

Notice to Members

NOVEMBER 2006

SUGGESTED ROUTING

Legal & Compliance
Operations
Registered Representatives
Senior Management
Systems
Trading

KEY TOPICS

ADF Trading Centers
Alternative Display Facility (ADF)
Regulation NMS
Trade Reporting

GUIDANCE

Alignment of NASD Rules with Regulation NMS

SEC Approves Amendments to NASD Rules to Align Them with Regulation NMS; **Effective Date: Regulation NMS Trading Phase Date, Currently Scheduled to Occur February 5, 2007**

Executive Summary

On September 28, 2006, the Securities and Exchange Commission (Commission or SEC) approved amendments to NASD Rules, including the rules governing the Alternative Display Facility (ADF),¹ in order to align them with Regulation NMS.² In addition, the SEC approved amendments to rules governing quoting, trade reporting, and clearing applicable to the ADF and extended this functionality to all NMS stocks, including stocks listed on the New York Stock Exchange (NYSE), American Stock Exchange (Amex), and certain other exchanges. Furthermore, the amendments reorganize ADF trade reporting rules and make changes to ADF rules to enhance their clarity. The SEC also approved changes to the ADF Trading Center Certification Record, which became effective upon SEC approval on September 28, 2006.

The Rules, as amended (See Exhibit 5 of the rule filing), and the ADF Trading Center Certification Record (See Exhibit 3 of the rule filing) are available at www.nasd.com/RulesRegulation/RuleFilings/2006RuleFilings/NASDW_017057. The amendments to NASD Rules become effective on the Regulation NMS Trading Phase Date, currently scheduled to occur on February 5, 2007.

Questions/Further Information

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Background and Discussion

On June 29, 2005, the Commission published its release adopting Regulation NMS.³ Regulation NMS established substantive rules designed to modernize and strengthen the regulatory structure of the U.S. equities markets. For example, the Order Protection Rule (SEC Rule 611) requires “trading centers” to establish, maintain and enforce written policies and procedures reasonably designed to prevent the execution of trades at prices inferior to protected quotations displayed by automated trading centers, subject to applicable exceptions.⁴ For trades to be protected, a quotation must be immediately and automatically accessible. In this regard, Regulation NMS includes an Access Rule (SEC Rule 610), which requires fair and non-discriminatory access to quotations, establishes a limit on access fees to harmonize the pricing of quotations across different trading centers, and requires NASD and the exchanges to establish, maintain and enforce written rules that prohibit their members from engaging in a pattern or practice of displaying any quotation that locks or crosses a protected quotation, or a manual quotation that locks or crosses a quotation disseminated pursuant to an effective National Market System Plan (NMS Plan).⁵

Aligning NASD Rules with Regulation NMS

NASD is amending its ADF Rules to align them with the Regulation NMS Order Protection Rule and the Access Rule. NASD also is making conforming changes to certain NASD Rules to reflect the new numbering of SEC Rules in Regulation NMS. Moreover, NASD has filed its ADF Trading Center Certification Record with the SEC. ADF Trading Centers are required to complete the ADF Trading Center Certification Record, provide all relevant supporting documentation and complete the ADF certification process prior to being permitted to post quotations through the ADF.

1. Implementation of the Order Protection Rule

Consistent with the goals articulated by the Commission in adopting SEC Rule 611, NASD is amending Rule 4300A(e) to specify that an ADF Trading Center must submit automated quotations, as defined in SEC Rule 600(b)(3). Under Rule 4300A(e), manual quotations, as defined in SEC Rule 600(b)(37), cannot be submitted to the ADF. In furtherance of the provision, Rule 4300A(e) requires that each ADF Trading Center adopt policies and procedures to ensure only automated quotations are submitted to the ADF. Moreover, an ADF Trading Center is required to monitor its systems on a real-time basis to assess whether they are functioning properly.

NASD also is amending the system outage procedures in Rule 4300A. A system outage now is defined in Rule 4300A(e)(2) as the inability to post automated quotations in the ADF⁶ and, in that regard, the inability to respond immediately and on an automated basis to orders. In light of the time frames that are pertinent in the Regulation NMS environment, NASD is amending Rule 4300A to address ADF Trading Center system outages. NASD will determine, in its discretion: (1) when three unexcused outages during a five-day period should result in the suspension of an ADF Trading Center from quoting in the ADF for a period of 20 days; and (2) whether an outage should be excused without limitation.⁷ NASD will strictly interpret the requirement under Rule 4300A that an ADF Trading Center submit only automated quotations. Moreover, if an ADF Trading Center experiences technical problems and is unable to submit automated quotations, it will have to withdraw its quotations from the ADF and notify NASD.

