comprising the Index are well-capitalized, highly liquid stocks. Given the large trading volume and capitalization of each of the stocks underlying the Index, the Commission believes that the listing and trading of the proposed Notes should not unduly impact the market for the securities underlying the Index or raise manipulative concerns. Moreover, as noted above, the issuers of the underlying securities comprising the Index are subject to reporting requirements under the Act, and all of the component stocks are either listed or traded on, or traded through the facilities of, U.S. securities markets. In addition, NASD's surveillance procedures should serve to deter as well as detect any potential manipulation.

Regarding the systemic concern that a broker-dealer, such as Merrill Lynch, or a subsidiary providing a hedge for the issuer will incur position exposure, the Commission finds, as in previous approval orders for hybrid instruments similar to Notes issued by broker-dealers, that this concern is minimal given the size of the Notes issuance in relation to the net worth of Merrill Lynch.[14]

Nasdaq also represents that index value of the Index is widely disseminated at least every 15 seconds. The Commission finds that such public dissemination of the index valuation will provide investors with timely and useful information concerning the value of their Notes.

The Commission finds good cause for approving proposed Amendment No. 2 before the thirtieth day of publication of notice of filing thereof in the **Federal Register** because Amendment No. 2 simply clarifies the continued listing criteria for the Notes.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether the amendment 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–2004–139 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 20549–0609.

All submissions should refer to File Number SR–NASD–2004–139. 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 Section, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the 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–2004–139 and should be submitted on or before July 18, 2005.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[15] that the proposed rule change, as amended by Amendment No. 1 (SR–NASD–2004–139), is hereby approved, and that Amendment No. 2 to the proposed rule change is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[16]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. E5–3326 Filed 6–24–05; 8:45 am]

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[14] *See supra* note 12. *See also* Securities Exchange Act Release Nos. 44913 (October 9, 2001), 66 FR 52469 (October 15, 2001) (approving the listing and trading of notes issued by Morgan Stanley Dean Witter & Co. whose return is based on the performance of the Nasdaq–100 Index); 44483 (June 27, 2001), 66 FR 35677 (July 6, 2001) (approving the listing and trading of notes issued by Merrill Lynch whose return is based on a portfolio of 20 securities selected from the Amex Institutional Index); and 37744 (September 27, 1996), 61 FR 52480 (October 7, 1996) (approving the listing and trading of notes issued by Merrill Lynch whose return is based on a weighted portfolio of the Healthcare/Biotechnology industry securities).

[15] 15 U.S.C. 78s(b)(2).

[16] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–51890; File No. SR–NASD–00–23]

Self-Regulatory Organizations; Notice of Filing of Amendment No. 2 to Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Amendments To Order Audit Trail System Rules

June 21, 2005.

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 April 19, 2000, the National Association of Securities Dealers, Inc. (''NASD'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') a proposed rule change relating to its Order Audit Trail System (''OATS''). On September 5, 2000, NASD filed Amendment No. 1 to the proposed rule change. The proposed rule change, as amended by Amendment No. 1, was published for comment in the **Federal Register** on October 3, 2000.[3] The Commission received 13 comment letters from 12 commenters in response to the publication.[4]

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 43344 (September 26, 2000), 65 FR 59038.

[4] *See* letters to Jonathan G. Katz, Secretary, Commission, from Harold M. Golz, Krys Boyle Freedman & Sawyer, P.C. on behalf of Rocky Mountain Securities & Investments, Inc., dated October 20, 2000; Mitchell M. Almy, President, Mitchell Securities Corporation of Oregon, dated October 20, 2000; Joanne Ferrari, Compliance Manager, Weeden & Co., dated October 23, 2000; Bonnie K. Wachtel, CEO and Wendie L. Wachtel, COO, Wachtel & Co., Inc., dated October 24, 2000 and March 26, 2001; Laurence Storch, Storch & Brenner, LLP, dated October 24, 2000; Allen Thomas, Vice President, A.G. Edwards & Sons, Inc., dated October 24, 2000; Stuart J. Kaswell, Senior Vice President and General Counsel, Securities Industry Association, Ad Hoc Committee, dated October 24, 2000; W. Leo McBlain, Chairman and Thomas J. Jordan, Executive Director, Financial Information Forum, dated October 24, 2000; Thomas F. Guinan, Senior Vice President, Pershing Division of Donaldson, Lufkin & Jenrette Securities Corporation, dated October, 24, 2000; Paul A Merolla, Senior Vice President and General Counsel, Instinet Corporation, dated October 25, 2000; Richard E. Schell, Vice President and Assistant General Counsel, First Options of Chicago, dated October 25, 2000; Jill W. Ostergaard,

Continued

On June 10, 2005, NASD filed Amendment No. 2 to the proposed rule change. Amendment No. 2 is 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 Amendment No. 2 to 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 amendments to its OATS rules. The text of the proposed rule change follows. Proposed new language is in italics; proposed deletions are in brackets.

