

Notice to Members

MAY 2007

SUGGESTED ROUTING

Executive Representative
Legal & Compliance
Operations
Registered Representatives
Senior Management
Systems
Trading

KEY TOPICS

Alternative Display Facility
ADF Trading Centers
Regulation NMS
SEC Rule 611
Trade Reporting
Trade Reporting Facilities

GUIDANCE

NASD Trade Reporting Requirements Related to Regulation NMS

Effective Dates: Regulation NMS Trading Phase Date (March 5, 2007) for Alternative Display Facility Participants; and Regulation NMS Pilot Stocks Phase Date (Scheduled to Occur July 9, 2007) for NASD Trade Reporting Facility Participants

Executive Summary

NASD is issuing this *Notice* to provide additional guidance to broker-dealer member firms on the proper use of NASD's new transaction reporting modifiers. These trade reporting modifiers were amended and expanded to allow reporting of certain exceptions and exemptions to Rule 611 of Regulation NMS to NASD facilities. The amended trade reporting requirements were effective for Alternative Display Facility (ADF) participants on March 5, 2007, the Regulation NMS Trading Phase Date. They will be operative for each of the NASD Trade Reporting Facilities (the TRFs) on the Regulation NMS Pilot Stocks Phase Date, which is scheduled to occur on July 9, 2007. In addition to this *Notice*, NASD members that are also members of the New York Stock Exchange (NYSE) should review Information Memo 07-44, which is being issued by the NYSE contemporaneously with this *Notice*.

Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Dave Chapman, Deputy Director, Market Regulation, at (240) 386-4995; Lisa Horrigan, Associate General Counsel, Office of General Counsel, at (202) 728-8190; Kathleen A. O'Mara, Associate General Counsel, Office of General Counsel, at (202) 728-8071; Peter D. Santori, Chief Counsel, Market Regulation, at (240) 386-5098; and Chris Stone, Associate Chief Counsel, Transparency Services, at (202) 728-8457.

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Background and Discussion

On June 9, 2005, the Securities and Exchange Commission (SEC) issued its release adopting Regulation NMS.¹ Regulation NMS established substantive rules designed to modernize and strengthen the regulatory structure of the U.S. equities markets. In particular, for purposes of the information provided in this *Notice*, Regulation NMS includes the Order Protection Rule (SEC Rule 611), which 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 (commonly referred to as a “trade-through”), subject to applicable exceptions and exemptions.² For quotations to be protected under the rule, a quotation must be immediately and automatically accessible.

On September 28, 2006, the SEC approved amendments to the ADF³ rules to, among other things, align them with Regulation NMS.⁴ NASD issued *Notice to Members 06-67* summarizing the amendments to the ADF rules, which became effective on the Regulation NMS Trading Phase Date, March 5, 2007.⁵ In addition, NASD has adopted substantially similar provisions to the trade reporting rules for each of the TRFs.⁶ Specifically, on January 8, 2007, NASD filed a proposed rule change to make conforming changes consistent with the requirements of Regulation NMS to the rules governing the NASD/NASDAQ TRF and on February 12, 2007, filed a similar proposed rule change relating to the NASD/NSX TRF, the NASD/BSE TRF and the NASD/NYSE TRF.⁷ These proposed rule changes were filed for immediate effectiveness and will be operative on the Regulation NMS Pilot Stocks Phase Date, which is currently scheduled to occur on July 9, 2007.⁸

Among other changes, NASD has adopted new transaction reporting modifiers that require members to indicate in transactions reported to NASD facilities whether the transaction qualified for an exception or exemption to SEC Rule 611 at the time of the trade. This *Notice* covers the proper use of these new transaction reporting modifiers. Note that NASD may, where appropriate, prescribe additional modifiers in the future and will provide at least 30-days advance written notice of any such additional modifiers to ensure that firms have sufficient time to accommodate such changes.

