

OMB APPROVAL

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

File No. SR - 2005 - 144

Amendment No.

Proposed Rule Change by National Association of Securities Dealers

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

Initial ☒ Amendment ☐ Withdrawal ☐

Section 19(b)(2) ☒Section 19(b)(3)(A) ☐Section 19(b)(3)(B) ☐

Rule

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Pilot ☐ Extension of Time Period
for Commission Action ☐ Date Expires

Exhibit 2 Sent As Paper Document
☐

Exhibit 3 Sent As Paper Document
☐

Description

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

Add new NASD Rule 3380 relating to order entry and execution practices

Contact Information

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

First Name Kathryn Last Name Moore
Title Assistant General Counsel
E-mail kathryn.moore@nasd.com
Telephone (202) 974-2974 Fax (202) 728-8264

Signature

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

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

Date 12/08/2005

By Stephanie M. Dumont
(Name)

Vice President, Associate General Counsel
(Title)

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

STEPHANIE DUMONT,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

Form 19b-4 Information

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

Exhibit 1 - Notice of Proposed Rule Change

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

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

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Exhibit Sent As Paper Document

☐

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

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

☐

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

Exhibit 4 - Marked Copies

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

Exhibit 5 - Proposed Rule Text

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

Partial Amendment

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

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to add new NASD Rule 3380 to prohibit members and associated persons from splitting any order into multiple smaller orders for execution or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind payment to the member or associated persons as a result of the execution of such orders or the transaction reporting of such executions. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

3380. Order Entry and Execution Practices

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

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on November 30, 2005, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution were provided an opportunity to consult with respect to the proposed rule change pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on December 1, 2005. No other action by NASD is necessary for the filing of this proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be not later than 30 days following publication of the Notice to Members announcing Commission approval.

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

(a) Purpose

"Trade shredding" is a term used to describe the practice of splitting customer orders for securities into multiple smaller orders (e.g., a 1,000 share order is split into 10 100 share orders) for the primary purpose of maximizing payments or rebates to the member. Among other things, concerns have been raised about market participants

increasingly engaging in the practice of trade shredding as a means to increase their share of market data revenues under the joint industry plans (“Plans”),¹ where the Plan participant has adopted a practice of sharing its Plan revenues with market participants who send it orders. Specifically, because the current allocation formulas for distributing Plan income heavily emphasize the number of trades, no matter how small the size of the trade, an incentive can exist for market participants to engage in distortive behavior, such as trade shredding, as a means to increase their share of market data revenues.

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

Although these modifications in Plan formulas should reduce the incentives for trade shredding, the SEC continues to believe that SRO rules prohibiting trade shredding are necessary and appropriate and has requested that all SROs implement rule changes to inhibit the practice of trade shredding. In response to the Commission’s request, NASD is proposing to adopt new Rule 3380, which would prohibit such practices. Specifically, new Rule 3380 would prohibit members and associated persons from splitting any order into multiple smaller orders for execution or any execution into multiple smaller

¹ The three joint-industry plans are (1) the CTA Plan, which is operated by the Consolidated Tape Association and disseminates transaction information for exchange-listed securities, (2) the CQ Plan, which disseminates consolidated quotation information for exchange-listed securities, and (3) the Nasdaq UTP Plan, which disseminates consolidated transaction and quotation information for Nasdaq-listed securities.

executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind payment to the member or associated persons as a result of the execution of such orders or the transaction reporting of such executions. For purposes of the proposed new rule, “monetary or in-kind amount” shall be defined to include, but not limited to credits, commissions, gratuities, payments for or rebates of fees, or any other payments of value to the member or associated person.

As noted in Item 2 of this filing, NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD’s rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rule change will further the goal of preventing manipulative acts and practices by prohibiting this potentially distortive practice.

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

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

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

Not applicable.

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

The proposed rule change is substantially similar to the New York Stock Exchange Rule 123G (Order Entry Practices).

9. Exhibits

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

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2005-144)
SELF-REGULATORY ORGANIZATIONS

Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to
Order Entry and Execution Practices

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on , the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

NASD is proposing to add new NASD Rule 3380 to prohibit members and associated persons from splitting any order into multiple smaller orders for execution or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind payment to the member or associated persons as a result of the execution of such orders or the transaction reporting of such executions. Proposed new language is in italics; proposed deletions are in brackets.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

* * * * *

3380. Order Entry and Execution Practices

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

* * * * *

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

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

“Trade shredding” is a term used to describe the practice of splitting customer orders for securities into multiple smaller orders (e.g., a 1,000 share order is split into 10

100 share orders) for the primary purpose of maximizing payments or rebates to the member. Among other things, concerns have been raised about market participants increasingly engaging in the practice of trade shredding as a means to increase their share of market data revenues under the joint industry plans (“Plans”),³ where the Plan participant has adopted a practice of sharing its Plan revenues with market participants who send it orders. Specifically, because the current allocation formulas for distributing Plan income heavily emphasize the number of trades, no matter how small the size of the trade, an incentive can exist for market participants to engage in distortive behavior, such as trade shredding, as a means to increase their share of market data revenues.

To address these concerns, among others, the SEC adopted Regulation NMS, which contains amendments to the current Plan formulas used to allocate Plan income.⁴ These modifications incorporate a more broad-based measure of a self-regulatory organization’s (“SRO”) contribution to the consolidated trade stream, including both an SRO’s quotes and trades, which is intended to reduce the incentives for trade shredding.

Although these modifications in Plan formulas should reduce the incentives for trade shredding, the SEC continues to believe that SRO rules prohibiting trade shredding are necessary and appropriate and has requested that all SROs implement rule changes to inhibit the practice of trade shredding. In response to the Commission’s request, NASD

³ The three joint-industry plans are (1) the CTA Plan, which is operated by the Consolidated Tape Association and disseminates transaction information for exchange-listed securities, (2) the CQ Plan, which disseminates consolidated quotation information for exchange-listed securities, and (3) the Nasdaq UTP Plan, which disseminates consolidated transaction and quotation information for Nasdaq-listed securities.

⁴ Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37469 (June 29, 2005).

is proposing to adopt new Rule 3380, which would prohibit such practices. Specifically, new Rule 3380 would prohibit members and associated persons from splitting any order into multiple smaller orders for execution or any execution into multiple smaller executions for transaction reporting for the primary purpose of maximizing a monetary or in-kind payment to the member or associated persons as a result of the execution of such orders or the transaction reporting of such executions. For purposes of the proposed new rule, “monetary or in-kind amount” shall be defined to include, but not be limited to credits, commissions, gratuities, payments for or rebates of fees, or any other payments of value to the member or associated person.

As noted in Item 2 of this filing, NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD’s rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rule change will further the goal of preventing manipulative acts and practices by prohibiting this potentially distortive practice.

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

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD- 2005-144 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2005-144. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NASD.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to the File Number SR-NASD-2005-144 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵

Secretary

⁵ 17 CFR 200.30-3(a)(12).