* * * * *

6951. Definitions

For purposes of Rules 6950 through 6957:

(a) Through (m) No Change.

(n) ''Reporting Member'' shall mean a member that receives or originates an order and has an obligation to record and report information under Rules 6954 and 6955. *A member shall not be considered a Reporting Member in connection with an order, if the following conditions are met:*

(1) The member engages in a non-discretionary order routing process, pursuant to which it immediately routes, by electronic or other means, all of its orders to a single receiving Reporting Member;

(2) The member does not direct and does not maintain control over subsequent routing or execution by the receiving Reporting Member;

(3) The receiving Reporting Member records and reports all information required under Rules 6954 and 6955 with respect to the order; and

(4) The member has a written agreement with the receiving Reporting Member specifying the respective functions and responsibilities of each party to effect full compliance with the requirements of Rules 6954 and 6955.

* * * * *

6954. Recording of Order Information

(a) No Change.

(b) Order Origination and Receipt.

Unless otherwise indicated, the following order information must be recorded under this Rule when an order is received or originated. *For purposes of this Rule, the order origination or receipt time is the time the order is received from the customer.*

(1) through (18) No Change.

(c) Order Transmittal.

Order information required to be recorded under this Rule when an order is transmitted includes the following.

(1) When a Reporting Member transmits an order to a[nother] department within the member, [other than to the trading department,] the Reporting Member shall record:

(A) Through (C) No Change.

(D) An identification of the department *and nature of the department* to which the order was transmitted, [and]

(E) The date and time the order was received by that department, (F) the number of shares to which the transmission applies, and

(G) Any special handling requests.[;]

(2) Through (6) No Change.

(d) No Change.

* * * * *

6955. Order Data Transmission Requirements

(a) Through (c) No Change.

(d) Exemptions.

(1) Pursuant to the Rule 9600 Series, the staff, for good cause shown after taking into consideration all relevant factors, may exempt, subject to specified terms and conditions, a member from the order data transmission requirements of this Rule for manual orders, if such exemption is consistent with the protection of investors and the public interest, and the member meets the following criteria:

(A) The member and current control affiliates and associated persons of the member have not been subject within the last five years to any final disciplinary action, and within the last ten years to any disciplinary action involving fraud;

(B) The member has annual revenues of less than $2 million;

(C) The member does not conduct any market making activities in Nasdaq Stock Market equity securities;

(D) The member does not execute principal transactions with its customers (with limited exception for principal transactions executed pursuant to error corrections); and

(E) The member does not conduct clearing or carrying activities for other firms.

(2) An exemption provided pursuant to this paragraph (d) shall not exceed a period of two years. At or prior to the expiration of a grant of exemptive relief under this paragraph (d), a member meeting the criteria set forth in paragraph (d)(1) may request, pursuant to the Rule 9600 Series, a subsequent exemption, which will be considered at the time of the request, consistent with the protection of investors and the public interest.

(3) This paragraph shall be in effect until [five years from the effective date of the proposed rule change].

* * * * *

9600. Procedures for Exemptions

9610. Application

(a) Where To File

A member seeking an exemption from Rule 1021, 1022, 1070, 2210, 2320, 2340, 2520, 2710, 2720, 2810, 2850, 2851, 2860, Interpretive Material 2860–1, 3010(b)(2), 3020, 3210, 3230, 3350, *6955,* 8211, 8212, 8213, 11870, or 11900, Interpretive Material 2110–1, or Municipal Securities Rulemaking Board Rule G–37 shall file a written application with the appropriate department or staff of NASD and provide a copy of the application to the Office of General Counsel of NASD.

(b) and (c) 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 April 19, 2000, NASD filed with the Commission proposed rule change SR–NASD–00–23, proposed amendments to the OATS rules (the ''original filing''). On September 5, 2000, NASD filed with the Commission Amendment No. 1 to SR–NASD–00–23, which proposed to make certain changes to the original filing. On September 26, 2000, the Commission published for comment the proposed rule change in the **Federal Register**.[5] Based on comments received in response to the publication of the proposed rule change in the **Federal Register** and discussions with the staff of the SEC, NASD is filing this Amendment No. 2 to SR–NASD–00–23

Vice President, Morgan Stanley Dean Witter, dated October 27, 2000.

[5] *See supra* note 3.

to make certain changes as described herein.[6]

Specifically, Amendment No. 2 would: (1) Provide that members are required to capture and report both the time the order is received by the member from the customer and the time the order is received by the member's trading desk or trading department,[7] if those times are different;[8] (2) exclude certain members from the definition of ''Reporting Member'' for those orders that meet specified conditions and are recorded and reported to OATS by another member; and (3) permit NASD to grant exemptive relief from the OATS reporting requirements in certain circumstances to members that meet specified criteria.