NASD also is amending ADF transaction reporting requirements to expressly require reporting members to append certain new identifiers to enhance regulation of the Order Protection Rule and to facilitate transparency to the marketplace. There are nine express exceptions in the Order Protection Rule.⁸ NASD is revising its transaction reporting requirement in Rule 4632A to conform NASD trade report modifiers to the identified exceptions in SEC Rule 611.⁹ Specifically, NASD is adopting a new unique trade report modifier that will be appended to a last sale report if the trade would be a trade-through of a protected quotation, but for the trade being qualified for an exception from SEC Rule 611. Furthermore, in addition to using the new unique identifier, reporting members are required to append an additional modifier, specified by NASD, which would, in certain circumstances, identify the specific applicable exception or exemption from SEC Rule 611 upon which the member is relying. Moreover, NASD plans to issue another *Notice* providing further guidance on Regulation NMS-related trade reporting requirements.

In addition, NASD is amending Rule 4632A to require separate trade report modifiers for certain trading situations that previously had been combined under one modifier. Additionally, NASD is creating several new trade report modifiers to supplement the amended modifiers. ADF order reporting requirements in Rule 4300A(b)(1)(N) and transaction reporting requirements in Rule 4632A(a)(4)(L) were amended to expressly require the reporting of "[a]ny other modifier as specified by NASD or the Securities and Exchange Commission." Further, NASD provided a comprehensive list of all required modifiers when it published ADF's technical specifications on October 16, 2006. The list is available at www.nasd.com/RegulatorySystems/ADF/FIXInformation/index.htm.

NASD will review the activities of ADF Trading Centers and other NASD member trading centers for compliance with the Order Protection Rule.¹⁰ To complement NASD's automated surveillance for member compliance with the Order Protection Rule and other NASD surveillance methods, NASD's Trading and Market Making Surveillance (TMMS) examination program will examine relevant NASD members for adequate written supervisory procedures and supervisory systems applicable to Regulation NMS and to determine the extent to which trading centers are reviewing compliance with such rules.

2. Implementation of the Access Rule

The Access Rule promotes fair and non-discriminatory access to quotations displayed by trading centers through a private linkage approach. In general, the Access Rule: (1) requires that self-regulatory organizations (SROs) not impose unfairly discriminatory terms that prevent or inhibit any person from obtaining efficient access through a member to the quotations in an NMS stock displayed through its SRO trading facility; (2) requires that each trading center that displays quotations in an NMS stock through an SRO display-only facility (such as the ADF) provide a level and cost of access to such quotations that is substantially equivalent to the level and cost of access to quotations displayed by SRO trading facilities in that stock and ensure that it does not impose unfairly discriminatory terms that prevent or inhibit any person from obtaining efficient access to such quotations through a member, subscriber or customer of the trading center; (3) adopts limits on fees for accessing quotations; and (4) requires SROs to establish, maintain and enforce specific written rules that are generally aimed at limiting the display of quotations that lock or cross any protected quotations in an NMS stock.

In approving Regulation NMS, the Commission articulated the expectation that NASD, as the SRO responsible for the OTC market, will act as “gatekeeper” of the ADF.¹¹ In that regard, NASD will have to make an “affirmative determination” as to whether ADF Trading Centers are complying with the SEC Rule 610 access standard.¹² NASD will fulfill this obligation in several ways. First, NASD is incorporating the Regulation NMS access standard into Rule 4300A. An ADF Trading Center will be expressly required to: (1) provide a level and cost of access to its quotations in an NMS stock displayed in the ADF that is substantially equivalent to the level and cost of access to quotations displayed by SRO trading facilities in that NMS stock; (2) demonstrate that it has sufficient technology to update automatically its quotations and immediately respond to orders routed for execution directly against the individual ADF Trading Center's best bid or offer (i.e., sufficient technology to display automated quotations); and (3) ensure that it does not impose unfairly discriminatory terms that prevent or inhibit any person, through a registered broker-dealer, from obtaining efficient access to such quotations. Further, NASD is amending Rule 4300A to require ADF Trading Centers to provide direct electronic access to registered broker-dealers seeking such access.¹³

