

Notice to Members

NOVEMBER 2003

ACTION REQUIRED

SUGGESTED ROUTING

Executive Representative
Legal & Compliance
Operations
Senior Management

KEY TOPICS

Transaction Reporting
Electronic Communication Networks

Electronic Communications Networks

SEC Approves Changes to Rules on Reporting of Transactions through Electronic Communications Networks (ECNs); **Changes Effective November 10, 2003**

Executive Summary

NASD is issuing this *Notice* to replace and supersede *Notice to Members (NtM) 03-55*, which discussed the SEC's approval of rules on reporting of transactions executed through electronic communications networks (ECNs). The effective date of the rules was originally October 6, 2003, but was delayed until November 10, 2003. Minor amendments to the rules have since been filed with the Securities and Exchange Commission (SEC) on an immediately effective basis, and are reflected in this *Notice*. This *Notice* also repeats information that is in *NtM 03-55*.

On September 4, 2003, the SEC approved changes to rules governing the reporting of transactions through Nasdaq's Automated Confirmation Transaction Service (ACT) in order to clarify the reporting requirements applicable to transactions conducted through electronic communications networks (ECNs).

The new rules do not apply to trades reported through NASD's Trade Reporting and Comparison Service (TRACS). The changes, which take effect **November 10, 2003**, describe the three methods that may be used by ECNs and/or their customers to report trades executed through an ECN's facilities. ECNs that use ACT to report some or all of the transactions executed through their facilities are required to file a notice of their trade-reporting methods prior to **November 10, 2003**. Please use Attachment A to file this notice. Notices must be filed with NASDAQ's MarketWatch Department, 9509 Key West Avenue, Rockville, MD 20850, Attention: Sheila Dagucon (or you may fax the notification to (240) 386-6050); and NASD's Market Regulation Department, 9509 Key West Avenue, Rockville, MD 20850, Attention: Alternative Trading Systems Group (or you may fax the notification to (240) 386-5139).

03-69

Questions/Further Information

Questions regarding this *Notice* may be directed to Sheila Dagucon, NASDAQ MarketWatch, at (240) 386-6049; or John Yetter, NASDAQ Office of General Counsel, at (202) 912-3039.

Background

Current practices of ECN trade reporting have developed over time in conjunction with the growth of the number of ECNs. As each new ECN entered the market, it registered under NASD Rule 4623 and informed NASDAQ and NASD concerning its planned method for reporting transactions. Although the use of different reporting methodologies by different ECNs has generally allowed ECNs to fulfill reporting obligations while tailoring their methodology to their own business needs and those of their subscribers, the absence of clearly defined rules has, in some circumstances, created confusion as to the trade reporting responsibilities of ECNs and their subscribers. The rule change approved by the Commission will provide members greater certainty concerning their trade reporting responsibilities, while allowing ECNs to continue using the various methods of trade reporting that have developed over time.

The rule change is based on NASDAQ's understanding of the different methods used by ECNs today to report trades, and, in general, the rule change is not intended to require ECNs to modify their current trade-reporting practices. Rather, the purpose of the rule change is to codify these practices in the form of clear, enforceable rules that will provide greater guidance to market participants. The rule change will apply to transactions in all securities that are executed through an ECN and reported to ACT.

The rule change permits ECNs to use any of three methods for reporting transactions. However, each ECN must inform, in writing, NASD and NASDAQ simultaneously which method it will use for reporting trades to ACT for each of its subscribers, although it may change its method at any time by providing advance written notice simultaneously to NASD and NASDAQ.

First, an ECN may assume sole responsibility for reporting transactions executed through its facilities and identify itself as the reporting party.

