

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54186; File No. SR-NASD-2006-081)

July 20, 2006

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change to Adopt New NASD Rule 5150 Relating to Trade-Throughs

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 11, 2006, 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 the NASD. 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 NASD is proposing to adopt, in anticipation of The NASDAQ Stock Market LLC (the “Nasdaq Exchange”) beginning to trade non-Nasdaq exchange-listed securities on an unlisted trading privileges (“UTP”) basis, new NASD Rule 5150 to require an NASD member that is registered as a market maker with the Nasdaq Exchange in a non-Nasdaq exchange-listed security to comply with the provisions of NASD Rule 5262 relating to trade-throughs with respect to that security for trades reported to the NASD. Below is the text of the proposed rule change. Proposed new language is underlined.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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5000. OTHER NASDAQ AND NASD MARKETS

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5150. Applicability of Trade-Through Rule to Nasdaq Market Makers

An NASD member shall comply with the provisions of Rule 5262 (Trade-Throughs), as if it were an ITS/CAES market maker, for purposes of transactions that are reported to NASD in any ITS Security, as that term is defined in Rule 5210(c), in which such member is registered as a market maker with The NASDAQ Stock Market LLC. For purposes of this Rule 5150, the term “Block Transaction” under Rule 5262(a)(7)(B) shall mean any trade that involves 10,000 or more shares of an ITS security or a quantity of any such security having a market value of \$200,000 or more.

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

In its filing with the Commission, the 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. The 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 proposed rule change is filed in anticipation of the Nasdaq Exchange operating as a national securities exchange for purposes of trading non-Nasdaq exchange-

listed securities on a UTP basis. The NASD is proposing a new rule to require an NASD member that is registered as a market maker with the Nasdaq Exchange in an ITS Security, as defined Rule 5210(c), to comply with the provisions of NASD Rule 5262 (Trade-Throughs) with respect to that security for trades reported to the NASD.

Background

On July 11, 2005, the NASD filed with the Commission proposed rule change SR-NASD-2005-087, which, among other things, proposed amendments to the Plan of Allocation and Delegation of Functions by the NASD to Subsidiaries, NASD By-Laws and NASD rules to reflect The Nasdaq Stock Market, Inc.'s ("Nasdaq") separation from the NASD upon the Nasdaq Exchange's operation as a national securities exchange.³ On June 15, 2006, the NASD filed Amendment No. 1 to SR-NASD-2005-087, which, among other things, proposed the NASD's and Nasdaq's implementation strategy for Nasdaq's operation as a national securities exchange. On June 30, 2006, the Commission approved SR-NASD-2005-087, as amended, the effective date of which will be the date upon which the Nasdaq Exchange operates as an exchange for Nasdaq-listed securities.⁴ The NASD intends to file a second proposed rule change proposing an NASD facility for over-the-counter quoting and trading of non-Nasdaq exchange-listed securities, to be made available when the Nasdaq Exchange begins to trade such securities on a UTP basis.

3 The Commission approved the Nasdaq Exchange application on January 13, 2006. See Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006).

4 See Securities Exchange Act Release No. 54084 (June 30, 2006), 71 FR 38935 (July 10, 2006).

Currently, NASD Rule 5262, also known as the Trade-Through Rule, restricts a member registered as an NASD ITS/CAES Market Maker⁵ in an ITS/CAES security⁶ from purchasing or selling such security, whether as principal or agent, at a price that is lower than the bid or higher than the offer displayed from an ITS Participant Exchange or ITS/CAES Market Maker. Current NASD Rule 5262 applies to all over-the-counter trading by NASD ITS/CAES Market Makers in that security, including trades executed outside of CAES and reported to the NASD.

The Nasdaq Exchange established a substantially similar rule, Nasdaq Rule 5262, which, by its terms, would apply to market makers registered with the Nasdaq Exchange (“Nasdaq market makers”) in ITS Securities. However, because the ITS Plan does not require the Nasdaq Exchange, or any other exchange, to have a trade-through rule applicable to its individual market participants, the Nasdaq Exchange has proposed to delete the rule upon integration of the Nasdaq Market Center and Nasdaq’s Brut and INET systems into a single book.⁷ If approved, the Nasdaq Exchange’s rule would be replaced with a trade-through obligation imposed on the Nasdaq Exchange itself.

⁵ For purposes of NASD Rule 5262, “ITS/CAES Market Maker” is defined in NASD Rule 5210(e) as a member that is registered as a market maker for the purposes of participating in the Intermarket Trading System (“ITS”) through the Computer Assisted Execution System (“CAES”) with respect to one or more specified ITS securities in which the member is then actively registered. The term also includes members that meet the definition of electronic communications network or alternative trading network. CAES is an automated system that is currently operated by The Nasdaq Stock Market, Inc. NASD members can direct agency and principal orders in exchange-listed securities to CAES for automated execution in the third market.