Based on guidance provided by Commission staff, Rule 4300A(d)(1) is being amended to require each ADF Trading Center to use a communication service(s) that is deemed sufficient by NASD. To facilitate this effort, NASD staff has posted on the NASD Web site a list of NASD-approved private-sector connectivity providers (e.g., financial extranet services and direct market access firms). The list of providers is available at www.nasd.com/RegulatorySystems/ADF/Participants/index.htm. This list will be reviewed periodically and updated on an as-needed basis. As stated in the rule filing, NASD staff will not necessarily review the technical functionality of the various connectivity providers, but will assess the reliability, cost effectiveness, and extent to which the service is sufficiently prevalent among firms that require the ability to route orders to an ADF Trading Center to meet their Order Protection Rule obligations.

In addition, while NASD staff will evaluate the level and cost of accessing an ADF Trading Center on a case-by-case basis, each ADF Trading Center is required to be accessible through at least two approved connectivity providers. It is important to note, however, that the approved private-sector connectivity provider list does not serve as an exclusive list of connectivity options for accessing an ADF Trading Center. For instance, an ADF Trading Center could approach NASD about adding a specific private-sector connectivity provider to the approved list that is not currently listed. In addition, to the extent a market participant deems it necessary, it could choose to connect to an ADF Trading Center via a dedicated telecommunications line. However, an ADF Trading Center will not be obligated to provide such dedicated access if it is accessible through at least two providers on the approved list. Also, in conformity with the guidance provided by the Commission in the Regulation NMS Approval Order, NASD expects an ADF Trading Center to defray connectivity costs to the extent that the level and cost of access offered by the ADF Trading Center is not substantially equivalent to the level and cost of access offered generally by SRO trading facilities.¹⁴

Second, NASD is amending its Certification Record process to address the standards set forth in SEC Rule 610 and Regulation NMS generally, including requiring documentation that demonstrates that ADF Trading Center costs are substantially equivalent to the costs of accessing SRO trading facilities generally.¹⁵ The Certification Record process will specifically require each ADF Trading Center to make fully supported representations that it is able to comply with the various requirements of Regulation NMS. To that end, one of the goals of NASD's amended Certification Record process is to make certain that ADF Trading Centers possess technology capable of offering automated quotations (*i.e.*, that ADF Trading Centers are capable of immediate internal order turnaround times). The Commission has tasked NASD with making an affirmative determination as to the extent to which each ADF Trading Center offers a substantially equivalent level and cost of access relative to SRO trading facilities. This requires NASD staff to consider the ADF Trading Center's system functionality, robustness, the ability of market participants to interface efficiently with the ADF Trading Center's system and the fee structure of the ADF Trading Center.

Third, NASD is amending Rule 4400A to provide standing for all registered broker-dealers, not just members, to file a direct or indirect access complaint with NASD. This will ensure that there is a process in place for promptly addressing claims that an ADF Trading Center is preventing or inhibiting efficient access to its quotations.¹⁶ NASD will allow such complaints to be filed via facsimile, email, personal delivery, courier or overnight mail. Moreover, the process specified in Rule 4400A will allow NASD to promptly address such issues and, if it were determined that there has been or were an ongoing limitation or denial of access, NASD will limit, as appropriate and necessary, an ADF Trading Center's participation in ADF, including the withdrawal of its quotations from ADF, until access is provided.¹⁷

Fourth, through the examination process and annual compliance questionnaires, NASD will review the activities of ADF Trading Centers. With regard to the Access Rule, NASD's automated surveillance for certain aspects of the Access Rule will be complemented through the review of relevant NASD members' written supervisory procedures through the TMMS examination program, among other investigative means. NASD also plans to use annual compliance questionnaires to determine ongoing compliance with requirements such as "substantially equivalent" access, access fees and conditions on access.

Lastly, in adopting Rule 4130A (Prohibition from Locking or Crossing Quotations in NMS Stocks), NASD is requiring members to reasonably avoid displaying, and expressly prohibiting members from engage in a pattern or practice of displaying, any quotation that locks or crosses a protected quotation in an NMS stock during regular trading hours, unless it meets a specified exception, and to avoid displaying a manual quotation that locks or crosses any quotation in an NMS stock previously disseminated pursuant to an effective NMS Plan.¹⁸ Commission staff asked each of the SROs to ensure that its locking or crossing quotation rules are generally consistent among the SROs. Accordingly, new Rule 4130A is adopted in conformity with the SRO requirements set forth in the Access Rule. Further, NASD is amending Rule 4613A to delete provisions that currently prohibit locked or crossed intra-market quotations during regular trading hours. New Rule 4130A will now be applied during regular market hours, rather than Rule 4613A. However, the provisions in Rule 4613A that address locked or crossed quotation conditions in the ADF prior to the market opening will remain. Rule 4613A also is being modified to clarify the application of the rule in a Regulation NMS environment.

