

OMB APPROVAL

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

File No. SR - 2004 - 130

Amendment No. 1

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		
Pilot ☐	Extension of Time Period for Commission Action ☐	Date Expires 	☐ 19b-4(f)(1) ☐ 19b-4(f)(2) ☐ 19b-4(f)(3)	☐ 19b-4(f)(4) ☐ 19b-4(f)(5) ☐ 19b-4(f)(6)	

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).

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 Last Name
Title
E-mail
Telephone Fax

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 By

(Name)

(Title)

NOTE: Clicking the button at right will digitally sign and lock
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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

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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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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”),¹ the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) Amendment No. 1 to SR-NASD-2004-130, which proposes to amend Rule 2320(g) (the “Three Quote Rule”) and the corresponding recordkeeping requirements under Rule 3110(b) to exclude from the Three Quote Rule’s coverage transactions in foreign securities of a foreign issuer that are part of the FTSE All-World Index. NASD is filing this Amendment No. 1 to SR-NASD-2004-130 to propose amendments to the original filing as described herein.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.²

* * * * *

2320. Best Execution and Interpositioning

(a) through (f) No Change.

(g)(1) Except as provided in subparagraph (3) below, [Unless two or more priced quotations for a non-Nasdaq security (as defined in the Rule 6700 Series) are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis,] in any transaction for or with a customer pertaining to the execution of an order in a non-Nasdaq security (as defined in the Rule 6700 Series), a member or person associated with a member, shall contact and obtain

¹ 15 U.S.C. 78s(b)(1).

² Note: NASD has proposed changes to Rule 2320(g) and Rule 3110(b), among other NASD rules, in SR-NASD-2005-087, which is currently pending at the SEC.

quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for the subject security.

(2) No Change.

(3) The requirements described in subparagraph (1) above shall not apply:

(A) when two or more priced quotations for a non-Nasdaq security are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis; or

(B) to any transaction pertaining to the execution of an order in a non-Nasdaq security of a foreign issuer that is a part of the FTSE All-World Index if such transaction is executed during the regular business hours of the foreign market for the foreign security and no trading halt or other similar trading or quoting restriction is in effect in the foreign market for such foreign security.

(4) Definitions

For purposes of this paragraph (g): [,]

(A) T[t]he term “inter-dealer quotation system” means any system of general circulation to brokers or dealers that regularly disseminates quotations of identified brokers or dealers.

(B) [(4) For purposes of this paragraph,] T[t]he term “quotation medium” means any inter-dealer quotation system or any publication or electronic communications network or other device that is used by brokers or dealers to make known to others their interest in transactions in any

security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell.

(5) No Change.

* * * * *

3110. Books and Records

(a) No Change.

(b) Marking of Customer Order Tickets

A person associated with a member shall indicate on the memorandum for each transaction in a non-Nasdaq security, as that term is defined in the Rule 6700 Series, the name of each dealer contacted and the quotations received to determine the best inter-dealer market; however, the requirements of this subparagraph shall not apply if the member can establish and has documented that:

(1) two or more priced quotations for the security are displayed in an inter-dealer quotation system, as defined in Rule 2320(g), that permits quotation updates on a real-time basis for which NASD [Regulation] has access to historical quotation information; or

(2) the transaction is effected in compliance with Rule 2320(g)(3)(B).

(c) through (j) No Change.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on July 21, 2004, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have been 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 Board of Governors of NASD had an opportunity to review the proposed rule change at its meeting on July 22, 2004. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the Board of Governors of NASD 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 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

Rule Filing History

On August 26, 2004, NASD filed with the Commission proposed rule change SR-NASD-2004-130, proposing amendments to Rule 2320(g) and Rule 3110(b) (the “original filing”) to exclude from the Three Quote Rule’s coverage transactions in foreign securities of a foreign issuer that are part of the FTSE World Index. NASD is filing this Amendment No. 1 to SR-NASD-2004-130 (“Amendment No. 1”), which

replaces and supersedes the original filing in its entirety, to change the proposed exclusion from the Three Quote Rule's coverage transactions in foreign securities of a foreign issuer that are part of the FTSE All-World Index, rather than the FTSE World Index.³

Proposal

The Three Quote Rule originally was adopted on May 2, 1988,⁴ as an amendment to NASD's best execution interpretation and generally requires that members that execute transactions in non-Nasdaq securities⁵ on behalf of customers contact a minimum of three dealers (or all dealers if three or less) and obtain quotations, if there are fewer than two quotations displayed on an inter-dealer quotation system that permits quotation

³ The FTSE World Index is a sub-set of the FTSE All-World Index. The list of securities that comprise the FTSE All-World Index are substantially similar to the list of securities that comprise the FTSE World Index. The key difference is that the FTSE All-World Index is comprised of securities from Developed, Advanced Emerging and Secondary Emerging markets, whereas the FTSE World Index is comprised of securities from Developed and Advanced Emerging market segments only. The FTSE World Index, however, is no longer offered other than to existing FTSE subscribers. Given that the FTSE World Index would not be widely accessible, NASD is amending its filing accordingly. See Exhibit 2 for additional details.