Second, an ECN may assume sole responsibility for transaction reporting, but identify a subscriber as the reporting party. In that case, the identified reporting party would be determined in accordance with the existing rules for allocating trade-reporting responsibility in NASD Rule 6130(c). Thus, if the subscribers conducting a transaction through the ECN were both market makers or both Order Entry Firms, the selling party would be identified as the reporting party; if the transaction were between a market maker and an Order Entry Firm, the market maker would be identified as the reporting party; and if the transaction were between a member (*i.e.*, a broker/dealer) and a non-member (such as an institutional investor), the member would be identified as the reporting party.

Third, the ECN may impose some or all of the responsibility for reporting on its subscribers. In that case, the ECN would notify the appropriate reporting party, determined in accordance with the existing rules of priority for trade reporting in NASD Rule 6130(c), that it had an obligation to submit a report concerning the trade.

At any given time, an ECN may utilize more than one of these methods, with the choice of the method varying depending on the needs of particular subscribers. Thus, an ECN may use one method for one of its subscribers and a different method for all of its other subscribers. The ECN must, however, provide simultaneously NASD and NASDAQ advance written notice concerning the method that it will use for each subscriber.

In each case, the party submitting a trade report is responsible for ensuring its accuracy and completeness, by providing the information specified by Rule 6130(d). In addition, when an ECN submits a trade report identifying another party as the reporting party, both the ECN and the identified reporting party are responsible for ensuring the accuracy and completeness of the report.

The rule change also addresses procedures for reporting transactions in several unique circumstances associated with ECNs. First, the rule change provides that when the parties to a transaction executed through an ECN are both non-members, the ECN must submit all required trade reports and identify itself as the reporting party. This is the case because, as non-members, the parties to the transaction would not be eligible to report trades through ACT. Second, in circumstances where one ECN routes an order to another ECN that executes the order, the ECN that executes the order would be responsible for reporting the transaction, or requiring a subscriber to report the transaction, in accordance with one of the three basic methods for trade reporting described above. For purposes of the rules for allocating trade-reporting responsibility between ECN subscribers, the routing ECN would be deemed to be an Order Entry Firm. Thus, if the executing ECN uses the second method of trade reporting (*i.e.*, reporting on behalf of its subscribers), and it receives an order from a routing ECN that is matched against the order of an Order Entry Firm or another ECN, the sell side would be identified as the reporting party. If the executing ECN matched the routed order against the order of a market maker, however, the market maker would be identified as the reporting party.

Finally, it should be noted that the rule change applies only to transactions that are reported to ACT, since NASDAQ does not have authority to establish rules governing the reporting of trades to non-NASDAQ systems, including NASD's TRACS system. Thus, in circumstances where an ECN has the option to report trades to ACT or to another trade-reporting system, such as NASD's TRACS system, the rule does not mandate that the ECN use ACT for trade reporting. However, to the extent that the ECN or its subscribers opt to use ACT to report a particular transaction, all provisions of the rule change would apply to that transaction.

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ATTACHMENT A

Notice Required by NASD Rule 6130(c) for Electronic Communications Network (ECN)
Transactions Reported through the Automated Confirmation Transaction Service (ACT)

Name of ECN: _____

Address: _____

Contact person: _____

Name of ECN subscriber

(if the same method will be used for
all subscribers, the subscribers are not
required to be identified by name):

Trade-Reporting Method

(identified by number as indicated below):

_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

Trade-reporting methods:

1. The ECN submits trade reports to ACT and identifies itself as the reporting party (NASD Rule 6130(c)(5)(A)).
2. The ECN submits trade reports to ACT on behalf of the reporting party and identifies the reporting party in accordance with the rules for determining reporting parties reflected in NASD Rule 6130(c)(1), (2), (3), and (4) (NASD Rule 6130(c)(5)(B)).
3. The ECN requires one of the parties to a transaction, determined in accordance with the rules for determining reporting parties reflected in NASD Rule 6130(c)(1), (2), (3), and (4), to submit the trade reports to ACT (NASD Rule 6130(c)(5)(C)).