3. Conforming Changes to Reflect New Numbering of SEC Rules in Regulation NMS

NASD also is adopting conforming changes to certain NASD rules to reflect the new numbering of SEC rules in Regulation NMS. To simplify the structure of the rules adopted under Section 11A of the Exchange Act (NMS Rules), the Commission renumbered previously adopted NMS Rules, incorporated such rules into Regulation NMS and established a new definitional rule, Rule 600. Accordingly, NASD is updating all references to the NMS Rules to reflect the new SEC rule numbers.

4. Overview of NASD Certification Record Process

As noted above, critical to NASD's Regulation NMS compliance effort is the establishment of an enhanced Certification Record process for ADF Trading Centers.¹⁹ In light of the importance of the Certification Record process to NASD's Regulation NMS program, NASD filed with the Commission a copy of its proposed Certification Record.²⁰ Each enumerated item on the ADF Trading Center Certification Record will have to be certified to by a duly authorized representative²¹ of the ADF Trading Center at the time of initial application to become an ADF participant. Moreover, recertification of the ADF Trading Center Certification Record is required within 30 days of the end of each ADF Trading Center fiscal year.²²

a. Order Protection Rule Certification

Consistent with the Order Protection Rule, an ADF Trading Center is required to certify that it monitors in real time protected quotations, including the protected quotations of other ADF Trading Centers and SRO trading facilities. An ADF Trading Center also must certify that it has implemented a clock synchronization protocol such that the ADF Trading Center's internal clock used for Regulation NMS compliance purposes is set to Eastern Standard or Daylight Time, as appropriate, is synchronized to the NIST Atomic Clock and in no event deviates more than one second away from the NIST Atomic Clock.

As noted above, and required by the amendment to Rule 4300A(e), each ADF Trading Center also is required to certify that it will submit only "automated quotations"²³ for display on the ADF and that under no circumstances will a manual quotation be submitted (including a quotation that otherwise would be an automated quotation but for an ADF Trading Center system error, malfunction, latency, etc.). Moreover, each ADF Trading Center is required to certify that it offers immediate-or-cancel order execution functionality for execution against its protected quotations and that such functionality is offered to those required to be granted access to protected quotations. An ADF Trading Center must also certify that it will accept intermarket sweep orders and execute them in conformity with Regulation NMS. Each ADF Trading Center also is required to certify that its order response time will at least meet the response time required for its quotations to qualify as automated quotations under Regulation NMS. In addition, an ADF Trading Center must, among other things, certify that it will immediately transmit to NASD any notifications it receives from another trading center that has invoked the "Self-Help Exception" to the Order Protection Rule, or any notifications that it sends to another trading center that the ADF Trading Center has invoked the "Self-Help Exception" to the Order Protection Rule.²⁴

b. Access Rule Certifications

NASD is amending its ADF Trading Center Certification Record process to ensure compliance with the Access Rule. In addition to access and order reporting requirements expressly set forth in Rule 4300A, many of the certifications seek to further ensure that each ADF Trading Center will "provide a level and cost of access" to quotations displayed through the ADF "that is substantially equivalent to the level and cost of access to quotations displayed by SRO trading facilities."²⁵ Each ADF Trading Center will be required to certify that it offers fair and non-discriminatory access. Moreover, each ADF Trading Center is required to provide documentation demonstrating that it is complying with these requirements. Further, each ADF Trading Center is required to certify its acknowledgment that, to the extent that NASD deems an ADF Trading Center not to be granting the requisite level and cost of access, an ADF Trading Center will defray the connectivity costs of those persons entitled to access the ADF Trading Center.