The information in this proposed rule change and in Exhibit 2 hereto relating to the FTSE All-World Index is based on information published on FTSE's Web site at www.ftse.com, as well as from conversations with FTSE staff.

⁴ See Exchange Act Release No. 25637 (May 2, 1988), 53 FR 16488 (May 9, 1988).

⁵ The Three Quote Rule applies to transactions in all non-Nasdaq securities. A non-Nasdaq security is defined in NASD Rule 6710 as "any equity security that is neither included in the Nasdaq Stock Market nor traded on any national securities exchange" Therefore, the rule by its terms applies to transactions effected on any foreign exchange. The term "national securities exchange" is not defined in NASD rules, but the requirements to qualify are set forth in Sections 6(a) and

updates on a real-time basis. The Three Quote Rule further defined a member's best execution obligation to customers by setting forth additional requirements for transactions in non-Nasdaq securities, particularly transactions involving relatively illiquid securities with non-transparent prices. The Three Quote Rule is a minimum standard, and compliance with the rule, in and of itself, does not mean a member has met its best execution obligations.

Since the adoption of the Three Quote Rule, the market for non-Nasdaq securities has changed significantly. NASD has found that under certain circumstances, the Three Quote Rule often can hinder, rather than further, best execution by causing significant delays in obtaining executions of customer orders. For example, in 2000, NASD amended the Three Quote Rule to eliminate the requirement to contact three market makers when there are at least two priced quotations displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis.⁶ NASD concluded that, where there were two transparent, firm quotes, the costs associated with delayed executions resulting from compliance with the Three Quote Rule were not outweighed by the benefits of obtaining three telephone quotes.

Similar concerns have been raised with respect to the Three Quote Rule's application in the area of orders in foreign securities of foreign issuers. Certain members

19(a) of the Act. See also Exchange Act Release No. 39266 (Oct. 22, 1997), 62 FR 56217 (Oct. 29, 1997).

⁶ See Exchange Act Release No. 43319 (Sept. 21, 2000), 65 FR 58589 (Sept. 29, 2000) (File No. SR-NASD-00-20). This rule change also alleviated the corresponding recordkeeping requirements under Rule 3110(b) where NASD could validate and confirm compliance with applicable requirements directly through its internal historical data.

and other interested parties had raised concerns that the Three Quote Rule was unnecessary and potentially harmful to the customer's best interests when a member, using reasonable diligence, has determined that the best market for a foreign security is a foreign market where the securities trade with sufficient liquidity and transparency.

NASD staff agreed that the protections of the Three Quote Rule may not be necessary with respect to all orders in foreign securities. In fact, the SEC, in its approval order granting NASD exemptive authority with respect to the Three Quote Rule, specifically indicated that exemptive relief may be appropriate for transactions executed on a foreign exchange.⁷ The SEC stated that exemptive relief may be appropriate in such circumstances because the foreign exchange may constitute the best market for securities that are listed on that market and the time delay involved in contacting three dealers may, therefore, hinder a member from obtaining best execution for the customers.⁸

Accordingly, NASD is proposing amendments that would exclude from the Three Quote Rule's coverage transactions effected in foreign securities of foreign issuers that are part of the FTSE All-World Index.⁹ Therefore, under the proposed rule change, a member would not be required to obtain three quotes in connection with transactions in foreign securities that are part of the FTSE All-World Index. The proposed rule change would not require that the transaction be executed on a foreign market so as not to limit the member's ability to determine, in fulfilling its best execution obligations, that a better execution would be obtained off the foreign market. However, to qualify for the

⁷ See Exchange Act Release No. 39266 (Oct. 22, 1997), 62 FR 56217 (Oct. 29, 1997).

⁸ Id.

exemption, the transaction must be executed during regular business hours of the foreign market for the security and no trading halt or other similar trading or quotation restriction may be in effect in the foreign market for such foreign security.¹⁰

NASD has selected the FTSE All-World Index in part because the SEC staff has deemed the foreign securities that are listed on the FTSE World Index, a subset of the FTSE All-World Index, as having a “ready market” and therefore eligible to receive comparable favorable treatment to U.S. equity securities under the securities haircut¹¹ provisions of the SEC’s net capital rule.¹² In addition, the Federal Reserve Board recognizes the FTSE World Index for determining whether stocks are eligible for margin treatment. NASD believes that the criteria used in determining the composition of the

⁹ The Financial Times and the London Stock Exchange operate the FTSE All-World Index. The FTSE All-World Index includes 48 different countries and approximately 3,000 stocks. See Exhibit 2 for a detailed description of the criteria used to determine the FTSE All-World Index.