Guidance Regarding the Proper Use of Regulation NMS-Related Trade Modifiers

The Trade Reporting Modifier Chart below demonstrates generally how member firms should use the new trade report modifiers when reporting a transaction that meets a recognized SEC Rule 611 exception or exemption. This chart provides the uniform methodology for reporting trade modifiers; however, the specific data entries used to report trades may vary depending upon the specific platform or system used. Therefore, the chart should be read in conjunction with the applicable system specifications.⁹

The new modifier format allows firms to submit significantly more trade reporting information than permitted under the previous format. Thus, for the most part, firms no longer have to program their systems to prioritize the use of transaction reporting modifiers. That said, members must ensure that they submit the appropriate information in the appropriate field or the subject transaction report will be rejected. In general, the Trade Reporting Modifier Chart specifies the information that is required to be reported for the various SEC Rule 611 exceptions or exemptions. The pertinent trade reporting fields are as follows:

1. **SEC Rule 611 Exception/Exemption Trade-Through Flag:** indicates that a trade-through exception or exemption applies to a reportable transaction; the firm must indicate that in its transaction report by populating the Trade-Through Exception/Exemption Flag;
2. **Trade Modifier Field 1: Settlement Type:** indicates the manner in which a transaction will settle (e.g., regular, cash, next day, etc.);
3. **Trade Modifier Field 2: Reason for SEC Rule 611 Exception or Exemption:** indicates which specific SEC Rule 611 exception or exemption applies to the transaction;
4. **Trade Modifier Field 3: Extended Hours/Sold:** indicates whether the transaction was reported late or executed outside normal market hours, as applicable; and
5. **Trade Modifier Field 4: SRO Required Detail:** identifies additional trade information required pursuant to NASD rules, as applicable (e.g., weighted average price, stopped stock, etc.).

Trade Reporting Modifier Chart

Applicable Regulation NMS Exception/Exemption	Trade Reporting Information to be Entered by Reporting Firm				
	SEC Rule 611 Exception/Exemption Trade-Through Flag	Settlement Type Field 1 ¹⁰	Reason for SEC Rule 611 Exception/Exemption Field 2	Extended Hours/Sold Field 3 ¹¹	SRO Required Detail Field 4 ¹²
SEC Rule 611(b)(1) (Self Help)	If applicable indicate Yes	Enter applicable settlement modifier	Self Help (Note: for SRO audit trail only-will not be disseminated)	Enter modifier if applicable	Enter modifier if applicable
SEC Rule 611(b)(2) (Not Regular Way)	If applicable indicate Yes	Cash, Next Day or Seller	If applicable, enter other SEC Rule 611 exception/exemption modifier for transaction	Enter modifier if applicable	Enter modifier if applicable
SEC Rule 611(b)(4) (Crossed Market)	If applicable indicate Yes	Enter applicable settlement modifier	If applicable, enter other SEC Rule 611 exception/exemption modifier for transaction	Enter modifier if applicable	Enter modifier if applicable
SEC Rule 611(b)(5) (Intermarket Sweep Order (inbound))	If applicable indicate Yes	Enter applicable settlement modifier	Inbound Intermarket Sweep Order (Note: This will be disseminated generically as an ISO)	Enter modifier if applicable	Enter modifier if applicable
SEC Rule 611(b)(6) (Intermarket Sweep Order (outbound))	If applicable indicate Yes	Enter applicable settlement modifier	Outbound Intermarket Sweep Order (Note: This will be disseminated generically as an ISO)	Enter modifier if applicable	Enter modifier if applicable
SEC Rule 611(b)(7) (Benchmark/ Derivatively Priced)	If applicable indicate Yes	Enter applicable settlement modifier	Derivatively Priced	Enter modifier if applicable	Prior Reference Price, Weighted Average Price or other modifier as applicable for transaction
SEC Rule 611(b)(9) (Stopped Stock)	If applicable indicate Yes	Enter applicable settlement modifier	Derivatively Priced	Enter modifier if applicable	Stopped Stock (Note: for SRO audit trail only - this will be disseminated as Weighted Average Price)
SEC Rule 611(d) (Qualified Contingent Trades)	If applicable indicate Yes	Enter applicable settlement modifier	Qualified Contingent Trade (Note: for SRO audit trail only-will not be disseminated)	Enter modifier if applicable	Enter modifier if applicable
SEC Rule 611(d) (Sub-Penny Trade-Throughs)	If applicable indicate Yes	Enter applicable settlement modifier	Sub-Penny Trade Through (Note: for SRO audit trail only-will not be disseminated)	Enter modifier if applicable	Enter modifier if applicable