In addition, each ADF Trading Center is required to certify that, if it charges a fee in excess of the fee cap for accessing orders other than protected quotations, it will provide functionality that prevents market participants that route orders for interaction only with protected quotes from inadvertently accessing a non-protected quotation and being charged a fee in excess of the fee cap. An ADF Trading Center also must acknowledge through the Certification Record process that NASD will not permit an ADF Trading Center's quotations to be displayed through the ADF, unless NASD determined that public notice has been provided of the ADF Trading Center's intention to display quotations through the ADF at least 60 days in advance of such activity and, at least initially, in conformity with the standard set forth by the Commission in its order extending certain Regulation NMS compliance dates.²⁶ With regard to an ADF Trading Center that displays quotations in the ADF prior to the implementation of Regulation NMS and seeks to continue uninterrupted quoting on the ADF after Regulation NMS implementation, such ADF Trading Center also must comply with this 60-day public notice period in advance of Regulation NMS implementation.

NASD requires that such advance public notice be given through reasonable means (e.g., through press releases, the NASD Web site and the ADF Trading Center's Web site). Further, each ADF Trading Center is required to certify as part of the pre-quotation notice period that it had made publicly available relevant connectivity and access technical specifications, including: (1) technical interface specifications (e.g., compatible system protocols, etc.); (2) testing schedules; (3) connectivity providers (e.g., extranet providers and direct market access firms) through which the ADF Trading Center's quotations may be accessed; and (4) all relevant subscriber and non-subscriber fees, access fees, port fees, connectivity fees and rebates.

Extend ADF Quoting and Trade Reporting Functionality to All NMS Stocks

NASD is amending rules that govern quoting, trade reporting and clearing applicable to the ADF and extending this functionality to all NMS stocks, as defined in SEC Rule 600(b)(47). Currently, the ADF accommodates the quoting, trade reporting and facilitation of clearing of only NASDAQ securities, but this rule amendment extends such rules and functionality to stocks listed on NYSE, Amex and certain other exchanges. Specifically, NASD is amending its rule to change the definition of "ADF-eligible security" to include all NMS stocks, as defined in SEC Rule 600(b)(47). In addition, NASD is amending ADF rules to adopt uniform rules governing quoting, trade reporting and comparison of NASDAQ, NYSE, Amex and certain other regionally listed securities. Since NASD is incorporating the requirements to quote and trade-report for all NMS stocks directly into the ADF rules, NASD no longer needs a separate set of rules (currently found in the Rule 6300 and 6400 Series) governing the quoting and trade reporting of NYSE, Amex and certain other regionally listed securities and is deleting these rule series.²⁷

Further, in conformity with the new standards articulated in Regulation NMS, NASD does not intend to be a participant of the Intermarket Trading System Plan (ITS Plan) or the new National Market System Linkage Plan (NMS Linkage Plan). Instead, ADF quotes in all NMS stocks will be accessible through private-connectivity providers in accordance with the quote and order access requirements set forth in Rule 4300A. This requires, among other things, that each ADF Trading Center provide direct electronic access to other ADF market participants and direct or indirect electronic access to all other registered broker-dealers seeking such access. Accordingly, because NASD does not intend to participate in the ITS Plan or the new NMS Linkage Plan, the Rule 5200 Series (containing ITS Rules) also is being deleted in its entirety.²⁸

Reorganize ADF Trade Reporting Rules to Enhance Clarity of the Rules

NASD is amending the ADF trade reporting rules to enhance their clarity. Specifically, NASD is amending Rule 4630A to clarify that a transaction executed otherwise than on an exchange would have to be reported to TRACS, in accordance with Rule 4632A or another pertinent NASD rule, unless it were reported to another facility designated by the Commission as being authorized to accept trade reports for trades executed otherwise than on an exchange.²⁹ In addition, NASD is amending Rule 4632A to reorganize the ADF trade reporting rules and to require members to report execution time in hours, minutes and seconds based on Eastern Time in military format, unless another provision of NASD rules requires that a different time be included on the report.³⁰ In general, NASD is incorporating in Rule 4632A(a) the same requirements that were previously found in Rule 5430(a), with certain technical and clarifying changes.

