

OMB APPROVAL

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2007 - 040

Amendment No.

Proposed Rule Change by National Association of Securities Dealers

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial ☒	Amendment ☐	Withdrawal ☐	Section 19(b)(2) ☐	Section 19(b)(3)(A) ☒	Section 19(b)(3)(B) ☐
Pilot ☐			Rule		
Extension of Time Period for Commission Action ☐			☐ 19b-4(f)(1) ☐ 19b-4(f)(4) ☐ 19b-4(f)(2) ☐ 19b-4(f)(5) ☐ 19b-4(f)(3) ☒ 19b-4(f)(6)		
Date Expires 					

Exhibit 2 Sent As Paper Document



Exhibit 3 Sent As Paper Document

**Description**

Provide a brief description of the proposed rule change (limit 250 characters).

Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Clearing Reports for Previously Executed Trades

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Last Name
Title
E-mail
Telephone Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date By

(Name)

(Title)

NOTE: Clicking the button at right will digitally sign and lock
this form. A digital signature is as legally binding as a physical
signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Add

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Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit Sent As Paper Document

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Exhibit 3 - Form, Report, or Questionnaire

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Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit Sent As Paper Document

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Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend NASD Rules 6130, 6130A, 6130C, 6130D and 6130E to prohibit members from submitting to an NASD Facility (i.e., the Alternative Display Facility (“ADF”) or a Trade Reporting Facility) any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to that NASD Facility, except where such report reflects the offsetting “riskless” portion of a riskless principal transaction. NASD also is proposing to amend NASD Rules 4632(d), 4632A(e), 4632C(d), 4632D(e) and 4632E(e) to clarify that where the first leg of a riskless principal transaction is reported to NASD, the second leg must also be reported to NASD; however, in such circumstance, members are not required to report both legs of the transaction to the same NASD Facility.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

4000. THE NASD/NASDAQ TRADE REPORTING FACILITY

* * * * *

4632. Transaction Reporting

(a) through (c) No Change.

¹ 15 U.S.C. 78s(b)(1).

(d) Procedures for Reporting Price and Volume

Members that report transactions to the NASD/Nasdaq Trade Reporting Facility, pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in designated securities in the following manner:

(1) through (2) No Change.

(3) (A) No Change.

(B) Exception: A “riskless” principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported to the NASD/Nasdaq Trade Reporting Facility as one transaction in the same manner as an agency transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless principal transaction [to the NASD/Nasdaq Trade Reporting Facility] by submitting the following report(s):

(i) The member with the obligation to report the transaction pursuant to paragraph (b) above must submit a last sale report for the initial leg of the transaction.

(ii) Where the initial leg of the transaction has been reported to [the NASD/Nasdaq Trade Reporting Facility] NASD, regardless of whether a member has a reporting obligation pursuant to paragraph (b) above, the firm must submit, for the

offsetting, “riskless” portion of the transaction, either:

a. a clearing-only report with a capacity indicator of “riskless principal,” if a clearing report is necessary to clear the transaction; or

b. a non-tape, non-clearing report with a capacity indicator of “riskless principal,” if a clearing report is not necessary to clear the transaction.

Example:

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a mark-down of \$12.50;

REPORT 100 shares at 40 by submitting [to the NASD/Nasdaq Trade Reporting Facility either] a single trade report marked with a “riskless principal” capacity indicator to the NASD/Nasdaq Trade Reporting Facility or by submitting the following reports:

[(1)]1. where required by this Rule, a tape report marked with a “principal” capacity indicator; and

[(2)]2. either a non-tape, non-clearing report or a clearing-only report marked with a “riskless principal” capacity indicator.

In a riskless principal transaction in which a member purchases or sells the security on an exchange to satisfy a customer's order, the [order] trade will be reported by the exchange. A member may, however, submit to the NASD/Nasdaq Trade Reporting Facility a clearing-only report or a non-tape, non-clearing report for the "riskless" leg of a riskless principal transaction where the initial leg has been reported on or through an exchange. Any such report submitted to the NASD/Nasdaq Trade Reporting Facility shall comply with all applicable requirements for trade reports set forth in this Rule 4632.

Example:

BUY as principal 100 shares on an exchange at 40 to fill an existing order;

DO NOT REPORT this leg (will be reported by exchange).

SELL as principal 100 shares to a customer at 40 plus a mark-up of \$12.50.

A member MAY submit to the NASD/Nasdaq Trade Reporting Facility either a non-tape, non-clearing report or a clearing-only report for this leg marked with a "riskless principal" capacity indicator.

(e) through (h) No Change.

* * * * *

6000. NASD SYSTEMS AND PROGRAMS

6100. CLEARING AND COMPARISON RULES

* * * * *

6130. Trade Report Input

(a) through (g) No Change.

(h) Members shall not submit to the System any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to the System, unless such report is submitted, pursuant to Rule 4632(d), to reflect the offsetting riskless portion of a riskless principal transaction.

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4000A. NASD Alternative Display Facility

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4632A. Transactions Reported by Members to TRACS

(a) through (d) No Change.

(e) Procedures for Reporting Price and Volume

(1) Members that are required, or have the option, to report transactions pursuant to paragraph (d) above shall transmit last sale reports in the following manner:

(A) through (B) No Change.

(C) (i) No Change.

(ii) Exception: A “riskless” principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the

security as principal at the same price to satisfy the order to sell, shall be reported to TRACS as one three party transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless principal transaction by submitting the following report(s) [to NASD]:

a. The member with the obligation to report the transaction pursuant to paragraph (d) above must submit a last sale report for the initial leg of the transaction.

b. Where the initial leg of the transaction has been reported to NASD, [R]regardless of whether a member has a reporting obligation pursuant to paragraph (d) above, the firm must submit, for the offsetting, "riskless" portion of the transaction, either:

1. a clearing-only report with a capacity indicator of "riskless principal," if a clearing report is necessary to clear the transaction; or

2. a non-tape, non-clearing report with a capacity indicator of "riskless principal," if a clearing report is not necessary to clear the transaction.

Example:

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a mark-down of \$12.50;

REPORT 100 shares at 40 by submitting [to NASD either] a single trade report marked with a "riskless principal" capacity indicator to TRACS or by submitting the following reports:

3. where required by this Rule, a tape report marked with a "principal" capacity indicator; and

4. either a non-tape, non-clearing report or a clearing-only report marked with a "riskless principal" capacity indicator.