¹⁰ Contingent upon approval of the proposed rule change, NASD staff plans to withdraw all existing exemptions it has granted to the Three Quote Rule that relate to foreign securities. NASD staff has granted seven exemptions for customer transactions in Canadian securities executed on a Canadian exchange on an agency or riskless principal basis. (See, e.g., Letter to Mr. Kenneth W. Perlman, General Counsel, Mayer Schweitzer, Inc. from Alden S. Adkins, Senior Vice President and General Counsel.)

¹¹ The SEC’s net capital rule requires broker-dealers, when computing net capital, to deduct from their net worth certain percentages of the market value of their proprietary securities positions, commonly referred to as “haircuts.” Haircuts are calculated under paragraphs (c)(2)(vi), (c)(2)(vii), and applicable appendices of the standard net capital rule, SEC Rule 15c3-1.

¹² See 1993 SEC No-Act LEXIS 967 (Aug. 13, 1993) (regarding foreign equity issues listed on the FT-Actuaries World Index as having a ready market with respect to the ready market and haircut provisions of the SEC’s net capital rule). Note: Calculation of the FT/S&P Actuaries World Index was taken over by FTSE in November 1999 and renamed, the FTSE World Index, which is a subset of the FTSE All-World Index.

FTSE World Index, which is substantially the same for the FTSE All-World Index, helps to ensure that the securities trade with a high degree of liquidity, consistency, and price transparency.¹³

Importantly, while the proposed rule change would not require a member to obtain three quotes in connection with transactions in foreign securities that are part of the FTSE All-World Index, members would continue to be required to comply with their best execution obligations under Rule 2320, and to the extent applicable, their suitability obligations under Rule 2310.

The proposed rule change also would provide a corresponding exclusion to the recordkeeping requirements set forth in Rule 3110(b) relating to the Three Quote Rule if the member can establish and document its reliance on this exclusion. Rule 3110(b) requires that members indicate on the order ticket for each transaction in a non-Nasdaq security the name of each dealer contacted and the quotations received to determine the best inter-dealer market as required by the Three Quote Rule.

In addition, NASD no longer refers to its subsidiary, NASD Regulation, Inc., using its full corporate name, “NASD Regulation” or NASD Regulation, Inc.” Instead, NASD uses “NASD” unless otherwise appropriate for corporate or regulatory reasons. Accordingly, the proposed rule change replaces one reference to “NASD Regulation” in the text of the proposed rule change with “NASD.”

¹³ The FTSE All-World Index is based on a set of rules that govern the construction and maintenance of the index. Stocks comprising the FTSE All-World Index are screened to, among other things, ensure there is sufficient liquidity and the availability of accurate and timely data. Factors in determining liquidity include the level of trading volume relative to shares outstanding. See Exhibit 2 for further information.

Finally, 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,¹⁴ which requires, among other things, that NASD 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 reduce the time and effort necessary in contacting three dealers in orders for foreign securities of certain foreign issuers where it has been demonstrated that such securities are trading with sufficient liquidity and price transparency.

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.

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.

¹⁴ 15 U.S.C. 78o-3(b)(6).

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.¹⁵

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

Not applicable.

9. Exhibits

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

Exhibit 2. Summary of the criteria used to construct the FTSE All-World Index.

Exhibit 4. Exhibit 4 shows the full text of rule change marking changes from the original filing, with the original filing changes shown as if adopted, and the new language in this Amendment No. 1 marked to show additions and deletions.

¹⁵ 15 U.S.C. 78s(b)(2).

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- _____ ; File No. SR-NASD-2004-130)

Self-Regulatory Organizations: National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change Relating to Amendments to Rule 2320(g) (Three Quote Rule) and Corresponding Recordkeeping Requirements under Rule 3110(b)

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 August 26, 2004, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") and amended on _____,³ 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 amend to Rule 2320(g) (the "Three Quote Rule") and the corresponding recordkeeping requirements under Rule 3110(b) to exclude from the Three Quote Rule's coverage transactions in foreign securities of a foreign issuer that are part of the FTSE All-World Index.

Below is the text of the proposed rule change. Proposed new language is in

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ On August 26, 2004, NASD filed SR-NASD-2004-130 with the Commission. Amendment No. 1 to SR-NASD-2004-130 replaced and superceded in its entirety the text of original filing.

italics; proposed deletions are in brackets.

* * * * *

2320. Best Execution and Interpositioning

(a) through (f) No Change.

(g)(1) Except as provided in subparagraph (3) below, [Unless two or more priced quotations for a non-Nasdaq security (as defined in the Rule 6700 Series) are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis,] in any transaction for or with a customer pertaining to the execution of an order in a non-Nasdaq security (as defined in the Rule 6700 Series), a member or person associated with a member, shall contact and obtain quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for the subject security.

(2) No Change.