Background

On March 6, 1998, the SEC approved NASD Rules 6950 through 6957 (''OATS Rules'').[9] OATS provides a substantially enhanced body of information regarding orders and transactions that improves NASD's ability to conduct surveillance and investigations of member firms for potential violations of NASD rules and the federal securities laws. OATS is designed, at a minimum, to: (1) Provide an accurate, time-sequenced record of orders and transactions, beginning with the receipt of an order at the first point of contact between the broker/dealer and the customer or counterparty and further documenting the life of the order through the process of execution; and (2) provide for market-wide synchronization of clocks used in connection with the recording of market events.

The OATS Rules generally impose obligations on member firms to record in electronic form and report to NASD on a daily basis certain information with respect to orders originated or received by NASD members relating to securities listed on Nasdaq. OATS captures this order information reported by NASD members and integrates it with quote and transaction information to create a time-sequenced record of orders and transactions. This information is critical to NASD staff in conducting surveillance and investigations of member firms for violations of federal securities laws and NASD rules.

The OATS requirements were implemented in three phases. All members were required to synchronize their computer system clocks and all mechanical clocks that record times for regulatory purposes by August 7, 1998, and July 1, 1999, respectively. In addition, electronic orders received at the trading department of a market maker and those received by ECNs were required to be reported to OATS as of March 1, 1999 (''Phase One''). Additional information relating to market maker and ECN electronic orders and all other electronic orders were required to be reported to OATS by August 1, 1999 (''Phase Two''). Pursuant to Rule 6957(c), the OATS Rules will apply to all manual orders effective 120 days after Commission approval of SR–NASD–00–23 (''Phase Three'').[10]

Since the implementation of OATS, NASD staff has reviewed OATS activities with the goal of identifying ways in which to improve OATS and enhance its effectiveness as a regulatory tool. In this regard, NASD identified several changes to OATS that it believed would enhance NASD's automated surveillance for compliance with trading and market making rules such as Interpretive Material (IM) 2110–2, (commonly referred to as the ''NASD's Limit Order Protection Interpretation''), the SEC's Order Handling Rules and a member firm's best execution obligations. NASD proposed these changes in SR–NASD–00–23 and Amendment No. 1 thereto. Provided below is a description of each of the proposed changes, a summary of the comments received in response to the SEC's publication of the proposed changes, and NASD's response, as applicable.

Proposed Definition of Time of Receipt

NASD Rule 6954 requires certain identifying information be recorded at various critical points during the life of an order, thereby assisting NASD in carrying out its regulatory responsibilities. In particular, NASD Rule 6954(b)(16) requires that members record and report the date and time the order is originated or received by a Reporting Member (''time of receipt''). The OATS Rules, which currently only apply to electronic orders, require that the time of receipt for an electronic order be the time an order is received by a firm's electronic order handling system. Once the OATS Rules are fully phased in, members will be required to record and report OATS information for manual orders. The time of receipt for manual orders is the time the order is received by the member from the customer, whether that is at a trading desk or at another location.

In the original filing, NASD proposed that the time of receipt for manual orders be the time the order is received by the member firm's trading desk or trading department for execution or further routing purposes. NASD also proposed to codify the staff's position that the time of receipt for electronic orders is the time the order is captured by a member's electronic order-routing or execution system.

NASD amended its original filing and proposed in Amendment No. 1 that the time of receipt for manual orders of less than 10,000 shares be the time the order is received by the member's trading desk or trading department for execution or routing purposes. For manual orders that are 10,000 shares or greater, the time of receipt would continue to be the time the order is received by the member from the customer.[11]

Comments on Proposed Definition of Time of Receipt

Commenters opposed having two definitions of time of receipt for manual orders. Specifically, commenters opposed the requirement that the time of receipt for a manual order of 10,000 shares or greater be the time the order is received by the member from the customer, rather than the time the order is received at the member's trading desk or trading department for execution or routing purposes. Commenters asserted that eliminating the time a 10,000 share or greater order is received by the trading desk for OATS purposes would impede NASD surveillance capabilities while, conversely, the inclusion of the customer order receipt time for these orders would not improve significantly

[6] NASD withdrew and separately proposed a portion of one of the proposed changes in SR–NASD–00–23, specifically the proposed change to require that electronic communications networks (''ECNs'') that electronically receive routed orders capture and report a routed order identifier. Because such change was proposed separately in SR–NASD–2004–137 and subsequently approved by the Commission (*see* Securities Exchange Act Release No. 50409 (September 17, 2004), 69 FR 57113 (September 23, 2004), it is not addressed herein.)

[7] The terms ''trading desk'' and ''trading department'' are used interchangeably in this rule filing.

[8] Members currently are required to capture and report the time the order is received by the member from the customer.

[9] *See* Securities Exchange Act Release No. 39729, 63 FR 12559 (March 13, 1998).