In a riskless principal transaction in which a member purchases or sells the security on an exchange to satisfy a customer's order, the trade will be reported by the exchange. A member may, however, submit to TRACS a clearing only report or a non-tape, non-clearing report for the "riskless" leg of a riskless principal transaction where the initial leg has been reported on or through an exchange. Any such report submitted to TRACS shall comply with all applicable requirements for trade reports set forth in this Rule 4632A.

Example:

BUY as principal 100 shares on an exchange at 40 to fill an existing order;

DO NOT REPORT this leg (will be reported by exchange).

SELL as principal 100 shares to a customer at 40 plus a mark-up of \$12.50.

A member MAY submit to TRACS either a non-tape, non-clearing report or a clearing-only report for this leg marked with a "riskless principal" capacity indicator.

(D) No Change.

(f) through (j) No Change.

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6000A. NASD ADF SYSTEMS AND PROGRAMS

6100A. TRACS TRADE COMPARISON SERVICE

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6130A. Trade Report Input

(a) through (c) No Change.

(d) Members shall not submit to TRACS any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to TRACS, unless such report is submitted, pursuant to Rule 4632A(e), to reflect the offsetting riskless portion of a riskless principal transaction.

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4000C. THE NASD/NSX TRADE REPORTING FACILITY

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4632C. Transaction Reporting

(a) through (c) No Change.

(d) Procedures for Reporting Price and Volume

Members that report transactions to the NASD/NSX Trade Reporting Facility, pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in designated securities in the following manner:

(1) through (2) No Change.

(3) (A) No Change.

(B) Exception: A “riskless” principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported to the NASD/NSX Trade Reporting Facility as one transaction in the same manner as an agency transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless principal transaction [to the NASD/NSX Trade Reporting Facility] by submitting the following report(s):

(i) The member with the obligation to report the transaction pursuant to paragraph (b) above must submit a last sale report for the initial leg of the transaction.

(ii) Where the initial leg of the transaction has been reported to [the NASD/NSX Trade Reporting Facility] NASD, regardless of whether a member has a reporting obligation pursuant to paragraph (b) above, the firm must submit, for the

offsetting, “riskless” portion of the transaction, either:

a. a clearing-only report with a capacity indicator of “riskless principal,” if a clearing report is necessary to clear the transaction; or

b. a non-tape, non-clearing report with a capacity indicator of “riskless principal,” if a clearing report is not necessary to clear the transaction.

Example:

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a mark-down of \$12.50;

REPORT 100 shares at 40 by submitting [to the NASD/NSX Trade Reporting Facility either] a single trade report marked with a “riskless principal” capacity indicator to the NASD/NSX Trade Reporting Facility or by submitting the following reports:

[(1)]1. where required by this Rule, a tape report marked with a “principal” capacity indicator; and

[(2)]2. either a non-tape, non-clearing report or a clearing-only report marked with a “riskless principal” capacity indicator.

In a riskless principal transaction in which a member purchases or sells the security on an exchange to satisfy a customer's order, the [order] trade will be reported by the exchange. A member may, however, submit to the NASD/NSX Trade Reporting Facility a clearing-only report or a non-tape, non-clearing report for the "riskless" leg of a riskless principal transaction where the initial leg has been reported on or through an exchange. Any such report submitted to the NASD/NSX Trade Reporting Facility shall comply with all applicable requirements for trade reports set forth in this Rule 4632C.

Example:

BUY as principal 100 shares on an exchange at 40 to fill an existing order;

DO NOT REPORT this leg (will be reported by exchange).

SELL as principal 100 shares to a customer at 40 plus a mark-up of \$12.50.

A member MAY submit to the NASD/NSX Trade Reporting Facility either a non-tape, non-clearing report or a clearing-only report for this leg marked with a "riskless principal" capacity indicator.

(e) through (h) No Change.

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6000C. NASD/NSX TRADE REPORTING FACILITY SYSTEMS AND PROGRAMS

6100C. CLEARING AND COMPARISON RULES

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6130C. Trade Report Input

(a) through (g) No Change.

(h) Members shall not submit to the System any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to the System, unless such report is submitted, pursuant to Rule 4632C(d), to reflect the offsetting riskless portion of a riskless principal transaction.

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4000D. THE NASD/BSE TRADE REPORTING FACILITY

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4632D. Transaction Reporting

(a) through (d) No Change.

(e) Procedures for Reporting Price and Volume

Members that report transactions to the NASD/BSE Trade Reporting Facility, pursuant to paragraph (b) above, shall transmit last sale reports for all purchases and sales in designated securities in the following manner:

(1) through (2) No Change.

(3) (A) No Change.

(B) Exception: A “riskless” principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported to the NASD/BSE Trade Reporting Facility as one transaction in the same manner as an agency

transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless principal transaction [to the NASD/BSE Trade Reporting Facility] by submitting the following report(s):

(i) The member with the obligation to report the transaction pursuant to paragraph (b) above must submit a last sale report for the initial leg of the transaction.

(ii) Where the initial leg of the transaction has been reported to [the NASD/BSE Trade Reporting Facility] NASD, regardless of whether a member has a reporting obligation pursuant to paragraph (b) above, the firm must submit, for the offsetting, “riskless” portion of the transaction, either:

a. a clearing-only report with a capacity indicator of “riskless principal,” if a clearing report is necessary to clear the transaction; or

b. a non-tape, non-clearing report with a capacity indicator of “riskless principal,” if a clearing report is not necessary to clear the transaction.

Example:

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a mark-down of \$12.50;

REPORT 100 shares at 40 by submitting [to the NASD/BSE Trade Reporting Facility either] a single trade report marked with a “riskless principal” capacity indicator to the NASD/BSE Trade Reporting Facility or by submitting the following reports:

[(1)]1. where required by this Rule, a tape report marked with a “principal” capacity indicator; and

[(2)]2. either a non-tape, non-clearing report or a clearing-only report marked with a “riskless principal” capacity indicator.