(3) The requirements described in subparagraph (1) above shall not apply:

(A) when two or more priced quotations for a non-Nasdaq security are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis; or

(B) to any transaction pertaining to the execution of an order in a non-Nasdaq security of a foreign issuer that is a part of the FTSE All-World Index if such transaction is executed during the regular business hours of the foreign market for the foreign security and no trading halt or other similar trading or quoting restriction is in effect in the foreign market for such foreign security.

(4) Definitions

For purposes of this paragraph (g): [,]

(A) T[t]he term “inter-dealer quotation system” means any system of general circulation to brokers or dealers that regularly disseminates quotations of identified brokers or dealers.

(B) [(4) For purposes of this paragraph,] T[t]he term “quotation medium” means any inter-dealer quotation system or any publication or electronic communications network or other device that is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell.

(5) No Change.

* * * * *

3110. Books and Records

(a) No Change.

(b) Marking of Customer Order Tickets

A person associated with a member shall indicate on the memorandum for each transaction in a non-Nasdaq security, as that term is defined in the Rule 6700 Series, the name of each dealer contacted and the quotations received to determine the best inter-dealer market; however, the requirements of this subparagraph shall not apply if the member can establish and has documented that:

(1) two or more priced quotations for the security are displayed in an inter-dealer quotation system, as defined in Rule 2320(g), that permits quotation

updates on a real-time basis for which NASD [Regulation] has access to historical quotation information; or

(2) the transaction is effected in compliance with Rule 2320(g)(3)(B).

(c) through (j) No Change.

* * * * *

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

Rule Filing History

On August 26, 2004, NASD filed with the Commission proposed rule change SR-NASD-2004-130, proposing amendments to Rule 2320(g) and Rule 3110(b) (the “original filing”) to exclude from the Three Quote Rule’s coverage transactions in foreign securities of a foreign issuer that are part of the FTSE World Index. NASD is filing this Amendment No. 1 to SR-NASD-2004-130 (“Amendment No. 1”), which replaces and supersedes the original filing in its entirety, to change the proposed exclusion from the

Three Quote Rule's coverage transactions in foreign securities of a foreign issuer that are part of the FTSE All-World Index, rather than the FTSE World Index.⁴

Proposal

The Three Quote Rule originally was adopted on May 2, 1988,⁵ as an amendment to NASD's best execution interpretation and generally requires that members that execute transactions in non-Nasdaq securities⁶ on behalf of customers contact a minimum of three dealers (or all dealers if three or less) and obtain quotations, if there are fewer than two quotations displayed on an inter-dealer quotation system that permits quotation updates on a real-time basis. The Three Quote Rule further defined a member's best execution obligation to customers by setting forth additional requirements for transactions in non-

⁴ The FTSE World Index is a sub-set of the FTSE All-World Index. The list of securities that comprise the FTSE All-World Index are substantially similar to the list of securities that comprise the FTSE World Index. The key difference is that the FTSE All-World Index is comprised of securities from Developed, Advanced Emerging and Secondary Emerging markets, whereas the FTSE World Index is comprised of securities from Developed and Advanced Emerging market segments only. The FTSE World Index, however, is no longer offered other than to existing FTSE subscribers. Given that the FTSE World Index would not be widely accessible, NASD is amending its filing accordingly. See Exhibit 2 for additional details.

The information in this proposed rule change and in Exhibit 2 hereto relating to the FTSE All-World Index is based on information published on FTSE's Web site at www.ftse.com, as well as from conversations with FTSE staff.

⁵ See Exchange Act Release No. 25637 (May 2, 1988), 53 FR 16488 (May 9, 1988).

⁶ The Three Quote Rule applies to transactions in all non-Nasdaq securities. A non-Nasdaq security is defined in NASD Rule 6710 as "any equity security that is neither included in the Nasdaq Stock Market nor traded on any national securities exchange" Therefore, the rule by its terms applies to transactions effected on any foreign exchange. The term "national securities exchange" is not defined in NASD rules, but the requirements to qualify are set forth in Sections 6(a) and 19(a) of the Act. See also Exchange Act Release No. 39266 (Oct. 22, 1997), 62 FR 56217 (Oct. 29, 1997).

Nasdaq securities, particularly transactions involving relatively illiquid securities with non-transparent prices. The Three Quote Rule is a minimum standard, and compliance with the rule, in and of itself, does not mean a member has met its best execution obligations.

Since the adoption of the Three Quote Rule, the market for non-Nasdaq securities has changed significantly. NASD has found that under certain circumstances, the Three Quote Rule often can hinder, rather than further, best execution by causing significant delays in obtaining executions of customer orders. For example, in 2000, NASD amended the Three Quote Rule to eliminate the requirement to contact three market makers when there are at least two priced quotations displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis.⁷ NASD concluded that, where there were two transparent, firm quotes, the costs associated with delayed executions resulting from compliance with the Three Quote Rule were not outweighed by the benefits of obtaining three telephone quotes.