It should be noted that the exception to Rule 611 for flickering quotations (see SEC Rule 611(b)(8))¹³ is not included in this chart because firms are not required to identify their reliance on that exception for purposes of NASD trade reporting requirements. In addition, the exception for a transaction in a single-priced opening, reopening or closing (see SEC Rule 611(b)(3)) is not included in this chart because NASD staff currently is not aware of a scenario in which the exception would apply to the execution of broker-dealer transactions otherwise than on an exchange (commonly referred to as over-the-counter or OTC trades).¹⁴

Moreover, it should be noted that NASD filed an immediately effective rule change with the SEC to address concerns raised by some firms that they may not be able to implement certain new Regulation NMS modifiers by the applicable effective date.¹⁵ Specifically, the proposed rule change provides NASD with exemptive authority to address implementation issues concerning: (1) the self-help modifier; (2) the qualified contingent trade modifier; (3) the sub-penny modifier; and (4) the modifier used to distinguish between inbound and outbound intermarket sweep orders.

Firms that cannot make the requisite technology changes by the applicable compliance date may request an exemption from NASD in writing. NASD will provide specific procedures and the information required to request such an exemption. It should be noted that any exemption will only be granted for good cause shown, after taking into consideration all relevant factors, and must be consistent with the protection of investors and the public interest. The duration of any exemption will be determined by NASD, but shall not exceed a six-month period.

As is always the case when reporting a transaction, the particular circumstances surrounding the execution of the transaction will determine the information that must be included in the corresponding transaction report. As previously noted, firms should always consult the technical specifications to determine what must be included in a particular transaction report. Additionally, firms should be aware that the specific form and content of a particular transaction report may vary depending on the interface (such as FIX, QIX or CTCL) used to report transactions to NASD. Lastly, NASD reiterates that firms using the trade report modifiers under the amended rules are responsible for determining that the transaction satisfies all requirements of the specific SEC Rule 611 exception or exemption.

Examples

For illustrative purposes, the following are two example trade reports—one where the transaction trades through protected quotations but is entitled to an exception pursuant to SEC Rule 611, and another for a transaction that does not constitute a trade through of a protected quotation.

Example #1: Trade-Through Trade Report Using the Benchmark/Derivatively Priced Exception

Assume that a market-on-open order has been executed and reported at 10:00:00 and it qualifies for a trade-through exception pursuant to SEC Rule 611(b)(7). Assume further that the price of the execution was based on the 9:30:00 market opening price and will settle regular way. The modifiers to be used when reporting the execution are determined through the following analysis:

Field	Value
SEC 611 Exception/Exemption Trade-Through Flag	Yes—the firm has determined that the execution qualifies for a trade-through exception pursuant to SEC Rule 611(b)(7).
Trade Modifier Field 1: Settlement Type	Regular way settlement
Trade Modifier Field 2: SEC Rule 611 Exception/Exemption Reason	Benchmark/Derivatively priced modifier must be used, consistent with SEC Rule 611(b)(7).
Trade Modifier Field 3: Extended Hours/Sold Sales Conditions	None—no modifier should be used in this field because none of the modifiers applies to this transaction.
Trade Modifier Field 4: SRO Required Detail Sales Condition	Prior reference price modifier must be used for this trade, given that the execution of this transaction occurred at 10:00:00 with a price based on the 9:30:00 market opening price.