Notice should be sent to:

- ▶ NASDAQ's MarketWatch Department
9509 Key West Avenue
Rockville, MD 20850

Or you may fax the notification to (240) 386-6050

Attention: Sheila Dagucon

AND

- ▶ NASD's Market Regulation Department
9509 Key West Avenue
Rockville, MD 20850

Or you may fax the notification to (240) 386-5139

Attention: Alternative Trading Systems Group

ATTACHMENT B — TEXT OF AMENDMENTS

New text is underlined; deletions are in brackets.

5400. NASDAQ STOCK MARKET AND ALTERNATIVE DISPLAY FACILITY TRADE REPORTING

* * * * *

5430. Transaction Reporting

(a) No change.

(b) Which Party Reports Transaction and to Which Facility

(1) In transactions between two Registered Reporting Nasdaq Market Makers, the member representing the sell side shall report the trade using ACT.

(2) In transactions between a Registered Reporting Nasdaq Market Maker and a Non-Registered Reporting Member, the Registered Reporting Nasdaq Market Maker shall report the trade using ACT.

(3) In transactions between two Non-Registered Reporting Members, the member representing the sell side shall report the trade using ACT or TRACS.

(4) In transactions between a member and a customer, the member shall report as follows:

(A) A Registered Reporting Nasdaq Market Maker shall report the trade using ACT;

(B) A Registered Reporting ADF Market Maker shall report the trade using TRACS; and

(C) A Non-Registered Reporting Member shall report the trade using ACT or TRACS.

(5) In transactions between two Registered Reporting ADF Market Makers, the member representing the sell side shall report the trade using TRACS.

(6) In transactions between a Registered Reporting ADF Market Maker and a Non-Registered Reporting Member, the Registered Reporting ADF Market Maker shall report the trade using TRACS.

(7) In transactions between a Registered Reporting Nasdaq Market Maker and a Registered Reporting ADF Market Maker, the member representing the sell side shall report as follows:

(A) A Registered Reporting Nasdaq Market Maker shall report the trade using ACT; and

(B) A Registered Reporting ADF Market Maker shall report the trade using TRACS.

(8) If a member simultaneously is a Registered Reporting Nasdaq Market Maker and a Registered Reporting ADF Market Maker, and has the trade reporting obligation pursuant to paragraphs (1), (2), (4), (5), (6), or (7), the member can report the trade using either ACT or TRACS, unless the trade is executed using ACES; the Nasdaq National Market Execution System ("NNMS"); [the SelectNet Service; the SmallCap Small Order Execution System ("SOES");] or the Primex Auction System ("Primex"). A trade executed using ACES must be reported using ACT, and trades executed using NNMS[, SelectNet, SOES,] or Primex will be reported to ACT automatically.

(9) In transactions conducted through an ACT ECN (as defined in Rule 6110) that are reported to ACT, the ACT ECN shall ensure that transactions are reported in accordance with Rule 6130(c). If an ACT ECN is also a Registered Reporting ADF ECN (as defined in Rule 4200A), Rule 6130(c) shall apply only to transactions conducted through the ECN for which trade reports are submitted to ACT.

* * * * *

6100. AUTOMATED CONFIRMATION TRANSACTION SERVICE (ACT)

6110. Definitions

(a) – (p) No change.

(q) The term "ACT ECN" shall mean a member of the Association that is an electronic communications network that is a member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member, to the extent that transactions executed through it are reported to ACT.

* * * * *

6130. Trade Report Input

(a) – (b) No change.