[10] The original effective date for Phase Three was July 31, 2000. NASD filed a proposed amendment with the SEC for immediate effectiveness to extend the implementation date of Phase Three to 120 days after SEC approval of SR–NASD–00–23. *See* Securities Exchange Act Release No. 43654 (December 1, 2000), 65 FR 77405 (December 11, 2000).

[11] Because certain order handling rules may apply differently to block orders of 10,000 shares or greater, Amendment No. 1 defined the time of receipt differently depending on the size of the order. For example, members may attach terms and conditions to certain block orders of 10,000 shares or greater for purposes of the NASD's Limit Order Protection Interpretation, and such orders are excepted from the SEC's limit order display rule unless a customer expressly requests otherwise.

NASD's ability to oversee and enforce sales practice violations. Further, commenters noted that NASD, where necessary, can obtain from members the customer order receipt time from members, which is required to be maintained under Rule 17a–3(a)(6) of the Act.[12] In addition, commenters indicated that the two differing definitions of receipt time would create unnecessary costs and burdens for members in establishing automated systems to capture OATS data at branch locations, as well as confusion for salespersons in the branches and trading desk personnel of firms, and would lead to inadvertent mistakes and delays in executions.

NASD agrees with commenters that having two differing definitions of time of receipt based solely on the size of the order would create burdens for members. However, because NASD believes that it is critical to NASD automated surveillance systems that OATS capture the time that an order is received by the trading desk, and have an electronic record of when orders, especially larger orders, are received at a firm to enable the staff to perform surveillance to detect violations such as frontrunning, NASD staff has determined that OATS should capture both the time the order is received by the member from the customer and the time the order is received by the member's trading desk or trading department, if those times are different.

Given that orders may be routed to multiple locations within a firm prior to reaching the trading desk (or even routed outside the firm directly from a desk other than the trading desk), NASD is proposing to capture the various receipt times (customer receipt time, trading desk receipt time, etc.) by expanding the OATS order transmittal requirements that apply to intra-firm routes to include orders routed to the trading department.[13] Specifically, if an order is not received immediately at the trading department, members would be required to capture information relating to the transfer of that order to the trading department under the order transmittal requirements of NASD Rule 6954(c). To the extent that the time of receipt of the order from the customer and receipt of the order by the trading department are the same, no Desk Report would be required, given that the New Order Report would accurately capture the time of receipt at the trading department.

The proposed rule change would apply equally to both electronic and manual orders. In other words, the time of receipt for purposes of order origination would always be the time the order is received from the customer. The proposed rule change also would require that members provide information on the nature of the department to which an order was transmitted, the number of shares to which the transmission applies, and any special handling requests. As with other technical requirements relating to OATS, NASD will specify in the *OATS Reporting Technical Specifications* how firms should report this information.

By proposing this change, NASD will capture the complete lifecycle of an order within a firm, even in those situations where an order is held at the sales trading or other desk within a member firm, and then later routed to the trading desk. Although NASD staff understands that this requirement may impose additional costs on member firms, NASD believes that it is critical to NASD's surveillance systems and regulatory program that OATS capture the full lifecycle of an order within a firm and, in particular, both the time that an order is received from the customer and the time the order is received by the trading desk. In recognition of the technological burdens that may be imposed on members as a result of this proposal, NASD staff proposes to provide an implementation date that is 120 days from Commission approval of the proposed change.

Exclusion From the Definition of "Reporting Member"

Certain NASD members engage in non-discretionary order routing processes whereby, immediately after receipt of a customer order, the member routes the order, by electronic or other means, to another member ("receiving Reporting Member") for further routing or execution at the receiving Reporting Member's discretion. Currently, the OATS rules require both the member with which the order originated and the receiving Reporting Member to create and report new order reports and possibly route reports. This results in the receipt of duplicative information by OATS. Therefore, NASD proposed in the original filing that the OATS rules be amended to require, in such instances, that only the receiving Reporting Member report OATS data. Under the proposed rule change, a member would not be required to report OATS data regarding an order, if the following conditions are met:

(1) The member engages in a non-discretionary order routing process, pursuant to which it immediately routes, by electronic or other means, all of its orders to a single receiving Reporting Member;[14]

(2) The member does not direct or maintain control over subsequent routing or execution by the receiving Reporting Member;

(3) The receiving Reporting Member records and reports all information required under NASD Rules 6954 and 6955 with respect to the order; and

(4) The member has a written agreement with the receiving Reporting Member specifying the respective functions and responsibilities of each party to effect full compliance with the requirements of NASD Rules 6954 and 6955.