In a riskless principal transaction in which a member purchases or sells the security on an exchange to satisfy a customer’s order, the [order] trade will be reported by the exchange. A member may, however, submit to the NASD/BSE Trade Reporting Facility a clearing-only report or a non-tape, non-clearing report for the “riskless” leg of a riskless principal transaction where the initial leg has been reported on or through an exchange. Any such report submitted to the NASD/BSE Trade Reporting Facility shall comply with all applicable requirements for trade reports set forth in this Rule 4632D.

Example:

BUY as principal 100 shares on an exchange at 40 to fill an existing order;
DO NOT REPORT this leg (will be reported by exchange).

SELL as principal 100 shares to a customer at 40 plus a mark-up of \$12.50.

A member MAY submit to the NASD/BSE Trade Reporting Facility either a non-tape, non-clearing report or a clearing-only report for this leg marked with a “riskless principal” capacity indicator.

(f) through (i) No Change.

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6000D. NASD/BSE TRADE REPORTING FACILITY SYSTEMS AND PROGRAMS

6100D. CLEARING AND COMPARISON RULES

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6130D. Trade Report Input

(a) through (g) No Change.

(h) Members shall not submit to the System any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to the System, unless such report is submitted, pursuant to Rule 4632D(e), to reflect the offsetting riskless portion of a riskless principal transaction.

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4000E. THE NASD/NYSE TRADE REPORTING FACILITY

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4632E. Transaction Reporting

(a) through (d) No Change.

(e) Procedures for Reporting Price and Volume

Members that report transactions to the NASD/NYSE Trade Reporting Facility, pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in designated securities in the following manner:

(1) through (2) No Change.

(3) (A) No Change.

(B) Exception: A “riskless” principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported to the NASD/NYSE Trade Reporting Facility as one transaction in the same manner as an agency transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless principal transaction [to the NASD/NYSE Trade Reporting Facility] by submitting the following report(s):

(i) The member with the obligation to report the transaction pursuant to paragraph (b) above must submit a last sale report for the initial leg of the transaction.

(ii) Where the initial leg of the transaction has been reported to [the NASD/NYSE Trade Reporting Facility] NASD, regardless of whether a member has a reporting obligation pursuant to paragraph (b) above, the firm must submit, for the offsetting, “riskless” portion of the transaction a non-tape, non-

clearing report with a capacity indicator of “riskless principal.”

Example:

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a mark-down of \$12.50;

REPORT 100 shares at 40 by submitting [to the NASD/NYSE Trade Reporting Facility either] a single trade report marked with a “riskless principal” capacity indicator to the NASD/NYSE Trade Reporting Facility or by submitting the following reports:

[(1)]a. where required by this Rule, a tape report marked with a “principal” capacity indicator; and

[(2)]b. a non-tape, non-clearing report marked with a “riskless principal” capacity indicator.

In a riskless principal transaction in which a member purchases or sells the security on an exchange to satisfy a customer's order, the [order] trade will be reported by the exchange. A member may, however, submit to the NASD/NYSE Trade Reporting Facility a non-tape, non-clearing report for the “riskless” leg of a riskless principal transaction where the initial leg has been reported on or through an exchange. Any such report submitted to the NASD/NYSE Trade Reporting Facility shall comply with all applicable requirements for trade reports set forth in this Rule 4632E.

Example:

BUY as principal 100 shares on an exchange at 40 to fill an existing order;

DO NOT REPORT this leg (will be reported by exchange).

SELL as principal 100 shares to a customer at 40 plus a mark-up of
\$12.50.

A member MAY submit to the NASD/NYSE Trade Reporting Facility a
non-tape, non-clearing report for this leg marked with a "riskless
principal" capacity indicator.

(f) through (i) No Change.

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6000E. NASD/NYSE TRADE REPORTING FACILITY SYSTEMS AND PROGRAMS

6100E. CLEARING AND COMPARISON RULES

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6130E. Trade Report Input

(a) through (g) No Change.

(h) Members shall not submit to the System any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to the System, unless such report is submitted, pursuant to Rule 4632E(e), to reflect the offsetting riskless portion of a riskless principal transaction.

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(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The Executive Committee of the Board of Governors of NASD approved and authorized the filing of this proposed rule change with the Commission by Unanimous Written Consent on February 16, 2007. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the Board of Governors of NASD to adopt amendments to NASD rules without recourse to the membership for approval.

NASD is filing the proposed rule change for immediate effectiveness. The proposed rule change will not become operative prior to the thirtieth day after the date of filing. NASD will announce the operative date on its website.

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

(a) Purpose

Proposed Changes Relating To Reports Associated With Previously Executed Trades

Currently, members can use the ADF and the NASD/Nasdaq Trade Reporting Facility (the “NASD/Nasdaq TRF”) to submit non-tape reports (i.e., the transaction is not reported to the tape for publication) and clearing-only reports (i.e., the transaction is not reported to the tape but may be submitted for clearing purposes) for a variety of reasons, including to re-allocate or cancel transactions previously executed and reported to the tape by an exchange. For example, Firm A buys 1000 shares of ABC security on the Nasdaq Exchange and then submits a clearing-only report to the ADF or NASD/Nasdaq

TRF to allocate those shares to Firm B (referred to as a “step-out”).² Similarly, a “reversal” is a clearing-only entry that allows a participant to cancel the effects of a prior submission to the National Securities Clearing Corporation.³ Such functionality is not prescribed by Rule, but rather has been offered as a service to members using the ADF and Nasdaq’s Automated Confirmation Transaction Service (ACT).⁴ Such functionality is not supported by any other NASD Facility.

NASD believes that members’ ability to submit non-tape reports should be limited across NASD Facilities for several reasons. First, where the previously executed transaction associated with a non-tape report is reported to an exchange, NASD’s audit trail will not include the original transaction report. The inclusion of non-tape reports that are not related to an NASD transaction report can create confusion and impair NASD staff’s ability to produce a complete and accurate audit trail.

Second, certain non-tape or clearing-only reports that provide for the re-allocation or cancellation of a previously reported transaction can make it more difficult for NASD

² A step-out allows members to allocate all or part of a previously executed trade to another broker-dealer. In other words, a step-out functions as a position transfer, rather than a trade; the parties are not exchanging shares and funds. The step-out function was designed and implemented to facilitate the clearing process for members involved in these types of transactions. See, e.g., NASD Notice to Members 05-11 (February 2005) and NASD Notice to Members 98-40 (May 1998).