Example #2: Trade Report of a Transaction that Does Not Constitute a Trade Through of a Protected Quote

Assume an order has been executed at 10:00:00 and the price is based on a weighted average price and would meet the requirements of SEC Rule 611(b)(7). Assume further that the execution did not trade through a protected quote; therefore, no Regulation NMS trade-through exception or exemption is applicable. The execution was reported within 1 second of execution at 10:00:01 and will settle regular way. The modifiers to be used when reporting this execution are determined through the following analysis:

Field	Value
SEC 611 Exception/Exemption Trade-Through Flag	<p>The firm has two reporting options:</p> <ul style="list-style-type: none"> (1) No—the execution did not trade through a protected quote and therefore an exemption or exception did not apply; or (2) Yes—if a valid exception or exemption exists from SEC Rule 611, the firm may identify the transaction as a trade-through exemption or exception, even though the transaction did not trade through a protected quotation. NASD is providing this option in recognition that quotations may move quickly in a Regulation NMS environment and firms may choose to operate in accordance with a trade-through exception or exemption, even when a trade-through did not actually occur.
Trade Modifier Field 1: Settlement Type	Regular way settlement
Trade Modifier Field 2: Rule 611 Exception/Exemption Reason	<p>Consistent with what is entered in the “SEC Rule 611 Exception/Exemption Trade-Through Flag” column, this can be reported as follows:</p> <ul style="list-style-type: none"> (1) None—if the firm did not mark the trade-through flag; or (2) Benchmark/Derivatively priced modifier—if the firm is entitled to an exception in accordance with SEC Rule 611(b)(7) and determined to mark the trade-through exception or exemption flag.
Trade Modifier Field 3: Extended Hours/Sold Sales Conditions	None. The extended hours/sold conditions do not apply to this transaction.
Trade Modifier Field 4: SRO Detail Sales Condition	The weighted average price code must be used.

Questions and Answers Relating to Amendments to NASD Rules and Trade Reporting with New Regulation NMS Modifiers

General Questions about Trade Reporting Modifiers

Q1: What is the purpose of the new Regulation NMS-related trade reporting modifier requirements?

A1: The purpose of the new Regulation NMS-related trade reporting modifier requirements is two-fold. First, the new requirements ensure that NASD obtains necessary regulatory information about the application of an exception or exemption to the Order Protection Rule with respect to a particular OTC trade. Second, certain information relating to the application of an exception or exemption to the Order Protection Rule will be provided to the SIP, which will disseminate that information to the tape.

Q2: Will any of the trade reporting modifiers that are currently used change in terms of meaning or value?

A2: For the most part, the modifiers used today will not change. For example, the prior reference price (.PRP) modifier will continue to be used to identify transactions executed at a price different from the current market when the price is based on a prior reference point in time and is not reported within 90 seconds of that prior reference point. However, there have been some minor modifications to certain trade report modifiers consistent with Regulation NMS. For example, firms previously used one identifier (.W) to identify stopped stock, exchange-for physicals, volume-weighted average-price trades, or another special pricing formula. Going forward, the .W modifier will no longer be used for stopped stock transactions. Instead, NASD has created a new, separate modifier for such transactions.¹⁶

Q3: Does the new modifier format allow for combinations of modifiers, where appropriate?

A3: Yes. For example, a firm will now be able to report that a transaction is both a weighted average price (.W) and extended hours (.T) transaction. In the past, when both the .W and .T modifiers applied to a particular transaction, firms were instructed to use the .W modifier rather than the .T modifier.¹⁷ Under the new modifier format, both modifiers can be accommodated on the transaction report and must be used if applicable.

Q4: Is there a correlation between the Regulation NMS modifiers found in Field 1 through Field 4 (i.e., what is reported in Field 2 for a particular transaction dictates what must be reported in Field 4 for the same transaction)?

A4: No. While there is generally no direct correlation or interrelationship between the separate columns, NASD expects that certain combinations of modifiers will occur frequently as the result of normal trading patterns. The facts and circumstances of the particular trade dictate the appropriate modifier that must be reported in each field. Accordingly, the reporting firm must include in the transaction report all of the information that is pertinent to a particular transaction. To determine what modifiers must be included in a particular transaction report, firms should analyze each column individually in the Trade Reporting Modifier Chart to determine what, if any, modifier is applicable for the transaction that is being reported.

Q5: Can the Trade Reporting Modifier Chart be used to report trades that do not constitute a trade through of a protected quote?