In addition to eliminating the reporting of duplicative information to OATS, the NASD believes that proposed rule change will reduce the regulatory burdens on members, particularly smaller members, that route all their orders to another receiving Reporting Member by means of a non-discretionary order routing process, for execution or further routing purposes.[15]

Comments on the Exclusion From the Definition of "Reporting Member"

Commenters suggested that the exclusion from the definition of "Reporting Member" for members that use a non-discretionary order routing process as described in the proposed rule change be expanded to allow for an

[12] 17 CFR 240.17a–3(a)(6).

[13] NASD Rule 6954(c) currently requires that certain information be recorded when an order is transmitted to a department within a firm, other than the trading department. In furtherance of this provision, the *OATS Reporting Technical Specifications* requires that this information be reported to OATS via a "Desk Report." When the OATS Rules originally were adopted in 1998, the OATS reporting framework was based on NASD staff's understanding that most electronic orders received by members were transferred to the trading department for execution and that such transfer was instantaneous with receipt of the order. Members had indicated that the "routine" order flow from point of receipt to the trading department would generate a significant number of OATS Desk Reports, and that reporting that information to OATS would be very burdensome and provide little additional information, since the transfer was instantaneous. As a result, Desk Reports only were required in those instances where orders were transmitted to departments other than the trading department (*e.g.,* block desk, arbitrage desk). Since that time, member order routing and handling systems have changed and a larger percentage of orders are not routed immediately to the trading desk. Therefore, NASD staff believes the exclusion for orders routed to the trading department no longer makes sense and may result in gaps in the audit trail.

[14] If any delay results in the routing of an order due to systems problems or other reasons, the member with which the order originated would be required to report OATS data.

[15] This exclusion would not change a member's requirement to capture and retain the time an order was received from a customer under SEC Rule 17a–3(a)(6).

additional exclusion for members that regularly route all of a particular type of order or class of securities to a single receiving Reporting Member pursuant to a contractual arrangement. For example, if a firm regularly routes to a receiving Reporting Member all transactions in margin accounts and the receiving Reporting Member otherwise has total execution discretion and meets the other requirements set forth in the proposed rule change, the firm should be excluded from reporting these orders under the OATS rules. A commenter noted that such an exclusion could be limited to no more that two or three such relationships. One commenter also suggested an order-by-order exclusion.

NASD amended its original filing and proposed in Amendment No. 1 that the time of receipt for manual orders of less than 10,000 shares be the time the order is received by the member's trading desk or trading department for execution or routing purposes. For manual orders that are 10,000 shares or greater, the time of receipt would continue to be the time the order is received by the member from the customer.[11]

Comments on Proposed Definition of Time of Receipt

Commenters opposed having two definitions of time of receipt for manual orders. Specifically, commenters opposed the requirement that the time of receipt for a manual order of 10,000 shares or greater be the time the order is received by the member from the customer, rather than the time the order is received at the member's trading desk or trading department for execution or routing purposes. Commenters asserted that eliminating the time a 10,000 share or greater order is received by the trading desk for OATS purposes would impede NASD surveillance capabilities while, conversely, the inclusion of the customer order receipt time for these orders would not improve significantly NASD's ability to oversee and enforce sales practice violations. Further, commenters noted that NASD, where necessary, can obtain from members the customer order receipt time from members, which is required to be maintained under Rule 17a–3(a)(6) of the Act.[12] In addition, commenters indicated that the two differing definitions of receipt time would create unnecessary costs and burdens for members in establishing automated systems to capture OATS data at branch locations, as well as confusion for salespersons in the branches and trading desk personnel of firms, and would lead to inadvertent mistakes and delays in executions.

NASD agrees with commenters that having two differing definitions of time of receipt based solely on the size of the order would create burdens for members. However, because NASD believes that it is critical to NASD automated surveillance systems that OATS capture the time that an order is received by the trading desk, and have an electronic record of when orders, especially larger orders, are received at a firm to enable the staff to perform surveillance to detect violations such as frontrunning, NASD staff has determined that OATS should capture both the time the order is received by the member from the customer and the time the order is received by the member's trading desk or trading department, if those times are different.

Given that orders may be routed to multiple locations within a firm prior to reaching the trading desk (or even routed outside the firm directly from a desk other than the trading desk), NASD is proposing to capture the various receipt times (customer receipt time, trading desk receipt time, etc.) by expanding the OATS order transmittal requirements that apply to intra-firm routes to include orders routed to the trading department.[13] Specifically, if an order is not received immediately at the trading department, members would be required to capture information relating to the transfer of that order to the trading department under the order transmittal requirements of NASD Rule 6954(c). To the extent that the time of receipt of the order from the customer and receipt of the order by the trading department are the same, no Desk Report would be required, given that the New Order Report would accurately capture the time of receipt at the trading department.

The proposed rule change would apply equally to both electronic and manual orders. In other words, the time of receipt for purposes of order origination would always be the time the order is received from the customer. The proposed rule change also would require that members provide information on the nature of the department to which an order was transmitted, the number of shares to which the transmission applies, and any special handling requests. As with other technical requirements relating to OATS, NASD will specify in the *OATS Reporting Technical Specifications* how firms should report this information.