NASD also is amending Rule 4632A(b) to set forth which party is responsible for reporting transactions to NASD. These rules are simplified to delineate reporting responsibility between registered reporting members, non-registered reporting members, and customers or non-members. In general, Rule 4632A(b) requires the following: (1) in transactions between two registered reporting members, the sell side is required to report the trade; (2) in transactions between a registered reporting member and non-registered reporting member, the registered reporting member is required to report the trade; (3) in transactions between two non-registered reporting members, the sell side is required to report the trade; (4) in transactions between a member and a customer or non-member, the member is required to report the trade.³¹

NASD also is amending Rule 4632A(f). Currently, Rule 4632A(f) allows for the aggregation of transaction reports under certain circumstances. NASD is amending Rule 4632A(f) to expressly prohibit aggregation of individual execution of orders in a security at the same price into a single transaction report (also referred to as "bunching"). NASD has determined that it no longer should allow members to bunch transactions for reporting purposes. By prohibiting bunching, NASD will ensure greater transparency of individual transactions. NASD also is amending Rule 4632A(l) to clarify a member's obligation under ADF rules to report cancelled trades in a timely manner. Lastly, NASD is amending the Rule 6100A Series concerning the TRACS Trade Comparison Service to use terminology consistent with the ADF rules found in the Rule 4000A Series.

Endnotes

- 1 The ADF is a quotation collection, trade comparison and trade reporting facility developed by NASD in accordance with the Commission's SuperMontage Approval Order and in conjunction with NASDAQ's registration as a national securities exchange. The ADF, which currently is operating on a pilot basis, provides ADF market participants the ability to post quotations in NASDAQ securities and provides all members that participate in the ADF the ability to view quotations and report transactions in NASDAQ securities to the exclusive Securities Information Processor (SIP) for NASDAQ-listed issues for consolidation and dissemination of data to vendors and ADF market participants.
- 2 Securities Exchange Act Release No. 54537 (September 28, 2006), 71 FR 59173 (October 6, 2006) (File No. SR-NASD-2006-91).
- 3 17 CFR 242.600 *et seq.* See also Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) ("Regulation NMS Approval Order").
- 4 A "trading center" is defined in SEC Rule 600(b)(78) as a national securities exchange or national securities association that operates an SRO trading facility, ATS, exchange market maker, OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing as agent. See Regulation NMS Approval Order, 70 FR at 37533. In accordance with SEC Rule 611, NASD members that meet the definition of a trading center, shall establish, maintain and enforce written policies and procedures designed to prevent trade-throughs on that trading center of protected quotations in NMS stocks that do not fall within an exception.
- 5 In addition, Regulation NMS adopted a subpenny rule that, in general, prohibits market participants from accepting, ranking or displaying orders, quotations or indications of interest in a pricing increment smaller than a penny, except for orders, quotations or indications of interest that are priced at less than \$1.00 per share. Further, Regulation NMS adopted amendments to the market data rules to update the requirements for consolidating, distributing and displaying market information, as well as amendments to the joint industry plans for disseminating market information that modify the formulas for allocating plan revenue and broadening participation in plan governance. This *Notice* describes rule amendments that primarily address implementation of the Order Protection Rule and the Access Rule. Neither the rule filing nor this *Notice* address Regulation NMS issues related to the sub-penny rule or market data rules.
- 6 NASD also is deleting IM-4613A that bans the automated update of certain quotations through the ADF. NASD originally adopted this IM to address capacity and operation concerns, but such a prohibition is no longer necessary.
- 7 Currently, Rule 4300A(e)(4) permits only five excused system outages to be granted in a 30-day period.
- 8 See 17 CFR 242.611(b). In addition, it should be noted that the SEC also adopted two new exemptions—one for "Qualified Contingent Trades" and another for "Certain Subpenny Trade-Throughs." See Securities Exchange Act Release No. 54389 (August 31, 2006), 71 FR 52829 (September 7, 2006) and Securities Exchange Act Release No. 54678 (October 31, 2006), 71 FR 65018 (November 6, 2006). To the extent that the Commission issues future exemptions or exceptions, NASD may require that additional modifiers be appended.
- 9 However, a firm would be responsible for ensuring that the specific transaction falls expressly into the exception as set forth in SEC Rule 611. Accordingly, a firm could not rely on the identification of a transaction pursuant to NASD rules as a type of trade that is excepted from Regulation NMS without ensuring the specific trade meets all of the criteria set forth in SEC Rule 611.