Similar concerns have been raised with respect to the Three Quote Rule's application in the area of orders in foreign securities of foreign issuers. Certain members and other interested parties had raised concerns that the Three Quote Rule was unnecessary and potentially harmful to the customer's best interests when a member, using reasonable diligence, has determined that the best market for a foreign security is a foreign market where the securities trade with sufficient liquidity and transparency.

⁷ See Exchange Act Release No. 43319 (Sept. 21, 2000), 65 FR 58589 (Sept. 29, 2000) (File No. SR-NASD-00-20). This rule change also alleviated the corresponding recordkeeping requirements under Rule 3110(b) where NASD could validate and confirm compliance with applicable requirements directly through its internal historical data.

NASD staff agreed that the protections of the Three Quote Rule may not be necessary with respect to all orders in foreign securities. In fact, the SEC, in its approval order granting NASD exemptive authority with respect to the Three Quote Rule, specifically indicated that exemptive relief may be appropriate for transactions executed on a foreign exchange.⁸ The SEC stated that exemptive relief may be appropriate in such circumstances because the foreign exchange may constitute the best market for securities that are listed on that market and the time delay involved in contacting three dealers may, therefore, hinder a member from obtaining best execution for the customers.⁹

Accordingly, NASD is proposing amendments that would exclude from the Three Quote Rule's coverage transactions effected in foreign securities of foreign issuers that are part of the FTSE All-World Index.¹⁰ Therefore, under the proposed rule change, a member would not be required to obtain three quotes in connection with transactions in foreign securities that are part of the FTSE All-World Index. The proposed rule change would not require that the transaction be executed on a foreign market so as not to limit the member's ability to determine, in fulfilling its best execution obligations, that a better execution would be obtained off the foreign market. However, to qualify for the exemption, the transaction must be executed during regular business hours of the foreign market for the security and no trading halt or other similar trading or quotation restriction

⁸ See Exchange Act Release No. 39266 (Oct. 22, 1997), 62 FR 56217 (Oct. 29, 1997).

⁹ Id.

¹⁰ The Financial Times and the London Stock Exchange operate the FTSE All-World Index. The FTSE All-World Index includes 48 different countries and approximately 3,000 stocks. See Exhibit 2 for a detailed description of the criteria used to determine the FTSE All-World Index.

may be in effect in the foreign market for such foreign security.¹¹

NASD has selected the FTSE All-World Index in part because the SEC staff has deemed the foreign securities that are listed on the FTSE World Index, a subset of the FTSE All-World Index, as having a “ready market” and therefore eligible to receive comparable favorable treatment to U.S. equity securities under the securities haircut¹² provisions of the SEC’s net capital rule.¹³ In addition, the Federal Reserve Board recognizes the FTSE World Index for determining whether stocks are eligible for margin treatment. NASD believes that the criteria used in determining the composition of the FTSE World Index, which is substantially the same for the FTSE All-World Index, helps to ensure that the securities trade with a high degree of liquidity, consistency, and price transparency.¹⁴

¹¹ Contingent upon approval of the proposed rule change, NASD staff plans to withdraw all existing exemptions it has granted to the Three Quote Rule that relate to foreign securities. NASD staff has granted seven exemptions for customer transactions in Canadian securities executed on a Canadian exchange on an agency or riskless principal basis. (See, e.g., Letter to Mr. Kenneth W. Perlman, General Counsel, Mayer Schweitzer, Inc. from Alden S. Adkins, Senior Vice President and General Counsel.)

¹² The SEC’s net capital rule requires broker-dealers, when computing net capital, to deduct from their net worth certain percentages of the market value of their proprietary securities positions, commonly referred to as “haircuts.” Haircuts are calculated under paragraphs (c)(2)(vi), (c)(2)(vii), and applicable appendices of the standard net capital rule, SEC Rule 15c3-1.

¹³ See 1993 SEC No-Act LEXIS 967 (Aug. 13, 1993) (regarding foreign equity issues listed on the FT-Actuaries World Index as having a ready market with respect to the ready market and haircut provisions of the SEC’s net capital rule). Note: Calculation of the FT/S&P Actuaries World Index was taken over by FTSE in November 1999 and renamed, the FTSE World Index, which is a subset of the FTSE All-World Index.

¹⁴ The FTSE All-World Index is based on a set of rules that govern the construction and maintenance of the index. Stocks comprising the FTSE All-World Index are

Importantly, while the proposed rule change would not require a member to obtain three quotes in connection with transactions in foreign securities that are part of the FTSE All-World Index, members would continue to be required to comply with their best execution obligations under Rule 2320, and to the extent applicable, their suitability obligations under Rule 2310.

The proposed rule change also would provide a corresponding exclusion to the recordkeeping requirements set forth in Rule 3110(b) relating to the Three Quote Rule if the member can establish and document its reliance on this exclusion. Rule 3110(b) requires that members indicate on the order ticket for each transaction in a non-Nasdaq security the name of each dealer contacted and the quotations received to determine the best inter-dealer market as required by the Three Quote Rule.