By proposing this change, NASD will capture the complete lifecycle of an order within a firm, even in those situations where an order is held at the sales trading or other desk within a member firm, and then later routed to the trading desk. Although NASD staff understands that this requirement may impose additional costs on member firms, NASD believes that it is critical to NASD's surveillance systems and regulatory program that OATS capture the full lifecycle of an order within a firm and, in particular, both the time that an order is received from the customer and the time the order is received by the trading desk. In recognition of the technological burdens that may be imposed on members as a result of this proposal, NASD staff proposes to provide an implementation date that is 120 days from Commission approval of the proposed change.

Exclusion From the Definition of ''Reporting Member''

Certain NASD members engage in non-discretionary order routing processes whereby, immediately after receipt of a customer order, the member routes the order, by electronic or other means, to another member (''receiving Reporting Member'') for further routing or execution at the receiving Reporting Member's discretion. Currently, the OATS rules require both the member with which the order originated and the receiving Reporting Member to create and report new order reports and possibly route reports. This results in

[11] Because certain order handling rules may apply differently to block orders of 10,000 shares or greater, Amendment No. 1 defined the time of receipt differently depending on the size of the order. For example, members may attach terms and conditions to certain block orders of 10,000 shares or greater for purposes of the NASD's Limit Order Protection Interpretation, and such orders are excepted from the SEC's limit order display rule unless a customer expressly requests otherwise.

[12] 17 CFR 240.17a–3(a)(6).

[13] NASD Rule 6954(c) currently requires that certain information be recorded when an order is transmitted to a department within a firm, other than the trading department. In furtherance of this provision, the *OATS Reporting Technical Specifications* requires that this information be reported to OATS via a ''Desk Report.'' When the OATS Rules originally were adopted in 1998, the OATS reporting framework was based on NASD staff's understanding that most electronic orders received by members were transferred to the trading department for execution and that such transfer was instantaneous with receipt of the order. Members had indicated that the ''routine'' order flow from point of receipt to the trading department would generate a significant number of OATS Desk Reports, and that reporting that information to OATS would be very burdensome and provide little additional information, since the transfer was instantaneous. As a result, Desk Reports only were required in those instances where orders were transmitted to departments other than the trading department (*e.g.,* block desk, arbitrage desk). Since that time, member order routing and handling systems have changed and a larger percentage of orders are not routed immediately to the trading desk. Therefore, NASD staff believes the exclusion for orders routed to the trading department no longer makes sense and may result in gaps in the audit trail.

the receipt of duplicative information by OATS. Therefore, NASD proposed in the original filing that the OATS rules be amended to require, in such instances, that only the receiving Reporting Member report OATS data. Under the proposed rule change, a member would not be required to report OATS data regarding an order, if the following conditions are met:

(1) The member engages in a non-discretionary order routing process, pursuant to which it immediately routes, by electronic or other means, all of its orders to a single receiving Reporting Member;[14]

(2) The member does not direct or maintain control over subsequent routing or execution by the receiving Reporting Member;

(3) The receiving Reporting Member records and reports all information required under NASD Rules 6954 and 6955 with respect to the order; and

(4) The member has a written agreement with the receiving Reporting Member specifying the respective functions and responsibilities of each party to effect full compliance with the requirements of NASD Rules 6954 and 6955.

In addition to eliminating the reporting of duplicative information to OATS, the NASD believes that proposed rule change will reduce the regulatory burdens on members, particularly smaller members, that route all their orders to another receiving Reporting Member by means of a non-discretionary order routing process, for execution or further routing purposes.[15]

Comments on the Exclusion From the Definition of ''Reporting Member''

Commenters suggested that the exclusion from the definition of ''Reporting Member'' for members that use a non-discretionary order routing process as described in the proposed rule change be expanded to allow for an additional exclusion for members that regularly route all of a particular type of order or class of securities to a single receiving Reporting Member pursuant to a contractual arrangement. For example, if a firm regularly routes to a receiving Reporting Member all transactions in margin accounts and the receiving Reporting Member otherwise has total execution discretion and meets the other requirements set forth in the proposed rule change, the firm should be excluded from reporting these orders under the OATS rules. A commenter noted that such an exclusion could be limited to no more that two or three such relationships. One commenter also suggested an order-by-order exclusion.

Other commenters stated that it is inequitable to provide an exclusion to correspondent firms that send all their order flow to their clearing firm, but not other kinds of order entry firms. The commenters generally argued that this proposed exclusion is unfair to other firms with different business models and is likely to hasten the decision by some firms to entrust all of their order flow with one executing party.