³ If a participant wants to cancel a previously submitted sell trade, it would have to submit a reversal as a buy to effectively unwind the position at clearing.

⁴ ACT has been licensed for use for trade reporting and clearing and comparison services through the NASD/Nasdaq TRF and also serves as the mechanism for reporting trades that are automatically executed through the Nasdaq Market Center. Nasdaq has advised NASD that it will submit a proposed rule change proposing to allow step-outs on ACT under Nasdaq rules with respect to any trade to which a Nasdaq member is a party, regardless of where it originated.

to tabulate accurately the aggregate dollar amount of its covered sales for purposes of Section 31 fees.⁵ Entry of these transactions in an NASD Facility, when the original transaction was reported and assessed a Section 31 fee by an exchange, can result in the misalignment of Section 31 fees with the appropriate market and market participants.

Thus, NASD is proposing to amend NASD Rules 6130 (relating to the NASD/Nasdaq TRF), 6130A (relating to the ADF), 6130C (relating to the NASD/NSX Trade Reporting Facility), 6130D (relating to the NASD/BSE Trade Reporting Facility), and 6130E (relating to the NASD/NYSE Trade Reporting Facility) to provide that members shall not submit to an NASD Facility any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to that NASD Facility. For example, a clearing-only entry for a step-out relating to a trade reported to the Nasdaq Exchange may not be submitted to the NASD/Nasdaq TRF. This proposed rule language also clarifies that members are not permitted to report a trade to an NASD Facility for submission to the National Securities Clearing Corporation for clearance and settlement purposes, if the trade was not reported to that same NASD Facility for public dissemination purposes. Thus, for example, a member may not tape report a trade to the NASD/NYSE TRF and use the NASD/Nasdaq TRF to clear that same trade.

However, NASD is proposing an exception to this prohibition for reports that reflect the offsetting “riskless” portion of a riskless principal transaction. For purposes of

⁵ For example, as explained in NASD Notice to Members 05-11 (February 2005), as part of the step-out function, ACT provides the ability to move the transaction fee associated with the trade to the ultimate seller of the security when the trade is allocated.

over-the-counter trade reporting requirements applicable to equity securities, a “riskless principal” transaction is a transaction in which a member, after having received an order to buy (sell) a security, purchases (sells) the security as principal and satisfies the original order by selling (buying) as principal at the same price (the offsetting, “riskless” leg). A riskless principal transaction can be submitted to NASD as a single trade report properly marked as riskless principal, or by submitting two separate reports: (1) a report that is submitted to the tape to reflect the initial leg of the transaction and (2) a non-tape (or clearing-only) report to reflect the offsetting, “riskless” leg of the transaction. Where a member chooses to report a riskless principal transaction to NASD by submitting two separate reports, both the tape report and non-tape (or clearing-only) report must be submitted to an NASD Facility. Where the initial leg of the transaction is executed on and reported through an exchange, a tape report would not be submitted to an NASD Facility to reflect the initial leg; however, members are permitted, but not required, to submit a non-tape (or clearing-only) report for the second leg of the transaction to an NASD Facility.

NASD believes it is appropriate to continue to permit members to submit a non-tape (or clearing-only) report for the second leg of a riskless principal transaction to an NASD Facility, even where the first leg of the transaction has been reported to the tape by an exchange, in light of the unique nature of riskless principal transactions. A riskless principal transaction is the economic equivalent of a single agency trade and therefore the second riskless principal report is suppressed from the tape to avoid double reporting and overstatement of volume, notwithstanding that, technically, it is a separate trade. In addition, the second leg, if appropriately reported pursuant to NASD rules, is not subject

to Section 31 fees. Accordingly, the proposed rule language includes an express carve-out to permit a report of an offsetting second leg of a riskless principal transaction submitted to an NASD Facility in connection with a first leg executed on and reported to an exchange.

The proposed rule change will ensure consistency across NASD Facilities, promote a more complete and accurate audit trail and enable NASD to properly assess applicable transaction-related fees. As noted above, currently only the ADF and NASD/Nasdaq TRF offer the above-described functionality relating to step-outs and reversals and, thus, the proposed rule change would require a systems change only for certain members using those facilities. With respect to the other NASD Facilities, the proposed rule change would merely codify current functionality.

Clarifying Changes to Riskless Principal Reporting Requirements

Currently, the rules relating to NASD's Trade Reporting Facilities ("TRFs") require that where the initial leg of a riskless principal transaction was reported to a TRF, the second leg must also be reported to that same TRF.⁶ NASD is proposing to revise these rules to clarify that where the first leg of a riskless principal transaction was reported to NASD, the second leg must also be reported to NASD; however, in that circumstance, members are not required to report both legs to the same TRF. NASD believes that the current provisions are too restrictive and could have the unintended consequence of requiring members to be participants in all TRFs in order to comply with

⁶ See Rules 4632(d)(3)(B), 4632C(d)(3)(B), 4632D(e)(3)(B) and 4632E(e)(3)(B).

NASD rules.⁷ NASD expects that where possible, members will report both legs of a riskless principal transaction to the same NASD Facility. NASD also is proposing conforming changes to Rule 4632A(e)(1)(C)(ii) relating to the ADF.

As noted in Item 2 of this filing, NASD is filing the proposed rule change for immediate effectiveness. The proposed rule change will not become operative prior to the thirtieth day after the date of filing. NASD will announce the operative date on its website.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁸ 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. NASD believes that the proposed rule change will promote a more complete and accurate audit trail and enable NASD to properly assess applicable transaction-related fees.

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

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

⁷ For example, assume Firm A is only a participant of TRF A and it executes the first leg of a riskless principal transaction otherwise than on exchange with Firm B, which is only a participant of TRF B. Assume further that Firm B has the reporting obligation under NASD rules. The initial leg of the riskless principal trade will be reported by Firm B to TRF B. Firm A must report the second leg of the riskless principal transaction to NASD, but because it is not a participant of TRF B, it cannot report the second leg to TRF B. The proposed changes would allow Firm A to report the second leg of the transaction to TRF A.

⁸ 15 U.S.C. 78o-3(b)(6).

Act.⁹

5. **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.

6. **Extension of Time Period for Commission Action**

Not applicable.