A5: Yes, as illustrated in Example 2 on page 7, the chart should be used in determining how to report such trades. As noted above, the facts and the circumstances of the particular trade dictate the appropriate modifier that must be included in the corresponding transaction report. Accordingly, the reporting firm should attach all the information that is pertinent to a particular transaction.

Q6: When reporting a trade as an ISO, is it permissible to use the Rule 611 exception/exemption trade-through flag even if the transaction does not result in a trade through of a protected quotation?

A6: Yes. As described above in A5 and in Example 2 found on page 7, NASD understands that quotations may move rapidly in a Regulation NMS environment and that there will be instances when ISO trades (or trades executed and reported in reliance on other trade-through exceptions or exemptions) will be reported as trade-through exempt even when a trade-through did not actually occur.

Q7: Can firms include both the prior reference price modifier in Field 4 and the late or late extended hours execution modifiers in Field 3 on the same transaction report?

A7: No. Trade reports should not contain both the prior reference price and the late or late extended hours execution modifiers.

Q8: Which trade reporting modifiers included in a transaction report will be publicly disseminated?

A8: Most of the modifiers identified in the Trade Reporting Modifier Chart will be disseminated to the tape (in conformity with each of the SIP's specifications). However, there are certain modifiers that will be submitted to NASD solely for regulatory purposes, and NASD will not forward them to the SIPs for public dissemination. The modifiers that will not be forwarded to the SIPs for dissemination include: (1) self-help; (2) qualified contingent trades; and (3) sub-penny trade-through. In addition, while firms are required to distinguish between the use of inbound and outbound Intermarket Sweep Order (ISO) exceptions (see SEC Rule 611(b)(5) and (6)) when reporting such trades to NASD, this information will be generically identified as an ISO when sent to the SIPs. Lastly, firms will expressly identify stop stock transactions when reporting a transaction to NASD, but NASD will send this trade to the SIPs as a weighted-average price modifier.

Q9: If multiple SEC Rule 611 exception/exemptions apply, which takes priority for purposes of populating the SEC Rule 611 Exception/Exemption Reason in Field 2?

A9: At this time, NASD is aware of only one instance that will commonly occur where a firm must prioritize multiple SEC Rule 611 exceptions or exemptions for purposes of determining the appropriate modifier to populate Field 2. Specifically, when both the self-help exception and an ISO exception are applicable to a particular trade-through scenario, the firm should identify in Field 2 that the transaction is an ISO rather than a self-help transaction.

Q10: When do the new modifiers go into effect?

A10: The new modifiers will go into effect in accordance with the effective dates provided in the applicable rule filings. The ADF rules became effective on March 5, 2007. The TRF rules currently are scheduled to go into effect with the start of the Pilot Stocks Phase on July 9, 2007.¹⁸ Firms, however, are advised to check the technical specifications for each TRF to determine message formatting requirements. The TRF technical specifications can be found on NASD's TRF Web page, www.nasd.com/RegulatorySystems/TRF/index.htm.

Q11: ADF and TRF rules have prohibited the aggregation of transactions; does this prohibit a firm from reporting a cross as one transaction?

A11: No. The prohibition only applies to the aggregation of separate, multiple executions, for transaction reporting purposes, into a single transaction report submitted to the ADF and the TRFs, which previously were permitted using the .B modifier. It does not apply to the matching of multiple buy and sell orders in a single execution (e.g., through the facilities of an Alternative Trading System (ATS)) or to transactions that are designated as .W (i.e., exchange-for physicals, volume-weighted average-price trades or another special pricing formula). Such transactions previously were not reported as bunched or aggregated using the ".B" modifier.

Q12: Do Regulation NMS trade reporting requirements apply to all OTC transactions?

A12: No. The new Regulation NMS trade reporting requirements only apply to OTC transactions in NMS stocks, as defined in SEC Rule 600(b)(46).¹⁹

Q13: A firm intends to use the ISO (outbound) exception, pursuant to SEC Rule 611(b)(6), to execute a block transaction for a customer that will trade-through one or more trading centers. What are the firm's trade reporting obligations under NASD rules in this circumstance?

A13: To comply with the ISO exception, simultaneously with execution of the block trade, the firm is required to route an ISO to execute against the full displayed size of any protected quotation with a price superior to the block trade price.²⁰ The ultimate handling and execution of the customer's block order, however, may depend on the preference of the customer.