(c) Which Party Inputs Trade Reports to ACT

ACT Participants shall, subject to the input requirements below, either input trade reports into the ACT system or utilize the Browse feature to accept or decline a trade within the applicable time-frames as specified in paragraph (b) of this Rule. Trade data input obligations are as follows:

(1) in transactions between a Market Maker and an Order Entry Firm, the Market Maker shall be required to submit a trade report to ACT;

(2) in transactions between two Market Makers, the member representing the sell side shall be required to submit a trade report to ACT;

(3) in transactions between two Order Entry Firms, the member representing the sell side shall be required to submit a trade report to ACT[.];

(4) in transactions between a member and a customer, the member shall be required to submit a trade report to ACT;

(5) in transactions conducted through an ACT ECN that are reported to ACT, the ACT ECN shall ensure that transactions are reported in accordance with one of the following methods:

(A) the ACT ECN shall submit the trade reports to ACT and identify itself as the reporting party;

(B) the ACT ECN shall submit the trade reports to ACT on behalf of the reporting party and identify the reporting party in accordance with the rules for determining reporting parties reflected in paragraphs (1), (2), (3), and (4) above; or

(C) the ACT ECN shall require one of the parties, determined in accordance with the rules for determining reporting parties reflected in paragraphs (1), (2), (3), and (4) above, to submit the trade reports to ACT.

When an ACT ECN reports transactions in accordance with subparagraph (A), the ACT ECN shall be responsible for ensuring that the trade reports are accurate and contain all information required by subsection (d) of this rule for both the ACT ECN and the identified non-reporting party. When an ACT ECN reports transactions in accordance with subparagraph (B), both the ACT ECN and the party identified as the reporting party shall be responsible for ensuring that the trade reports are accurate and contain all information required by subsection (d) of this rule for both the ACT ECN and the identified reporting party. When an ACT ECN requires reporting of transactions in accordance with subparagraph (C), the reporting party shall be responsible for ensuring the accuracy and completeness of the trade report.

An ACT ECN shall provide written notice to the Association of the method of trade reporting used by the ACT ECN for each of its subscribers, and may change the method of trade reporting used for a subscriber by providing advance written notice of the change to the Association;

(6) in transactions conducted through two ACT ECNs or an ACT ECN and an ECN that is not an ACT ECN, an ACT ECN shall be responsible for complying with the requirements of paragraph (5) above for reporting a transaction executed through its facilities, and an ECN that routed an order to it for execution shall be deemed to be an Order Entry Firm and a member for purposes of the rules for determining reporting parties reflected in paragraphs (1), (3), and (4) above; and

(7) in transactions conducted through an ACT ECN in which neither of the parties is a member, the ACT ECN shall report the transaction in accordance with the requirements of subparagraph (5)(A) above.

(d) Trade Information To Be Input

Each ACT report shall contain the following information:

- (1) Security identification symbol of the eligible security (SECID);
- (2) Number of shares;
- (3) Unit price, excluding commissions, mark-ups or mark-downs;
- (4) Execution time for any transaction in Nasdaq or CQS securities not reported within 90 seconds of execution;
- (5) A symbol indicating whether the party submitting the trade report represents the Market Maker side or the Order Entry side;
- (6) A symbol indicating whether the transaction is a buy, sell, sell short, sell short exempt or cross;
- (7) A symbol indicating whether the trade is as principal, riskless principal, or agent;
- (8) Reporting side clearing broker (if other than normal clearing broker);
- (9) Reporting side executing broker as "give-up" (if any);
- (10) Contra side executing broker;
- (11) Contra side introducing broker in case of "give-up" trade;

(12) Contra side clearing broker (if other than normal clearing broker).

(13) For any transaction in an order for which a member has recording and reporting obligations under Rules 6954 and 6955, the trade report must include:

(A) An order identifier, meeting such parameters as may be prescribed by the Association, assigned to the order that uniquely identifies the order for the date it was received (see Rule 6954(b)(1)).

(B) The time of the execution expressed in hours, minutes, and seconds. This information must be reported regardless of the period of time between execution of the trade and the ACT trade report. All times reported to the ACT system shall be in Eastern Time.

(e) Aggregation of Transaction Reports

Individual executions of orders in a security at the same price may be aggregated, for ACT reporting purposes, into a single report if the transactions are with the identical contra party; provided, however, that a reporting party may not withhold reporting a trade in anticipation of aggregating the transaction with other transactions.