7. **Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

The proposed rule change is effective upon filing pursuant to Section 19(b)(3) of the Act and paragraph (f)(6) of Rule 19b-4 thereunder,¹⁰ in that the proposed rule change does not significantly affect the protection of investors or the public interest; does not impose any significant burden on competition; and does not become operative for 30 days after filing. NASD believes that the filing is appropriately designated as “non-controversial” because the proposed rule change would merely limit functionality that is offered as a service to members reporting to the ADF or NASD/Nasdaq TRF and is not prescribed by Rule.¹¹ In accordance with Rule 19b-4,¹² NASD submitted written 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.

⁹ 15 U.S.C. 78a.

¹⁰ 17 CFR 240.19b-4.

¹¹ As noted above, this service is not available to members using the other NASD Facilities.

¹² 17 CFR 240.19b-4.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2007-040)

Self-Regulatory Organizations: National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Clearing Reports for Previously Executed Trades

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 , the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. NASD has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,³ which renders the proposal effective upon receipt of this filing by the Commission. 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

NASD is proposing to amend NASD Rules 6130, 6130A, 6130C, 6130D and 6130E to prohibit members from submitting to an NASD Facility (i.e., the Alternative Display Facility (“ADF”) or a Trade Reporting Facility) any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to that NASD Facility, except where such report reflects the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4.

offsetting “riskless” portion of a riskless principal transaction. NASD also is proposing to amend NASD Rules 4632(d), 4632A(e), 4632C(d), 4632D(e) and 4632E(e) to clarify that where the first leg of a riskless principal transaction is reported to NASD, the second leg must also be reported to NASD; however, in such circumstance, members are not required to report both legs of the transaction to the same NASD Facility.

Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * * * *

4000. THE NASD/NASDAQ TRADE REPORTING FACILITY

* * * * *

4632. Transaction Reporting

(a) through (c) No Change.

(d) Procedures for Reporting Price and Volume

Members that report transactions to the NASD/Nasdaq Trade Reporting Facility, pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in designated securities in the following manner:

(1) through (2) No Change.

(3) (A) No Change.

(B) Exception: A “riskless” principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported to the NASD/Nasdaq

Trade Reporting Facility as one transaction in the same manner as an agency transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless principal transaction [to the NASD/Nasdaq Trade Reporting Facility] by submitting the following report(s):

(i) The member with the obligation to report the transaction pursuant to paragraph (b) above must submit a last sale report for the initial leg of the transaction.

(ii) Where the initial leg of the transaction has been reported to [the NASD/Nasdaq Trade Reporting Facility] NASD, regardless of whether a member has a reporting obligation pursuant to paragraph (b) above, the firm must submit, for the offsetting, “riskless” portion of the transaction, either:

a. a clearing-only report with a capacity indicator of “riskless principal,” if a clearing report is necessary to clear the transaction; or

b. a non-tape, non-clearing report with a capacity indicator of “riskless principal,” if a clearing report is not necessary to clear the transaction.

Example:

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a

mark-down of \$12.50;

REPORT 100 shares at 40 by submitting [to the NASD/Nasdaq Trade Reporting Facility either] a single trade report marked with a “riskless principal” capacity indicator to the NASD/Nasdaq Trade Reporting Facility or by submitting the following reports:

[(1)]1. where required by this Rule, a tape report marked with a “principal” capacity indicator; and

[(2)]2. either a non-tape, non-clearing report or a clearing-only report marked with a “riskless principal” capacity indicator.

In a riskless principal transaction in which a member purchases or sells the security on an exchange to satisfy a customer’s order, the [order] trade will be reported by the exchange. A member may, however, submit to the NASD/Nasdaq Trade Reporting Facility a clearing-only report or a non-tape, non-clearing report for the “riskless” leg of a riskless principal transaction where the initial leg has been reported on or through an exchange. Any such report submitted to the NASD/Nasdaq Trade Reporting Facility shall comply with all applicable requirements for trade reports set forth in this Rule 4632.

Example:

BUY as principal 100 shares on an exchange at 40 to fill an

existing order;

DO NOT REPORT this leg (will be reported by exchange).

SELL as principal 100 shares to a customer at 40 plus a mark-up of \$12.50.

A member MAY submit to the NASD/Nasdaq Trade Reporting Facility either a non-tape, non-clearing report or a clearing-only report for this leg marked with a “riskless principal” capacity indicator.

(e) through (h) No Change.

* * * * *

6000. NASD SYSTEMS AND PROGRAMS

6100. CLEARING AND COMPARISON RULES

* * * * *

6130. Trade Report Input

(a) through (g) No Change.

(h) Members shall not submit to the System any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to the System, unless such report is submitted, pursuant to Rule 4632(d), to reflect the offsetting riskless portion of a riskless principal transaction.

* * * * *

4000A. NASD ALTERNATIVE DISPLAY FACILITY

* * * * *

4632A. Transactions Reported by Members to TRACS

(a) through (d) No Change.

(e) Procedures for Reporting Price and Volume

(1) Members that are required, or have the option, to report transactions pursuant to paragraph (d) above shall transmit last sale reports in the following manner:

(A) through (B) No Change.

(C) (i) No Change.

(ii) Exception: A “riskless” principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported to TRACS as one three party transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless principal transaction by submitting the following report(s) [to NASD]:

a. The member with the obligation to report the transaction pursuant to paragraph (d) above must submit a last sale report for the initial leg of the transaction.

b. Where the initial leg of the transaction has been reported to NASD, [R]regardless of whether a member has a reporting obligation pursuant to paragraph (d) above, the

firm must submit, for the offsetting, "riskless" portion of the transaction, either:

1. a clearing-only report with a capacity indicator of "riskless principal," if a clearing report is necessary to clear the transaction; or
2. a non-tape, non-clearing report with a capacity indicator of "riskless principal," if a clearing report is not necessary to clear the transaction.

Example:

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a mark-down of \$12.50;

REPORT 100 shares at 40 by submitting [to NASD either] a single trade report marked with a "riskless principal" capacity indicator to TRACS or by submitting the following reports:

3. where required by this Rule, a tape report marked with a "principal" capacity indicator; and
4. either a non-tape, non-clearing report or a clearing-only report marked with a "riskless principal" capacity indicator.