In addition, NASD no longer refers to its subsidiary, NASD Regulation, Inc., using its full corporate name, “NASD Regulation” or NASD Regulation, Inc.” Instead, NASD uses “NASD” unless otherwise appropriate for corporate or regulatory reasons. Accordingly, the proposed rule change replaces one reference to “NASD Regulation” in the text of the proposed rule change with “NASD.”

Finally, 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.

screened to, among other things, ensure there is sufficient liquidity and the availability of accurate and timely data. Factors in determining liquidity include the level of trading volume relative to shares outstanding. See Exhibit 2 for further information.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁵ which requires, among other things, that NASD 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 reduce the time and effort necessary in contacting three dealers in orders for foreign securities of certain foreign issuers where it has been demonstrated that such securities are trading with sufficient liquidity and price transparency.

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.

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

¹⁵ 15 U.S.C. 78o-3(b)(6).

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- 2004-130 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2004-130. 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. 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 File Number SR-NASD-2004-130 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.¹⁶

Nancy M. Morris

Secretary

¹⁶ 17 CFR 200.30-3(a)(12).

EXHIBIT 2

FTSE All-World Index¹

The FTSE All-World Index, which is a subset of the FTSE Global Equity Index,² includes 48 different countries and approximately 3,000 stocks. The FTSE All-World Index is governed by a set of “Ground Rules”,³ which establishes, among other things, the construction and maintenance of the index, the review criteria for the index constituents⁴ as well as additions and deletions to the index. These Ground Rules have been approved and reviewed by an independent committee of market professionals, the FTSE Equity Indices Committee.⁵ The FTSE Equity Indices Committee also handles such matters as conducting reviews, changing the Ground Rules, and deciding on the treatment of complex corporate actions.

Inclusion Criteria

As noted above, the FTSE All-World Index consists of 48 countries.⁶ To be included in the FTSE All-World Index, a country must meet eligibility requirements. In this regard, the countries listed in the FTSE All-World Index are those that have met the country

¹ The information contained herein is based on information published on FTSE’s Web site, www.ftse.com, as well as from conversations with FTSE staff.

² The FTSE Global Equity Index includes 48 different countries and over 7,000 stocks, capturing 98% of the world’s investable market capitalization. As noted above, the FTSE All-World Index is a subset of the FTSE Global Equity Index. Unlike the FTSE All-World Index, however, the FTSE Global Equity Index includes small cap stocks. See also note 15.

³ A single set of ground rules applies to the FTSE All-World Index, the FTSE Global Equity Index and the FTSE World Index. The FTSE World Index, which is a subset of the FTSE All-World Index, is a successor to the FT/S&P Actuaries World Index. Calculation of the FT/S&P Actuaries World Index was taken over by FTSE in November 1999 and renamed, the FTSE World Index.

⁴ The term “constituents” refers to those securities comprising the FTSE All-World Index.

⁵ The FTSE Equity Indices Committee, which meets quarterly, is comprised of 10 to 14 market professionals (including pension plan trustees, investment managers and financial analysts) chosen based on, among other factors, industry experience. Additional information regarding the FTSE Equity Indices Committee can be found on FTSE’s Web site at www.ftse.com.

⁶ A list of the countries comprising the FTSE All-World Index can be found on FTSE’s Web site at www.ftse.com.

inclusion criteria set forth in the Grounds Rules. Specifically, before a country can be included in the FTSE All-World Index, the country must meet each of the following criteria: (1) permits direct investment by non-nationals; (2) has accurate and timely data available; (3) no significant exchange controls that would prevent the timely repatriation of capital or dividends; (4) demonstration of significant international investor interest in the local equity market; and (5) existence of adequate liquidity in the market. The countries that remain are grouped into seven regions⁷ and form the country universe in the FTSE All-World Index.⁸ After forming the country universe, each company is then allocated to a single country, which is consistent across all FTSE indices. Allocations are generally based on their state of incorporation and primary listing market.

Within each country, companies are then filtered based on securities market eligibility.⁹ Securities listed on a stock exchange or recognized market are generally eligible for inclusion. After conducting the securities market filter, companies are then removed if

⁷ The seven regions are (1) Asia Pacific (except Japan), (2) Developed Europe, (3) Emerging Europe, (4) Japan, (5) Latin America, (6) Middle East and Africa and (7) North America. A list of the countries that are included in each region can be found on FTSE's Web site at www.ftse.com.

⁸ The FTSE All-World Index includes Developed, Advanced Emerging and Secondary Emerging countries, depending on their level of development and certain primary and second factors. The primary factors include: data quality (availability and timeliness), free flow of foreign exchange, Gross Domestic Product (per capita), market breadth (number of eligible companies), reliable price information, stock market capitalization versus Gross Domestic Product, and unrestricted/low restrictions on foreign investment. The secondary factors include: the existence of efficient settlement systems, liquidity, market maturity, membership of economic group or common currency block and total stock market capitalization. A list of the Developed, Advanced Emerging and Secondary Emerging countries within the FTSE All-World Index can be found on FTSE's Web site at www.ftse.com.