* * * * *

6400. REPORTING TRANSACTIONS IN LISTED SECURITIES

* * * * *

6420. Transaction Reporting

(a) No change.

(b) Which Party Reports Transaction

(1) Transactions executed on an exchange are reported by the exchange and shall not be reported by members.

(2) In transactions between two Registered Reporting Members, only the member representing the sell side shall report.

(3) In transactions between a Registered Reporting Member and a Non-Registered Reporting Member, only the Registered Reporting Member shall report.

(4) In transactions between Non-Registered Reporting Members, only the member representing the sell side shall report.

(5) In transactions conducted through an ACT ECN (as defined in Rule 6110), the ACT ECN shall ensure that the transactions are reported in accordance with Rule 6130(c).

(c) - (e) No change.

IM-6420. Transactions in Eligible Securities

Summary Of Provisions Governing Members' Requirements To Report Transaction In Eligible Securities

Chart 1 — General Reporting Requirements Under Rule 6420(b)

Member	Transaction	Member Reports When Contra-Party Is			
		[Designated] <u>Registered</u> Reporting	Non-[Designated] <u>Registered</u> Reporting		
		Member	Member	Exchange	Customer
[Designated] <u>Registered</u> Reporting Member	buys from:	No	Yes	No	Yes
	sells to:	Yes	Yes	No	Yes
Non-[Designated] <u>Registered</u> Reporting Member	buys from:	No	No	No	Yes
	sells to:	No	Yes	No	Yes
ACT ECN		See 6130(c)	See 6130(c)	No	See 6130(c)

Chart II — Reporting Requirements for "Riskless" Transactions as Defined in Rule 6420(d)(4)

Member	Transaction	Member Reports When Contra-Party Is			
		[Designated] <u>Registered</u> Reporting	Non-[Designated] <u>Registered</u> Reporting		
		Member	Member	Exchange	Customer
[Designated] <u>Registered</u> Reporting Member	buys from customer and sells to:	Yes	Yes	No	Yes
	sells to customer and buys from:	No	Yes	No	Yes
Non-[Designated] <u>Registered</u> Reporting Member	buys from customer and sells to:	No	Yes	No	Yes
	sells to customer and buys from:	No	No	No	Yes

* * * * *

6600. REPORTING TRANSACTIONS IN OVER-THE-COUNTER SECURITIES

* * * * *

6620. Transaction Reporting

(a) No change.

(b) Which Party Reports Transaction

(1) In transactions between two OTC Market Makers, only the member representing the sell side shall report.

(2) In transactions between an OTC Market Maker and a Non-Market Maker, only the OTC Market Maker shall report.

(3) In transactions between two Non-Market Makers, only the member representing the sell side shall report.

(4) In transactions between a member and a customer, the member shall report.

(5) In transactions conducted through an ACT ECN (as defined in Rule 6110), the ACT ECN shall ensure that the transactions are reported in accordance with Rule 6130(c), and the term "Market Maker" as used in such rule shall be construed to include an OTC Market Maker.

(c) - (e) No change.

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6900. REPORTING TRANSACTIONS IN DIRECT PARTICIPATION PROGRAMS

* * * * *

6920. Transaction Reporting.

(a) No change.

(b) Which Party Reports Transactions

(1) In transactions between two members, only the member representing the sell side shall report.

(2) In transactions between a member and a customer, the member shall report.

(3) In transactions conducted through an ACT ECN (as defined in Rule 6110), the ACT ECN shall ensure that the transactions are reported in accordance with Rule 6130(c); provided that for purposes of Rule 6130(c)(5) (B) and (C), the party with the reporting obligation shall be as set forth in Rule 6130(c)(3) and the term "Order Entry Firm" as used in such rule shall be construed to refer to any member.

(c) – (e) No change.