In a riskless principal transaction in which a member purchases or sells the security on an exchange to satisfy a customer's order, the trade will be reported by the exchange. A member may, however, submit to TRACS a clearing only report or a non-tape, non-clearing report for the "riskless" leg of a riskless principal transaction where the initial leg has been reported on or through an exchange. Any such report submitted to TRACS shall comply with all applicable requirements for trade reports set forth in this Rule 4632A.

Example:

BUY as principal 100 shares on an exchange at 40 to fill an existing order;

DO NOT REPORT this leg (will be reported by exchange).

SELL as principal 100 shares to a customer at 40 plus a mark-up of \$12.50.

A member MAY submit to TRACS either a non-tape, non-clearing report or a clearing-only report for this leg marked with a "riskless principal" capacity indicator.

(D) No Change.

(f) through (j) No Change.

* * * * *

6000A. NASD ADF SYSTEMS AND PROGRAMS

6100A. TRACS TRADE COMPARISON SERVICE

* * * * *

6130A. Trade Report Input

(a) through (c) No Change.

(d) Members shall not submit to TRACS any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to TRACS, unless such report is submitted, pursuant to Rule 4632A(e), to reflect the offsetting riskless portion of a riskless principal transaction.

* * * * *

4000C. THE NASD/NSX TRADE REPORTING FACILITY

* * * * *

4632C. Transaction Reporting

(a) through (c) No Change.

(d) Procedures for Reporting Price and Volume

Members that report transactions to the NASD/NSX Trade Reporting Facility, pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in designated securities in the following manner:

(1) through (2) No Change.

(3) (A) No Change.

(B) Exception: A “riskless” principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported to the NASD/NSX Trade

Reporting Facility as one transaction in the same manner as an agency transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless principal transaction [to the NASD/NSX Trade Reporting Facility] by submitting the following report(s):

(i) The member with the obligation to report the transaction pursuant to paragraph (b) above must submit a last sale report for the initial leg of the transaction.

(ii) Where the initial leg of the transaction has been reported to [the NASD/NSX Trade Reporting Facility] NASD, regardless of whether a member has a reporting obligation pursuant to paragraph (b) above, the firm must submit, for the offsetting, “riskless” portion of the transaction, either:

a. a clearing-only report with a capacity indicator of “riskless principal,” if a clearing report is necessary to clear the transaction; or

b. a non-tape, non-clearing report with a capacity indicator of “riskless principal,” if a clearing report is not necessary to clear the transaction.

Example:

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a mark-

down of \$12.50;

REPORT 100 shares at 40 by submitting [to the NASD/NSX Trade Reporting Facility either] a single trade report marked with a “riskless principal” capacity indicator to the NASD/NSX Trade Reporting Facility or by submitting the following reports:

[(1)]1. where required by this Rule, a tape report marked with a “principal” capacity indicator; and

[(2)]2. either a non-tape, non-clearing report or a clearing-only report marked with a “riskless principal” capacity indicator.

In a riskless principal transaction in which a member purchases or sells the security on an exchange to satisfy a customer’s order, the [order] trade will be reported by the exchange. A member may, however, submit to the NASD/NSX Trade Reporting Facility a clearing-only report or a non-tape, non-clearing report for the “riskless” leg of a riskless principal transaction where the initial leg has been reported on or through an exchange. Any such report submitted to the NASD/NSX Trade Reporting Facility shall comply with all applicable requirements for trade reports set forth in this Rule 4632C.

Example:

BUY as principal 100 shares on an exchange at 40 to fill an existing order;

DO NOT REPORT this leg (will be reported by exchange).

SELL as principal 100 shares to a customer at 40 plus a mark-up of

\$12.50.

A member MAY submit to the NASD/NSX Trade Reporting Facility either a non-tape, non-clearing report or a clearing-only report for this leg marked with a “riskless principal” capacity indicator.

(e) through (h) No Change.

* * * * *

6000C. NASD/NSX TRADE REPORTING FACILITY SYSTEMS AND PROGRAMS

6100C. CLEARING AND COMPARISON RULES

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6130C. Trade Report Input

(a) through (g) No Change.

(h) Members shall not submit to the System any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to the System, unless such report is submitted, pursuant to Rule 4632C(d), to reflect the offsetting riskless portion of a riskless principal transaction.

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4000D. THE NASD/BSE TRADE REPORTING FACILITY

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4632D. Transaction Reporting

(a) through (d) No Change.

(e) Procedures for Reporting Price and Volume

Members that report transactions to the NASD/BSE Trade Reporting Facility,

pursuant to paragraph (b) above, shall transmit last sale reports for all purchases and sales in designated securities in the following manner:

(1) through (2) No Change.

(3) (A) No Change.

(B) Exception: A “riskless” principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported to the NASD/BSE Trade Reporting Facility as one transaction in the same manner as an agency transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless principal transaction [to the NASD/BSE Trade Reporting Facility] by submitting the following report(s):

(i) The member with the obligation to report the transaction pursuant to paragraph (b) above must submit a last sale report for the initial leg of the transaction.

(ii) Where the initial leg of the transaction has been reported to [the NASD/BSE Trade Reporting Facility] NASD, regardless of whether a member has a reporting obligation pursuant to paragraph (b) above, the firm must submit, for the offsetting, “riskless” portion of the transaction, either:

a. a clearing-only report with a capacity indicator

of “riskless principal,” if a clearing report is necessary to clear the transaction; or

b. a non-tape, non-clearing report with a capacity indicator of “riskless principal,” if a clearing report is not necessary to clear the transaction.

Example:

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a mark-down of \$12.50;

REPORT 100 shares at 40 by submitting [to the NASD/BSE Trade Reporting Facility either] a single trade report marked with a “riskless principal” capacity indicator to the NASD/BSE Trade Reporting Facility or by submitting the following reports:

[(1)]1. where required by this Rule, a tape report marked with a “principal” capacity indicator; and

[(2)]2. either a non-tape, non-clearing report or a clearing-only report marked with a “riskless principal” capacity indicator.

In a riskless principal transaction in which a member purchases or sells the security on an exchange to satisfy a customer’s order, the [order] trade

will be reported by the exchange. A member may, however, submit to the NASD/BSE Trade Reporting Facility a clearing-only report or a non-tape, non-clearing report for the “riskless” leg of a riskless principal transaction where the initial leg has been reported on or through an exchange. Any such report submitted to the NASD/BSE Trade Reporting Facility shall comply with all applicable requirements for trade reports set forth in this Rule 4632D.