Country classifications, which are reviewed on a regular basis by the FTSE Regional Committee, are subject to change depending on the primary and secondary factors discussed above. The FTSE Equity Indices Committee publishes a watch list of countries being monitored for changing country classifications. At least three months prior notice is generally provided before changing a country's classification. See *supra* note 22 for a discussion of the FTSE Regional Committees.

⁹ A list of the eligible markets and exchanges within each country is available on FTSE's Web site at www.ftse.com.

the securities do not meet the security class eligibility criteria for inclusion in the index.¹⁰ With respect to security class eligibility, most equity securities as well as shares listed on a stock exchange or recognized market are eligible for inclusion in the index. Exchange traded funds, companies whose share price is a direct derivation of the value of underlying holdings, convertible preference shares and loan stocks are excluded from the index.

Then, all of the eligible securities are ranked by full market capitalization. Companies that fall in the bottom 2% of each region by market capitalization are then excluded; thus, 98% of each region by market capitalization remains, forming the Index Universe. In determining which securities to include in the FTSE All-World Index, eligible securities are subject to three investibility screens. The first screen is a size screen that excludes those companies with a market capitalization of less than \$100 million. The second screen is a liquidity screen that requires that companies trade at least 0.5% of their shares in issue per month in ten out the twelve months prior to review.¹¹ In the third screen, each constituent is subjected to a free float screen.¹² If a security has a free float of less than 5%, it will not be eligible for the index.¹³ The remaining securities form the constituents of the FTSE Global Equity Index. Then, the constituents of the FTSE All-

¹⁰ A list of the types of classes of securities included in each country that are eligible for inclusion in the FTSE All-World Index is available on FTSE's Web site at www.ftse.com.

¹¹ Existing constituents must trade at least 0.5% of their shares in issue per month in eight out the twelve months prior to review.

¹² Free float is expressed as a percentage figure, indicating what proportion of the company's shares can be bought in the market. The FTSE All-World Index is periodically reviewed for changes in free float, which coincides with the quarterly reviews undertaken by the FTSE Regional Committees. Eligible companies also are subject to adjustment for, among other things, cross-holdings, corporate actions and foreign ownership limits.

¹³ A security with a free float greater than 5% but less than or equal to 15% is eligible for inclusion in the FTSE All-World Index if the security's market capitalization exceeds \$5 billion.

World Index are formed¹⁴ from the wider FTSE Global Equity Index by excluding the FTSE Global Small Cap Index.¹⁵

Then, all constituents of the FTSE All-World Index are assigned to either the Large Cap index or Mid Cap index depending on their ranking.¹⁶ To determine the appropriate capitalization index within the FTSE All-World Index, securities are ranked by market capitalization within each region. Those companies at or above 68% of the Index Universe are included in the Large Cap index for the region. Those companies ranked below 68% but within the top 86% of the Index Universe by capitalization will be included in the Mid Cap index for the region.¹⁷

Regional Reviews

Existing constituents are subject to regular reviews¹⁸ to determine if they continue to meet the foregoing criteria.¹⁹ Reviews are done by region on an annual basis. With

¹⁴ The FTSE All-World Review provides month-end data of the FTSE All-World Index. Constituents in the FTSE All-World Index can be obtained from the monthly FTSE All-World Review under the “Country Details” section of the review. The FTSE All-World Review is available for free on the on FTSE’s Web site at www.ftse.com by registering to access the data. Daily updated constituent lists are also available to paying subscribers from FTSE and other data vendors.

¹⁵ The FTSE Global Small Cap Index, which is a subset of the FTSE Global Equity Index, includes 48 countries and over 4,300 securities. The FTSE Global Small Cap Index captures the bottom 10% of the seven regional markets in the FTSE Global Equity Index, whereas, the FTSE All-World Index captures the top 90% of the seven regional markets in the FTSE Global Equity Index.

¹⁶ FTSE provides Large Cap, Mid Cap and Small Cap indices. The FTSE All-World Index does not include small cap securities. See supra note 15.

¹⁷ For existing FTSE All-World Index constituents, Large Cap constituents will remain if they fall within the top 72% of the Index Universe. Existing Mid Cap constituents will move to the Large Cap if they are within the top 68% of the Index Universe, otherwise if they are ranked between 68% and 92% of the Index Universe, they will remain in the Mid Cap index. If an existing Mid Cap constituent is ranked below 92% of the Index Universe, it will be removed from the FTSE All-World Index.

¹⁸ A timetable for the review of the regions within the FTSE All-World Index can be found on FTSE’s Web site at www.ftse.com.