⁶ The term “ITS Security” is defined in NASD Rule 5210(c) as “any security which may be traded through the [ITS] System by an ITS/CAES Market Maker.”

⁷ See Securities Exchange Act Release No. 53583 (March 31, 2006), 71 FR 19573 (April 14, 2006) (SR-NASDAQ-2006-001).

Further, once the Nasdaq Exchange is operating as an exchange for non-Nasdaq exchange-listed securities, it is expected that some of the current NASD ITS/CAES Market Makers will no longer be registered with the NASD in this capacity, but instead will become registered solely as Nasdaq Market Makers. As such, no trade-through rule would apply to over-the-counter trading activity by these Nasdaq market makers that are not also registered as NASD ITS/CAES market makers. Specifically, NASD Rule 5262 only applies to trading by NASD ITS/CAES market makers. Nasdaq Rule 5262 would be similarly limited in its application to Nasdaq market makers trading on or through the Nasdaq Exchange, and is expected to be eliminated altogether upon approval of the Nasdaq Exchange's system integration.

Proposed New NASD Rule 5150

The NASD is proposing new NASD Rule 5150⁸ that would subject an NASD member registered as a market maker with the Nasdaq Exchange in an ITS Security to the provisions of NASD Rule 5262 for purposes of trades in that ITS Security reported to the NASD, as if such market maker were an ITS/CAES Market Maker. Thus, an NASD member that is a Nasdaq market maker trading ITS Securities otherwise than on an exchange – for example, through the Trade Reporting Facility approved as part of SR-NASD-2005-087 – would be subject to the provisions of NASD Rule 5262, including its trade-through complaint procedures.

All of the exclusions to the Trade-Through Rule applicable under NASD Rule 5262(a) would be available to Nasdaq market makers subject to proposed NASD Rule

⁸ Pursuant to SR-NASD-2005-087, the NASD Rule 5000 Series will be renamed “Trading Otherwise Than On An Exchange” and for purposes of the NASD Rule 5000 Series, “otherwise than on an exchange” will mean a trade effected by an NASD member otherwise than on or through a national securities exchange.

5150 and would apply as they do today to ITS/CAES Market Makers, with one limited exception. The NASD is proposing that, for purposes of applying the term “Block Transaction” under NASD Rule 5262(a)(7)(B) to Nasdaq market makers that are not NASD ITS/CAES Market Makers, the term mean any trade that involves 10,000 or more shares of an ITS security or a quantity of any such security having a market value of \$200,000 or more. This limitation makes the term consistent with the definition of “block size” in Regulation NMS Rule 600, which currently serves to exempt certain NASD members from a requirement to become NASD ITS/CAES Market Makers under certain circumstances. As such, Nasdaq market makers that are not also NASD ITS/CAES Market Makers would not be subject to the requirement in Rule 5264(a) to send commitments to other venues when executing block size trades or the other block transaction requirements in NASD Rule 5264(b)(2) and (3), such as the requirement to effect a block trade as a cross or at a price other than the ITS/CAES Market Maker’s quote.

The NASD believes proposed NASD Rule 5150 is necessary to maintain the application of the Trade-Through Rule until implementation of Regulation NMS, and specifically the Order Protection Rule mandating intermarket protection against trade-throughs for all Nasdaq and exchange-listed securities.⁹ Effective upon the implementation of the Order Protection Rule, the NASD would repeal NASD Rule 5150 in favor of a more general rule complying with Regulation NMS.

⁹ See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (Final Rule). The effective date for NMS Rule 611, the Order Protection Rule, was August 29, 2005; however, the initial compliance date has been extended from June 29, 2006 to a series of five dates, beginning on October 16, 2006. See Securities Exchange Act Release No. 53829 (May 18, 2006), 71 FR 30038 (May 24, 2006).

The effective date of the proposed rule change will be the date upon which the Nasdaq Exchange begins to trade non-Nasdaq exchange-listed securities on a UTP basis.

2. Statutory Basis

The NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁰ which requires, among other things, that NASD rules be 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. The NASD believes that the proposed rule change will enhance investor protection by maintaining trade through protection for over-the-counter trades in exchange-listed securities.

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

The NASD 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.

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:

¹⁰ 15 U.S.C. 78o-3(b)(6).

(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. Please include File Number SR-NASD-2006-081 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-2006-081. 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 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-2006-081 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Nancy M. Morris
Secretary

¹¹ 17 CFR 200.30-3(a)(12).