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- 10 Specifically, NASD will oversee NASD ADF Trading Centers and other NASD members that meet the definition of a “trading center” set forth in 600(b)(78) to determine, among other things, if they have meet their SEC Rule 611 obligations to establish, maintain and enforce written policies and procedures designed to prevent trade-throughs on that trading center of protected quotations in NMS stocks that do not otherwise fall within an exception.
- 11 See Regulation NMS Approval Order, 70 FR at 37543.
- 12 See *id.*
- 13 NASD also is amending 4300A to add a new paragraph (g) to require each Registered Reporting ADF ECN to post at least one marketable quote/order through the ADF on each side of the market each 30 calendar days or lose its ADF certification.
- 14 See Regulation NMS Approval Order, 70 FR at 37543 (“Under Rule 610(b)(1)...ADF participants will be required to bear the costs of the necessary connectivity to facilitate efficient access to their quotations”).
- 15 In this regard, NASD is required to evaluate “substantially equivalent” cost of access on a per transaction basis. As the Commission noted in the Regulation NMS Approval Order, this cannot be evaluated in terms of absolute dollars. For example, in evaluating access, a \$1,000 port charge for an ECN participating in ADF that trades one million shares per day would not be substantially equivalent to a \$1,000 port charge by an SRO trading facility trading 100 million shares per day. See Regulation NMS Approval Order, 70 FR at 37543. In evaluating “substantially equivalent” cost of access, NASD will look at cost related to directly accessing SRO trading facilities generally. Specifically, NASD will look at ADF Trading Center and SRO connectivity costs such as line costs and port charges. In addition, NASD also will consider costs associated with SRO membership in evaluating “substantially equivalent” costs.
- 16 Rule 4400A, as amended, allows any registered broker-dealer to file a direct or indirect access complaint against an ADF Trading Center with NASD to allege a denial of or limitation on access. It should be noted, however, that the filing of a frivolous direct or indirect access complaint by an NASD member could constitute a violation of Rule 2110.
- 17 The Commission noted in the Regulation NMS Approval Order that, if an ADF participant were not complying with these access standards, NASD would have a responsibility “to stop publishing the participant’s quotations until the participant comes into compliance. See Regulation NMS Approval Order, 70 FR at 37543. Rule 4400A is being amended to expressly incorporate this authority.
- 18 It should be noted that NASD expressly prohibits the display of manual quotations in the ADF, as specified in Rule 4300A.
- 19 NASD is amending Rule 4200A to define the term “Certification Record.” In addition, Rule 4300A is amended to expressly require compliance with the “terms agreed to in the Certification Record.”
- 20 The SEC approved changes to the ADF Trading Center Certification Record, which became effective upon SEC approval on September 28, 2006.
- 21 This representative typically should be the Chief Compliance Officer or other principal with appropriate oversight responsibilities.
- 22 Current ADF Trading Centers also are required to be re-certified prior to the implementation of Regulation NMS. Accordingly, there is no “grandfather” allowance for current ADF Trading Centers.
- 23 See 17 CFR 242.600(b)(3).
- 24 See Regulation NMS Approval Order for a description of the “Self-Help Exception.”
- 25 17 CFR 242.610.

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- 26 See Securities Exchange Act Release No. 53829 (May 18, 2006), 71 FR 30038 (May 24, 2006) (requiring ADF participants to meet the new automation requirements discussed above to qualify).
- 27 While ADF rules are applied in a uniform manner to all NMS stocks to the extent possible, NMS stocks are subject to two separate transaction reporting plans. NASDAQ securities are governed by the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for NASDAQ-Listed Securities Traded on Exchanges on an Unlisted Trading Privilege Basis (UTP Plan); and NYSE, Amex, and certain other regionally listed securities are governed by the Consolidated Quotation Plan (CQ Plan) and the Consolidated Tape Association Plan (CTA Plan).
- 28 As noted above, the changes discussed in this *Notice* (including the adoption of the rules, as amended, discussed herein and the deletion of the Rule 6300 and 6400 Series) will occur on the Regulation NMS Trading Phase Date, currently scheduled to occur on February 5, 2007.
- 29 See, e.g., Securities Exchange Act Release No. 54084 (June 30, 2006), 71 FR 38935 (July 10, 2006) (File No. SR-NASD-2005-087) (establishing, among other things, rules for the trade reporting of transactions otherwise than on an exchange through the new TRF).
- 30 As described previously in the Order Protection Rule discussion, NASD also is changing the required modifiers set forth in Rule 4632A(a) to more closely align them with Regulation NMS and has inserted a general provision that requires a member to report “[a]ny other modifier as specified by NASD or the Securities and Exchange Commission.”
- 31 Rule 4200A definitions also are amended to define “registered reporting member” and “non-registered reporting member” as used in the transaction reporting rules.

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