Example:

BUY as principal 100 shares on an exchange at 40 to fill an existing order;
DO NOT REPORT this leg (will be reported by exchange).

SELL as principal 100 shares to a customer at 40 plus a mark-up of
\$12.50.

A member MAY submit to the NASD/BSE Trade Reporting Facility either a non-tape, non-clearing report or a clearing-only report for this leg marked with a “riskless principal” capacity indicator.

(f) through (i) No Change.

* * * * *

**6000D. NASD/BSE TRADE REPORTING FACILITY SYSTEMS AND
PROGRAMS**

6100D. CLEARING AND COMPARISON RULES

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6130D. Trade Report Input

(a) through (g) No Change.

(h) Members shall not submit to the System any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to the System, unless such report is submitted, pursuant to Rule 4632D(e), to reflect the offsetting riskless portion of a riskless principal transaction.

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4000E. THE NASD/NYSE TRADE REPORTING FACILITY

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4632E. Transaction Reporting

(a) through (d) No Change.

(e) Procedures for Reporting Price and Volume

Members that report transactions to the NASD/NYSE Trade Reporting Facility, pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in designated securities in the following manner:

(1) through (2) No Change.

(3) (A) No Change.

(B) Exception: A “riskless” principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported to the NASD/NYSE Trade Reporting Facility as one transaction in the same manner as an agency transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless

principal transaction [to the NASD/NYSE Trade Reporting Facility] by submitting the following report(s):

(i) The member with the obligation to report the transaction pursuant to paragraph (b) above must submit a last sale report for the initial leg of the transaction.

(ii) Where the initial leg of the transaction has been reported to [the NASD/NYSE Trade Reporting Facility] NASD, regardless of whether a member has a reporting obligation pursuant to paragraph (b) above, the firm must submit, for the offsetting, “riskless” portion of the transaction a non-tape, non-clearing report with a capacity indicator of “riskless principal.”

Example:

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a mark-down of \$12.50;

REPORT 100 shares at 40 by submitting [to the NASD/NYSE Trade Reporting Facility either] a single trade report marked with a “riskless principal” capacity indicator to the NASD/NYSE Trade Reporting Facility or by submitting the following reports:

[(1)]1. where required by this Rule, a tape report marked with a “principal” capacity indicator; and

[(2)]2. a non-tape, non-clearing report marked with

a “riskless principal” capacity indicator.

In a riskless principal transaction in which a member purchases or sells the security on an exchange to satisfy a customer's order, the [order] trade will be reported by the exchange. A member may, however, submit to the NASD/NYSE Trade Reporting Facility a non-tape, non-clearing report for the “riskless” leg of a riskless principal transaction where the initial leg has been reported on or through an exchange. Any such report submitted to the NASD/NYSE Trade Reporting Facility shall comply with all applicable requirements for trade reports set forth in this Rule 4632E.

Example:

BUY as principal 100 shares on an exchange at 40 to fill an existing order;

DO NOT REPORT this leg (will be reported by exchange).

SELL as principal 100 shares to a customer at 40 plus a mark-up of \$12.50.

A member MAY submit to the NASD/NYSE Trade Reporting Facility a non-tape, non-clearing report for this leg marked with a "riskless principal" capacity indicator.

(f) through (i) No Change.

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6000E. NASD/NYSE TRADE REPORTING FACILITY SYSTEMS AND PROGRAMS

6100E. CLEARING AND COMPARISON RULES

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6130E. Trade Report Input

(a) through (g) No Change.

(h) Members shall not submit to the System any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to the System, unless such report is submitted, pursuant to Rule 4632E(e), to reflect the offsetting riskless portion of a riskless principal transaction.

* * * * *

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

Proposed Changes Relating To Reports Associated With Previously Executed Trades

Currently, members can use the ADF and the NASD/Nasdaq Trade Reporting Facility (the "NASD/Nasdaq TRF") to submit non-tape reports (i.e., the transaction is not reported to the tape for publication) and clearing-only reports (i.e., the transaction is not reported to the tape but may be submitted for clearing purposes) for a variety of reasons, including to re-allocate or cancel transactions previously executed and reported to the tape by an exchange. For example, Firm A buys 1000 shares of ABC security on the

Nasdaq Exchange and then submits a clearing-only report to the ADF or NASD/Nasdaq TRF to allocate those shares to Firm B (referred to as a “step-out”).⁴ Similarly, a “reversal” is a clearing-only entry that allows a participant to cancel the effects of a prior submission to the National Securities Clearing Corporation.⁵ Such functionality is not prescribed by Rule, but rather has been offered as a service to members using the ADF and Nasdaq’s Automated Confirmation Transaction Service (ACT).⁶ Such functionality is not supported by any other NASD Facility.

NASD believes that members’ ability to submit non-tape reports should be limited across NASD Facilities for several reasons. First, where the previously executed transaction associated with a non-tape report is reported to an exchange, NASD’s audit trail will not include the original transaction report. The inclusion of non-tape reports that are not related to an NASD transaction report can create confusion and impair NASD staff’s ability to produce a complete and accurate audit trail.

Second, certain non-tape or clearing-only reports that provide for the re-allocation

⁴ A step-out allows members to allocate all or part of a previously executed trade to another broker-dealer. In other words, a step-out functions as a position transfer, rather than a trade; the parties are not exchanging shares and funds. The step-out function was designed and implemented to facilitate the clearing process for members involved in these types of transactions. See, e.g., NASD Notice to Members 05-11 (February 2005) and NASD Notice to Members 98-40 (May 1998).

⁵ If a participant wants to cancel a previously submitted sell trade, it would have to submit a reversal as a buy to effectively unwind the position at clearing.

⁶ ACT has been licensed for use for trade reporting and clearing and comparison services through the NASD/Nasdaq TRF and also serves as the mechanism for reporting trades that are automatically executed through the Nasdaq Market Center. Nasdaq has advised NASD that it will submit a proposed rule change proposing to allow step-outs on ACT under Nasdaq rules with respect to any trade to which a Nasdaq member is a party, regardless of where it originated.

or cancellation of a previously reported transaction can make it more difficult for NASD to tabulate accurately the aggregate dollar amount of its covered sales for purposes of Section 31 fees.⁷ Entry of these transactions in an NASD Facility, when the original transaction was reported and assessed a Section 31 fee by an exchange, can result in the misalignment of Section 31 fees with the appropriate market and market participants.