¹⁹ Country allocations of any FTSE All-World Index constituents, however, may be reassessed at any time. Market type criteria and securities class type criteria are subject to periodic review.

respect to the country eligibility requirements, countries are usually reviewed annually based on country inclusion criteria described above. As part of the annual review, existing constituents are also subjected to the capitalization ranking and the three investibility screens described above. In addition, existing index constituents are reviewed to determine if they continue to meet the capitalization criteria for the Large Cap or Mid Cap index, as applicable, or if they need to be adjusted upward or downward or excluded entirely.

Other Reviews

In addition to the regional review cycle, securities may be added to or deleted from the FTSE All-World Index based on the Fast Exit and Fast Entry Ground Rules. With respect to the Fast Exit Rule, existing constituents not undergoing a full review are tested quarterly to determine if the constituent either (1) is valued at less than \$75 million by full market capitalization for two consecutive quarters or (2) falls below 99% of the Regional Universe by full market capitalization for two consecutive quarters.²⁰ If a constituent meets either threshold, then it is ineligible for inclusion and will be removed from the index. Under the Fast Entry Rule, constituents are added if they meet certain criteria, depending on whether they fall within the Developed, Advanced Emerging and Secondary Emerging. Securities may also be deleted from the list of constituents at other times: (1) for a change in circumstances concerning investability; (2) if any of the other selection criteria would make it ineligible if a full review were conducted; or (3) the constituent is delisted from its stock exchange or becomes bankrupt, insolvent or liquidated.²¹

Provided a country complies with the foregoing criteria for inclusion, the FTSE Regional and FTSE Equity Indices Committees may add a new country to the FTSE All-World Index at any time after a prior announcement.²² A country may be suspended or deleted if it fails to meet one or more of the foregoing country eligibility criteria. A decision to delete a country is considered by the appropriate FTSE Regional Committee and then approved by the FTSE Equity Indices Committee.

²⁰ Annual adjustments to the above thresholds may be made in December by the FTSE Equity Indices Committee. If any adjustment is made, such adjustment will be applied at the next review in March of the following year.

²¹ The removal of such constituent will be applied on the next trading day following the third Friday in March, June, September or December, as applicable.

²² There are three FTSE Regional Committees – the FTSE Americas Regional Committee, the FTSE Europe/Middle East/Africa Regional Committee and the FTSE Asia/Pacific Committee. Additional information regarding the FTSE Regional Committees can be found on FTSE’s Web site at www.ftse.com.

EXHIBIT 4

Exhibit 4 shows the full text of rule change marking changes from the original filing to this Amendment No. 1, with the language in the original filing shown as if adopted, and the new language marked to show additions and deletions.

Subsequent to the original filing, NASD filed for immediate effectiveness proposed rule change SR-NASD-2004-175 that, among other things, amended the text of Rule 3110(b). Specifically, SR-NASD-2004-175 deleted certain rule text included as part of the original filing. This Exhibit 4 conforms the rule text in the proposed rule change to reflect the changes made changes in SR-NASD-2004-175.

Deletions made by SR-NASD-2004-175 are shown stricken through below.
Proposed new language in this Amendment No. 1 is underlined.
Proposed deletions in this Amendment No. 1 are bracketed.

* * * * *

2320. Best Execution and Interpositioning

(a) through (f) No change.

(g) (1) Except as provided in subparagraph (3) below, in any transaction for or with a customer pertaining to the execution of an order in a non-Nasdaq security (as defined in the Rule 6700 Series), a member or person associated with a member, shall contact and obtain quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for the subject security.

(2) No Change.

(3) The requirements described in subparagraph (1) above shall not apply:

(A) when two or more priced quotations for a non-Nasdaq security are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis; and

(B) to any transaction pertaining to the execution of an order in a

non-Nasdaq security of a foreign issuer that is a part of the FTSE All-World Index Series if such transaction is executed during the regular business hours of the foreign market for the foreign security and no trading halt or other similar trading or quoting restriction is in effect in the foreign market for such foreign security.

(4) Definitions

For purposes of this paragraph (g):

(A) The term “inter-dealer quotation system” means any system of general circulation to brokers or dealers that regularly disseminates quotations of identified brokers or dealers.

(B) The term “quotation medium” means any inter-dealer quotation system or any publication or electronic communications network or other device that is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell.

(5) No Change.

* * * * *

3110. Books and Records

(a) No change.

(b) Marking of Customer Order Tickets

~~(1) No Change.~~

~~(2)~~—A person associated with a member shall indicate on the memorandum for each transaction in a non-Nasdaq security, as that term is defined in the Rule 6700 Series, the name of each dealer contacted and the quotations received to

determine the best inter-dealer market; however, the requirements of this subparagraph shall not apply if the member can establish and has documented that:

[(A)](1) two or more priced quotations for the security are displayed in an inter-dealer quotation system, as defined in Rule 2320(g), that permits quotation updates on a real-time basis for which NASD has access to historical quotation information; or

[(B)](2) the transaction is effected in compliance with Rule 2320(g)(3)(B).

(c) No Change.