 U.S.C. 78o-3(b)(6).

practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The Commission believes that it is reasonable for FINRA to amend IM-2110-2 and Rule 2111 to exempt members when routing certain Regulation NMS-compliant ISOs. The proposed rule change should enable members to comply with the ISO routing requirements of Rule 611 of Regulation NMS without violating IM-2110-2 and Rule 2111 and, given the ISO routing exemption that currently exists under NYSE Rule 92, will subject ISO routing to consistent standards.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁸ that the proposed rule change (SR-FINRA-2007-039), as modified by Amendment Nos. 1 and 2, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁹

Florence E. Harmon
Deputy Secretary

¹⁸ 15 U.S.C. 78s(b)(2).

¹⁹ 17 CFR 200.30-3(a)(12).