As discussed above, the proposed exclusion from the definition of Reporting Member is directed at those members that use a non-discretionary order routing process whereby, immediately after receipt of its customer orders, the member routes all its orders, by electronic or other means, to a single receiving Reporting Member for further routing or execution at the receiving Reporting Member's discretion. This proposed exclusion is not limited to correspondent/clearing relationships, but applies to any relationship that meets the proposed conditions.

The goal of the proposed rule is to eliminate the reporting of duplicative information to OATS where *all* of the OATS data of one member would be captured by the receiving Reporting Member. If the proposed rule were to permit deviations from this as commenters suggest, the exclusion would, in effect, permit an exclusion for almost any category of orders that are routed to another firm. Without the condition that all orders be routed to one firm, NASD will not have the ability to easily identify which receiving Reporting Member is providing the OATS order information that corresponds to the orders initially received by the member. Therefore, NASD does not believe any further changes to this proposed rule as described by commenters are appropriate. However, NASD is proposing an amendment to the rule text to clarify that, to qualify for the proposed exclusion to the definition of ''Reporting Member,'' the member must route all of its orders to a *single* receiving Reporting Member.

Recording and Reporting a Routed Order Identifier

OATS has the capability of tracking the history of an order by linking such orders across firms through the use of a routed order identifier. If the order does not contain a routed order identifier, the order cannot be linked systematically to subsequent actions, such as further routing or execution by other firms or Nasdaq systems. In this regard, the complete history of a significant percentage of orders may not be tracked because the OATS rules do not require a receiving Reporting Member to capture and report a routed order identifier if the order is routed to it manually.

Comments on Recording and Reporting a Routed Order Identifier

Several commenters opposed the proposed requirement that members be required to capture and report a transmitting member's unique identifier for all manually routed orders. Commenters stated that members should not be responsible for capturing accurately on a manual basis the routed order identifier from other firms. Errors will be frequent and carried on to the next firm to which the order is routed. Further, commenters indicated that this would impose a significant increase in numeric data that must be captured for a limited amount of heightened surveillance ability.

Commenters further noted that the proposed requirement would lead to delays in order communication and executions and ultimately harm public investors. Because orders that are transmitted manually may not be entered into a firm's system and no systematic order identifier generated, commenters indicated that the proposed requirement would pose serious operational and logistical problems. Commenters also argued that NASD could effectively link or match together routed orders with new orders of the firm they are routed to, without the routed order identifier information.

As discussed above, the use of a routed order identifier reported through OATS permits NASD to track the history of orders routed between firms on an automated basis. If the order does not contain a routed order identifier, the order cannot be linked systematically on an automated basis to subsequent actions, such as further routing or execution by other firms. In the case of manually routed orders, however, NASD does not believe that the benefits provided by such an identifier clearly outweigh the related costs to members. NASD notes in particular the commenters' concerns that requiring routed order identifiers for manually routed orders creates potential delays in the handling and execution of customer orders and creates the likelihood of high levels of data errors. Further, while NASD will not be able to track the history of manual orders between firms

[14] If any delay results in the routing of an order due to systems problems or other reasons, the member with which the order originated would be required to report OATS data.

[15] This exclusion would not change a member's requirement to capture and retain the time an order was received from a customer under SEC Rule 17a–3(a)(6).

on an automated basis without a routed order identifier, the staff can create, on an order by order basis, a process that links manual orders to subsequent events with an acceptable level of accuracy. Therefore, the staff has concluded that the costs imposed by this proposed requirement relating to manually routed orders as described by commenters are not outweighed by the incremental benefits to NASD regulatory data and surveillance systems.

Exemptive Relief

Finally, NASD proposed in Amendment No. 1 new paragraph (d) of NASD Rule 6955 and an amendment to NASD Rule 9610(a) to permit NASD to grant exemptive relief to certain members from the reporting requirements of the OATS rules under the procedures set forth in the NASD Rule 9600 series. Specifically, members that meet the following criteria would be eligible to request an exemption to the OATS reporting requirements for manual orders:

(1) The member and current control affiliates and associated persons of the member have not been subject within the last five years to any disciplinary action, and within the last ten years to any disciplinary action involving fraud;

(2) The member has annual revenues of less than $2 million;

(3) The member does not conduct any market making activities in Nasdaq Stock Market equity securities;

(4) The member does not execute principal transactions with its customers (with limited exceptions for error corrections); and

(5) The member does not conduct clearing or carrying activities for other firms.

Under the proposed rule change, any exemptive relief granted would expire no later than two years from the date the member receives the exemptive relief. At or prior to the expiration of a grant of exemptive relief, members meeting the specified criteria may request a subsequent exemption. In addition, under the proposed rule change, NASD's exemptive authority shall be in effect for five years from the effective date of the proposed rule change.

The proposed exemptive authority would provide NASD the ability to grant relief to members meeting the specified criteria in situations where, for example, reporting of such information would be unduly burdensome for the member or where temporary relief from the rules (in the form of additional time to achieve compliance) would permit the member to avoid unnecessary expense or hardship.