Thus, NASD is proposing to amend NASD Rules 6130 (relating to the NASD/Nasdaq TRF), 6130A (relating to the ADF), 6130C (relating to the NASD/NSX Trade Reporting Facility), 6130D (relating to the NASD/BSE Trade Reporting Facility), and 6130E (relating to the NASD/NYSE Trade Reporting Facility) to provide that members shall not submit to an NASD Facility any report (including but not limited to reports of step-outs and reversals) associated with a previously executed trade that was not reported to that NASD Facility. For example, a clearing-only entry for a step-out relating to a trade reported to the Nasdaq Exchange may not be submitted to the NASD/Nasdaq TRF. This proposed rule language also clarifies that members are not permitted to report a trade to an NASD Facility for submission to the National Securities Clearing Corporation for clearance and settlement purposes, if the trade was not reported to that same NASD Facility for public dissemination purposes. Thus, for example, a member may not tape report a trade to the NASD/NYSE TRF and use the NASD/Nasdaq TRF to clear that same trade.

However, NASD is proposing an exception to this prohibition for reports that reflect the offsetting “riskless” portion of a riskless principal transaction. For purposes of

⁷ For example, as explained in NASD Notice to Members 05-11 (February 2005), as part of the step-out function, ACT provides the ability to move the transaction fee associated with the trade to the ultimate seller of the security when the trade is allocated.

over-the-counter trade reporting requirements applicable to equity securities, a “riskless principal” transaction is a transaction in which a member, after having received an order to buy (sell) a security, purchases (sells) the security as principal and satisfies the original order by selling (buying) as principal at the same price (the offsetting, “riskless” leg). A riskless principal transaction can be submitted to NASD as a single trade report properly marked as riskless principal, or by submitting two separate reports: (1) a report that is submitted to the tape to reflect the initial leg of the transaction and (2) a non-tape (or clearing-only) report to reflect the offsetting, “riskless” leg of the transaction. Where a member chooses to report a riskless principal transaction to NASD by submitting two separate reports, both the tape report and non-tape (or clearing-only) report must be submitted to an NASD Facility. Where the initial leg of the transaction is executed on and reported through an exchange, a tape report would not be submitted to an NASD Facility to reflect the initial leg; however, members are permitted, but not required, to submit a non-tape (or clearing-only) report for the second leg of the transaction to an NASD Facility.

NASD believes it is appropriate to continue to permit members to submit a non-tape (or clearing-only) report for the second leg of a riskless principal transaction to an NASD Facility, even where the first leg of the transaction has been reported to the tape by an exchange, in light of the unique nature of riskless principal transactions. A riskless principal transaction is the economic equivalent of a single agency trade and therefore the second riskless principal report is suppressed from the tape to avoid double reporting and overstatement of volume, notwithstanding that, technically, it is a separate trade. In addition, the second leg, if appropriately reported pursuant to NASD rules, is not subject

to Section 31 fees. Accordingly, the proposed rule language includes an express carve-out to permit a report of an offsetting second leg of a riskless principal transaction submitted to an NASD Facility in connection with a first leg executed on and reported to an exchange.

The proposed rule change will ensure consistency across NASD Facilities, promote a more complete and accurate audit trail and enable NASD to properly assess applicable transaction-related fees. As noted above, currently only the ADF and NASD/Nasdaq TRF offer the above-described functionality relating to step-outs and reversals and, thus, the proposed rule change would require a systems change only for certain members using those facilities. With respect to the other NASD Facilities, the proposed rule change would merely codify current functionality.

Clarifying Changes to Riskless Principal Reporting Requirements

Currently, the rules relating to NASD's Trade Reporting Facilities ("TRFs") require that where the initial leg of a riskless principal transaction was reported to a TRF, the second leg must also be reported to that same TRF.⁸ NASD is proposing to revise these rules to clarify that where the first leg of a riskless principal transaction was reported to NASD, the second leg must also be reported to NASD; however, in that circumstance, members are not required to report both legs to the same TRF. NASD believes that the current provisions are too restrictive and could have the unintended consequence of requiring members to be participants in all TRFs in order to comply with NASD rules.⁹ NASD expects that where possible, members will report both legs of a

⁸ See Rules 4632(d)(3)(B), 4632C(d)(3)(B), 4632D(e)(3)(B) and 4632E(e)(3)(B).

⁹ For example, assume Firm A is only a participant of TRF A and it executes the

riskless principal transaction to the same NASD Facility. NASD also is proposing conforming changes to Rule 4632A(e)(1)(C)(ii) relating to the ADF.

NASD is filing the proposed rule change for immediate effectiveness. The proposed rule change will not become operative prior to the thirtieth day after the date of filing. NASD will announce the operative date on its website.

2. Statutory Basis

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. NASD believes that the proposed rule change will promote a more complete and accurate audit trail and enable NASD to properly assess applicable transaction-related fees.

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

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.¹¹

first leg of a riskless principal transaction otherwise than on exchange with Firm B, which is only a participant of TRF B. Assume further that Firm B has the reporting obligation under NASD rules. The initial leg of the riskless principal trade will be reported by Firm B to TRF B. Firm A must report the second leg of the riskless principal transaction to NASD, but because it is not a participant of TRF B, it cannot report the second leg to TRF B. The proposed changes would allow Firm A to report the second leg of the transaction to TRF A.

¹⁰ 15 U.S.C. 78o-3(b)(6).

¹¹ 15 U.S.C. 78a.

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**

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.¹² NASD believes that the filing is appropriately designated as “non-controversial” because the proposed rule change would merely limit functionality that is offered as a service to members reporting to the ADF or NASD/Nasdaq TRF and is not prescribed by Rule.¹³ In accordance with Rule 19b-4,¹⁴ NASD submitted written 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.

At any time within 60 days of the filing of the 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.

¹² 17 CFR 240.19b-4(f)(6).

¹³ As noted above, this service is not available to members using the other NASD Facilities.

¹⁴ 17 CFR 240.19b-4.

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-2007-040 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-2007-040. 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 File Number SR-NASD-2007-040 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.¹⁵

Nancy M. Morris

Secretary

¹⁵ 17 CFR 200.30-3(a)(12).