

# Notice to Members

APRIL 2006

## SUGGESTED ROUTING

Legal and Compliance  
Operations  
Senior Management  
Trading

## KEY TOPICS

Market Orders  
Rule 3380  
Trade Shredding

## GUIDANCE

### Trade Shredding

SEC Approves New Rule 3380, Order Entry and Execution Practices; Effective Date: May 25, 2006

#### Executive Summary

On February 24, 2006, the Securities and Exchange Commission (SEC) approved new Rule 3380, Order Entry and Execution Practices, which prohibits conduct known as “trade shredding.”<sup>1</sup> Specifically, under the new rule, members and associated persons are prohibited from splitting any order into multiple smaller orders for execution, or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind payment to the member or associated persons as a result of the execution of such orders or the transaction reporting of such executions. Rule 3380, as adopted, is set forth in Attachment A of this *Notice*. The rule becomes effective on May 25, 2006.

#### Questions/Further Information

Questions regarding this *Notice* may be directed to the Legal Section, Market Regulation, at (240) 386-5126; or Kathryn M. Moore, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 974-2974.

#### Background and Discussion

“Trade shredding” is a term used to describe the practice of splitting customer orders for securities into multiple smaller orders (e.g., a 1,000 share order is split into ten 100-share orders) for the primary purpose of maximizing payments or rebates to the member. Among other things, concerns have been raised about market participants increasingly engaging in the practice of trade shredding as a means to increase their share of market data revenues under the joint industry plans (Plans), where a Plan participant has adopted a practice of sharing its Plan revenues with market participants that send it orders.

---

To address these concerns, among others, the SEC adopted Regulation NMS, which contains amendments to the current Plan formulas used to allocate Plan income.<sup>2</sup> These modifications incorporate a more broad-based measure of a self-regulatory organization's (SRO) contribution to the consolidated trade stream, including both an SRO's quotes and trades, which is intended to reduce the incentives for trade shredding.

Although these modifications in Plan formulas should reduce the incentives for trade shredding, NASD proposed, and the SEC approved, new Rule 3380 to prohibit such practices. Specifically, new Rule 3380 prohibits members and associated persons from splitting any order into multiple smaller orders for execution or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind payment to the member or associated persons as a result of the execution of such orders or the transaction reporting of such executions. For purposes of Rule 3380, "monetary or in-kind amount" includes, but is not limited to, credits, commissions, gratuities, payments for or rebates of fees, or any other payments of value to the member or associated person.

Rule 3380 becomes effective May 25, 2006.

## Endnotes

1 See Securities Exchange Act Release No. 53371 (February 24, 2006), 71 FR 11008 (March 3, 2006) (File No. SR-NASD-2005-144).

2 See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37469 (June 29, 2005).

---

©2006. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

---

## ATTACHMENT A

New language is underlined.

### 3380. Order Entry and Execution Practices

No member or associated person may engage in conduct that has the intent or effect of splitting any order into multiple smaller orders for execution or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind amount to be received by the member or associated person as a result of the execution of such orders or the transaction reporting of such executions. For purposes of this rule, "monetary or in-kind amount" shall be defined to include, but not be limited to, any credits, commissions, gratuities, payments for or rebates of fees, or any other payments of value to the member or associated person.