Comments on Exemptive Relief

Commenters generally supported the proposed rule change that would provide NASD with the authority to exempt certain members from OATS reporting for manual orders, but opposed many of the conditions placed on members in order for them to request exemptive relief. For example, several commenters suggested changes to the proposed condition that requires that members requesting exemptive relief not have been subject within the last five years to any disciplinary action, and within the last ten years to any disciplinary action involving fraud. Commenters indicated that the five and ten year disciplinary action test should commence from the date the disciplinary action is initiated, rather than when the disciplinary action is finalized. Commenters indicated that the date of initiation of the disciplinary action is the date most closely linked to the conduct that is triggering the sanction and that members should not be discouraged from seeking a hearing or other recourse due to the proposed condition on obtaining exemptive relief for OATS purposes. One commenter suggested a *de minimis* exception for single disciplinary action incurring a fine of not more than $10,000, while another commenter suggested that NASD be provided discretion to consider a firm's overall disciplinary history in determining whether to grant an exemption.

One commenter suggested that exemptive relief be available for market makers that conduct principal trades. Another commenter recommended eliminating the condition restricting firms that clear for others from obtaining exemptive relief where the introducing firm is not a reporting member under NASD Rule 6951 (except the exclusion that another member report its trades) and/or the introducing firm obtains an exemption under NASD Rule 6955.

One commenter noted that the five-year ''sunset'' provision on NASD's ability to grant exemptions should be extended indefinitely, noting that there currently is no reason to believe the rationale for providing NASD exemptive authority will be any different in five years. Moreover, the procedural impediments necessary for NASD to request that its exemptive authority be extended would be very burdensome.

Another commenter stated that exemptive relief should be provided from all OATS reporting requirements for any NASD member that: (1) Carries no accounts for customers; (2) provides execution services in Nasdaq equity securities only to other dealers who are acting as market makers or proprietary traders and not on behalf of a customer; and (3) does not itself (other than in an error account) engage in market making or proprietary trading.

NASD is not proposing any changes to this exemptive provision at this time. However, if the rule change is approved, NASD staff intends to review and analyze closely the application of such conditions to exemptive authority and determine whether it would be appropriate to seek changes to these conditions, including the types of changes suggested by commenters.

Clarifying Change to Rule Language

NASD also is amending proposed NASD Rule 6955(d)(1)(A) to clarify that this condition on members that may request exemptive relief under the proposed rule only applies to *final* disciplinary actions within the last five years and does not include minor rule violations pursuant to Rule 19d–1(c)(2) of the Act.[16]

The effective date of the proposed rule change will be 120 days following Commission 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.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[17] 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 enhance NASD's ability to conduct surveillance and investigations of member firms for violations of NASD's and other applicable rules.

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 on the proposed rule change were solicited by the Commission in response to SR–NASD–

[16] 17 CFR 240.19d–1(c)(2).

[17] 15 U.S.C. 78o3(b)(6).

00–23, which proposed several changes relating to OATS requirements. The Commission received 13 comment letters from 12 commenters in response to the **Federal Register** publication of SR–NASD–00–23. The comments are summarized above.

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–00–23 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–00–23. 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–00–23 and should be submitted on or before July 18, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[18]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. E5–3329 Filed 6–24–05; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–51882; File No. SR–NSCC–2005–06]

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Expand the Number of Extended Settlement Days for Fixed Income Securities

June 20, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that on June 8, 2005, National Securities Clearing Corporation (''NSCC'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change described in Items I, II, and III below, which items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the rule change from interested parties.

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

The rule change expands NSCC's number of extended settlement days for fixed income securities.

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

In its filing with the Commission, NSCC 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. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.[2]

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Under NSCC's current debt securities processing procedures, members can designate a maximum of 18 days for a fixed income transaction to settle. However, debt securities are now processed at NSCC by a real-time trade matching (''RTTM'') mechanism, which operationally has the capability to provide a settlement option of up to 50 days. NSCC is proposing to amend its Rules and Procedures to provide for this increased functionality. The change will be implemented no sooner than two weeks after the date of this filing, and NSCC will announce the effective date to its members by an Important Notice.

NSCC believes the proposed rule change is consistent with the requirements of Section 17A of the Act[3] and the rules and regulations thereunder applicable to NSCC because it modifies NSCC's procedures to allow the implementation of a mechanism that enhances the settlement of fixed income transactions. As such, NSCC believes it is a change to an existing service that will not affect the safeguarding of securities and funds in NSCC's custody or control.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NSCC does not believe that the proposed rule change will have an impact or impose any burden on competition.

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

Written comments relating to the proposed rule change have not been solicited or received.

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[18] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] The Commission has modified the text of the summaries prepared by NSCC.

[3] 15 U.S.C. 78q–1.