

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57388; File No. SR-FINRA-2007-039)

February 27, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto to Establish an Exemption for Certain Regulation NMS-Compliant Intermarket Sweep Orders from the Requirements in IM-2110-2 (Trading Ahead of Customer Limit Order) and Rule 2111 (Trading Ahead of Customer Market Orders)

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 December 21, 2007, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)), filed with the Securities and Exchange Commission (“Commission” or “SEC”) the proposed rule change as described in Items I, II and III below, which Items have been prepared substantially by FINRA. On February 11, 2008, FINRA filed Amendment No. 1 to make certain clarifying changes to the description of the purpose of the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

FINRA is proposing to amend NASD Interpretive Material (IM) 2110-2 (Trading Ahead of Customer Limit Order) and NASD Rule 2111 (Trading Ahead of Customer Market Orders) to establish an exemption for certain proprietary trades that are a result of intermarket sweep orders (“ISOs”). The text of the proposed rule change is available at www.finra.org, the principal offices of FINRA, and the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

In its filing with the Commission, FINRA 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. FINRA 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

IM-2110-2 (also referred to as the “Manning Rule”) generally prohibits a member from trading for its own account in an exchange-listed security at a price that is equal to or better than an unexecuted customer limit order in that security, unless the member immediately thereafter executes the customer limit order at the price at which it traded for its own account or better.³ The legal underpinnings for the Manning Rule are a member’s basic fiduciary obligations and the requirement that a member must, in the conduct of its business, “observe high standards of commercial honor and just and equitable principles of trade.”⁴ The same principles on which the Manning Rule is based apply to the treatment of customer market orders pursuant to Rule 2111, which generally prohibits a member that accepts and holds a customer market order from trading

³ The SEC approved changes to IM-2110-2 that, among other things, expand the scope to OTC equity securities. See Securities Exchange Act Release No. 55351 (February 26, 2007), 72 FR 9810 (March 5, 2007) (SR-NASD-2005-146). See also NASD Notice to Members 07-19 (April 2007). See also Securities Exchange Act Release Nos. 57133 (January 11, 2008), 73 FR 3500 (January 18, 2008) (SR-FINRA-2007-038); 56822 (November 20, 2007), 72 FR 67326 (November 28, 2007) (SR-FINRA-2007-023); 56297 (August 21, 2007), 72 FR 49337 (August 28, 2007) (SR-NASD-2007-041); 56103 (July 19, 2007), 72 FR 40918 (July 25, 2007) (SR-NASD-2007-039).

⁴ See NASD Rule 2110.

for its own account at prices that would satisfy the customer market order, unless the firm immediately thereafter executes the customer market order. The NYSE has similar customer order protections in NYSE Rule 92 (Limitations on Members' Trading Because of Customers' Orders), which generally prohibits members or member organizations from entering proprietary orders ahead of, or along with, customer orders that are executable at the same price as the proprietary order.⁵

On July 5, 2007, the SEC approved amendments to NYSE Rule 92 that, among other things, added an exemption relating to ISOs.⁶ Specifically, as amended, NYSE Rule 92 provides that when routing ISOs, the member organization is required to yield its principal executions to those open customer orders that are required to be protected by NYSE Rule 92 and capable of accepting the fill.⁷ In addition, if a firm executes an ISO to facilitate a customer order at a price that is inferior to one or more protected quotations, that customer must consent to not receiving the better price obtained by the ISO(s) or the firm must yield its principal execution to that customer.

FINRA is proposing to establish a similar exemption from the requirements in IM-2110-2 and Rule 2111 for certain Regulation NMS-compliant ISOs. Specifically, FINRA is proposing to amend IM-2110-2 and Rule 2111 to provide an exemption relating to trading for a member's

⁵ NYSE Rule 92 applies to customer orders and does not distinguish between customer limit orders and customer market orders.

⁶ See Securities Exchange Release No. 56017 (July 5, 2007), 72 FR 38110 (July 12, 2007) (SR-NYSE-2007-21).

⁷ Pursuant to NYSE Rule 92, customer orders that are required to be protected are those open customer orders that are known to the member organization before the entry of the ISO. See NYSE Information Memo 07-68 (July 6, 2007).

own account that is the result of an ISO routed in compliance with Rules 600(b)(30)(ii)⁸ and 611(b)(6)⁹ of Regulation NMS where the customer order is received after the member routed the ISO. Additionally, the proposed amendments to IM-2110-2 and Rule 2111 would provide an exemption relating to trading for a member's own account that is the result of an ISO where the member executes the ISO to facilitate a customer order and that customer has consented to not receiving the better prices obtained by the ISO.

FINRA believes the proposed rule change appropriately balances important limit and market order protection requirements while facilitating member compliance with Rule 611 of Regulation NMS, and will more closely align IM-2110-2 and Rule 2111 with NYSE Rule 92. FINRA understands that the turnaround time from when an ISO is sent out and the response time to the sender is extremely short. Given this short time period, FINRA believes that the proposed exemption is appropriate. FINRA also believes that the proposed rule change will facilitate and clarify the ISO process for members. The proposed rule change will be effective upon the Commission's approval.

⁸ The term "intermarket sweep order" is defined in Rule 600(b)(30) of Regulation NMS as a limit order for an NMS stock that meets the following requirements: (i) when routed to a trading center, the limit order is identified as an intermarket sweep order; and (ii) simultaneously with the routing of the limit order identified as an intermarket sweep order, one or more additional limit orders, as necessary, are routed to execute against the full displayed size of any protected bid, in the case of a limit order to sell, or the full displayed size of any protected offer, in the case of a limit order to buy, for the NMS stock with a price that is superior to the limit price of the limit order identified as an intermarket sweep order. These additional routed orders also must be marked as intermarket sweep orders. See 17 CFR 242.600(b)(30).

⁹ Rule 611(b)(6) of Regulation NMS provides an exception for a trade-through transaction effected by a trading center that simultaneously routes an ISO to execute against the full displayed size of any protected quotation in the NMS stock that was traded through. See 17 CFR 242.611(b)(6).

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁰ which requires, among other things, that FINRA 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. FINRA believes that the proposed rule change will facilitate members' compliance with their ISO routing obligations under Rule 611 of Regulation NMS and provide an exemption from IM-2110-2 and Rule 2111, substantially consistent with the changes in SR-NYSE-2007-21.¹¹

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

FINRA does not believe that the proposed rule change will impose 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 Nasdaq 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.

¹⁰ 15 U.S.C. 78o-3(b)(6).

¹¹ See Securities Exchange Release No. 56017 (July 5, 2007), 72 FR 38110 (July 12, 2007).

FINRA has requested accelerated approval of this proposed rule change prior to the 30th day after the date of publication of the notice of the filing thereof. The Commission is considering granting accelerated approval of the proposed rule change at the end of a 15-day comment period.

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-FINRA-2007-039 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-FINRA-2007-039. 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, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. 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 publicly available. All submissions should refer to File Number SR-FINRA-2007-039 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹²

Florence E. Harmon
Deputy Secretary

¹² 17 CFR 200.30-3(a)(12).