If a customer represents that it does *not* want to receive the benefit of any better prices obtained by the ISOs, the firm could promptly report the full size of the block to NASD as an ISO pursuant to SEC Rule 611(b)(6) since all material terms are known.²¹ If, however, the firm's customer is silent or affirmatively chooses to receive the benefit of any better prices obtained by the execution of any routed ISOs against the superior price protected quotations of other trading centers, any fills received from the execution of the routed ISO orders will reduce the size of the block trade that is reported to NASD as an ISO pursuant to SEC Rule 611(b)(6).²² Accordingly, in this instance the firm that was responsible for executing the block trade will only report the amount of the block that it executed (minus the number of shares executed by another trading center).

Q14: If Firm A receives and executes an ISO order from Firm B, what is Firm A's trade reporting obligation?

A14: Assuming Firm A has the trade reporting obligation, Firm A should report the trade with the trade-through exception/exemption flag marked "yes" and with the ISO inbound trade modifier pursuant to SEC Rule 611(b)(5). However, as noted in Q8, the transaction will be identified by the SIP with a generic ISO indicator for the purposes of dissemination to the public.

Q15: If the SEC suspends the operation of the trade-through provisions of Regulation NMS by issuing notice of an industry-wide “self help” exception to the Order Protection Rule, how will such notice be communicated to member firms and the industry generally?

A15: The SEC stated that, if serious market-wide systems problems arise, the SEC may suspend the operation of the trade-through provisions of Regulation NMS by issuing notice of an industry-wide “self help” exception to the Order Protection Rule.²³ Accordingly, NASD member firms should be advised that, if the SEC issues notice of an industry-wide self-help exception, NASD also will communicate the issuance of such a notice via a Member Alert, which will be posted in the Member Alert section of the NASD Web site²⁴ and distributed via email to those on the executive representative email distribution list. To the extent that the executive representative of an NASD member firm receives such an email and such individual is not the appropriate person at the firm to take the necessary actions, that executive representative should be prepared to forward immediately the email to the appropriate individual(s) at the member.

OATS Reporting Question

Q16: Are there any Order Audit Trail System (OATS) reporting obligations for NASDAQ securities relating to Regulation NMS?

A16: Yes. For orders subject to the OATS Rules, members will be required to identify on the applicable OATS report the receipt and routing of an ISO. Specifically:

1. A new Special Handling Code of “ISO” has been added to the New Order Report, Combined Order/Route Report, Combined Order/Execution Report and Cancel/Replace Report to reflect the receipt of an ISO by a trading center; and
2. A new Routing Method Code of “I” will be added to the Route Report and Combined Order/Route Report to identify orders, or portions of orders, that are routed to another trading center and identified to such trading center as an ISO.

The ISO Special Handling Code for trading centers receiving an ISO will be mandatory on July 9, 2007, the Pilot Stocks Phase Date under Regulation NMS. NASD has filed a proposed rule change with the SEC to establish the new Routing Method Code.²⁵ If the rule change is approved, the Routing Method Code “I” for members routing ISOs to other trading centers will be available on June 11, 2007, but will not be mandatory until February 4, 2008. This will provide firms with additional time to program for the new code.

For illustrative purposes, the following are examples of the applicability of these new OATS codes:

Example #1: "ISO" Special Handling Code: An ADF trading center is displaying a protected quotation in the ADF. Another broker-dealer wishes to access this protected quotation by routing an ISO to execute against its full displayed size, as required by SEC Rule 611(b)(6). This broker-dealer therefore routes an ISO to the ADF trading center to access the protected quote.

OATS reporting obligations of the ADF trading center in Example #1:

The ADF trading center must submit to OATS: (1) a New Order Report with a Special Handling Code of ISO to reflect the receipt of an order; and (2) an Execution Report reflecting execution of the routed ISO, if applicable.

Example #2: "I" Routing Method Code: A member firm intends to utilize the ISO exception to the trade-through rule to obtain executions for an order that it has received from its customer. To satisfy its obligations under SEC Rule 611, the member firm routes ISOs, which it chooses to send on an agency basis, to execute against the relevant protected quotations.

OATS reporting obligations of the member firm in Example #2:

The member firm must submit to OATS: (1) a New Order Report reflecting receipt of the order from its customer; (2) a Route Report for each ISO sent, on an agency basis, to another trading center with a Routing Method Code of "I" and a Destination Code reflecting the specific exchange or trading center to which the order was routed; and (3) to the extent that the member routed the ISOs, on an agency basis, with the intent of executing on a principal basis the balance, if any, of the customer order not satisfied by the routing (and subsequent execution, if any) of such ISOs, an Execution Report to reflect the execution of the balance of the block order with its customer.

Questions Relating to ADF Requirements

In addition to the questions and answers below, firms should also review *Notice to Members 06-67* for additional information on Regulation NMS requirements relating to the ADF.

Q17: Can member firms, exchange trading facilities, or other ADF trading centers access ADF trading centers through NASD or the ADF?

A17: No. The ADF is a display-only facility. Accordingly, neither NASD nor the ADF offers a single common access point or central connectivity linkage. ADF trading center quotes are accessible through direct and/or indirect access in accordance with ADF rules. Please refer to the specifications of the applicable ADF trading center located on NASD's ADF Web page for specific quote access information: www.nasd.com/RegulatorySystems/ADF/Participants/index.htm.

Q18: Will market participants be able to tell which ADF trading center is posting a quote that represents the best bid or offer (BBO) in the ADF at any given time (particularly if multiple ADF trading centers are posting equally priced bids or offers on the same side of the market)?

A18: Yes. The quotation data feeds for NMS stocks display the specific ADF trading center MPID that is setting the ADF BBO.

Q19: What securities does the ADF support?

A19: As of March 5, 2007, all NMS stocks became eligible for quoting, trade reporting and comparison through the ADF. Previously, only NASDAQ-listed securities were supported.

Q20: Will participants quoting through NASD facilities continue to be accessible through the Intermarket Trading System (ITS)?

A20: No. As of March 5, 2007, participants quoting through NASD facilities are no longer accessible through ITS for CQS securities. ADF trading center quotes are currently accessible through direct and/or indirect access, as set forth in NASD's ADF rules.

Endnotes

- 1 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).
- 2 In addition, Regulation NMS adopted: (1) an Access Rule that, among other things, requires fair and non-discriminatory access to quotations; (2) a Sub-Penny 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; and (3) amendments to 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 changes to NASD's trade reporting rules that primarily relate to implementation of the Order Protection Rule.
- 3 The ADF is a quotation collection, trade comparison and trade reporting facility developed by NASD, which provides ADF trading centers the ability to post quotations in NMS stocks and provides all firms that participate in the ADF the ability to view quotations and report transactions in NMS stocks to the appropriate Exclusive Securities Information Processor (SIP or Processor) for consolidation and dissemination of data to vendors.
- 4 See Securities Exchange Act Release No. 54537 (September 28, 2006), 71 FR 59173 (October 6, 2006) (File No. SR-NASD-2006-91).
- 5 The SEC also approved changes to the ADF Trading Center Certification Record, which became effective on September 28, 2006.
- 6 Generally, the TRFs are mechanisms for firms to report trades in NMS stocks effected otherwise than on an exchange. Currently, four TRFs are operational: the NASD/NASDAQ TRF, the NASD/NSX TRF, the NASD/BSE TRF and the NASD/NYSE TRF. Each TRF is a facility of NASD, subject to regulation by NASD and NASD's registration as a national securities association. Unlike the ADF, the TRFs are trade reporting mechanisms only; they do not permit quoting.
- 7 See Securities Exchange Act Release No. 55101 (January 12, 2007), 72 FR 2568 (January 19, 2007) (notice of filing and immediate effectiveness of SR-NASD-2007-002) and Securities Exchange Act Release No. 55346 (February 26, 2007), 72 FR 9807 (March 5, 2007) (notice of filing and immediate effectiveness of SR-NASD-2007-014) available at www.nasd.com/RulesRegulation/RuleFilings/2007RuleFilings/NA_SDW_018634.
- 8 While the new NASD trade reporting requirements for the TRFs are effective on this date, it should be noted, however, that the Order Protection Rule will only be applicable to certain NMS stocks on that date, in accordance with the compliance schedule set forth by the SEC in Securities Exchange Act Release No. 55160 (January 24, 2007), 72 FR 4202 (January 30, 2007). Accordingly, members will not be required to comply with the new Regulation NMS trade reporting modifiers for those NMS stocks that are not yet subject to the Order Protection Rule. However, members may voluntarily report such information to NASD for all NMS stocks.
- 9 ADF and TRF technical specifications can be found on the NASD Web site at www.nasd.com/RegulatorySystems/ADF/FIXInformation/index.htm and www.nasd.com/RegulatorySystems/TRF/Exchange_Participants/index.htm, respectively.
- 10 The full universe of settlement type modifiers that can be used, as appropriate, in the "Settlement Type - Field 1" are found in the applicable technical specifications.

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- 11 The full universe of trade type modifiers that can be used, as appropriate, in the "Extended Hours/Sold – Field 3" are found in the applicable technical specifications.
- 12 The full universe of trade type modifiers that can be used, as appropriate, in the "SRO Required Detail – Field 4" are found in the applicable technical specifications.
- 13 See SEC Rule 611(b)(8) which states: [t]he trading center displaying the protected quotation that was traded through had displayed, within one second prior to execution of the transaction that constituted the trade-through, a best bid or best offer, as applicable, for the NMS stock with a price that was equal or inferior to the price of the trade-through transaction.
- 14 To the extent that an NASD member firm believes that it can properly rely on the exception set forth in SEC Rule 611(b)(3) for an OTC trade, it should verify this with SEC staff. In addition, once the SEC staff determines that it is appropriate for the NASD member firm to rely on such exception, the firm should promptly notify NASD.
- 15 See SR-NASD-2007-032. The rule filing is available on NASD's Web site at www.nasd.com/RulesRegulation/RuleFilings/2007RuleFilings/NASDW_019139.
- 16 It is important to note, however, that consistent with the Commission's prior guidance concerning the applicability of the exception in SEC Rule 611(b)(9) (Stopped Stock) to certain "error corrections," firms should use the derivatively priced modifier in Field 2 to identify such situations, and not the stopped stock modifier in Field 4. See Question 3.11, Division of Market Regulation: Responses to Frequently Asked Questions concerning SEC Rule 611 and Rule 610 of Regulation NMS (October 31, 2006 update).
- 17 See NASDAQ Head Trader Alert 2004-081 (June 22, 2004).
- 18 See note 8.
- 19 Firms reporting OTC transactions in Non-NMS Stocks, e.g., OTC Bulletin Board and Pink Sheet securities, to the OTC Reporting Facility will be required to use the new four byte messaging format because the OTC Reporting Facility uses the same technology platform as the NASD/NASDAQ TRF. However, as noted above, the Regulation NMS-related trade reporting modifiers do not apply to transactions in these securities and, accordingly, should not be used when reporting transactions in Non-NMS Stocks.
- 20 To meet this requirement, the trading center will need to utilize an automated system that is capable of ascertaining current protected quotations and simultaneously routing the necessary ISOs.
- 21 See Question 3.03, Division of Market Regulation: Responses to Frequently Asked Questions concerning SEC Rule 611 and Rule 610 of Regulation NMS (October 31, 2006 update).
- 22 It is possible that the execution of the routed ISOs would satisfy the customer's order such that there would be no need to execute a block transaction with the customer pursuant to SEC Rule 611(b)(6).
- 23 See SEC Press Release 2007-029, dated March 2, 2007 (www.sec.gov/news/press/2007/2007-29.htm).
- 24 See www.nasd.com/RulesRegulation/MemberAlerts/2007MemberAlerts/index.htm.
- 25 See SR-NASD-2007-028. The rule filing is available on NASD's Web site at www.nasd.com/RulesRegulation/RuleFilings/2007RuleFilings/NASDW_018978

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