

No. SR-ISE-2006-72 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 No. SR-ISE-2006-72. 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 the filing also will be available for inspection and copying at the principal office of the Exchange.

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 No. SR-ISE-2006-72 and should be submitted on or before February 7, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-55061; File No. SR-NASDAQ-2006-061]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the NASDAQ Stock Market LLC To Codify Sponsored Access Rule

January 8, 2007.

Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange

Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> The NASDAQ Stock Market LLC ("Nasdaq") is filing with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. 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 the Substance of the Proposed Rule Change

Nasdaq is filing with the Commission a proposed rule change to update and clarify the requirements for members that provide electronic access to Nasdaq's execution services, and to codify these requirements in Nasdaq's rules.

Nasdaq has designated this proposal as one effecting a change that: (i) Does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) by its terms, does not become operative for 30 days after the date of the filing.

Nasdaq has provided the Commission with written notice of its intent to file this proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change pursuant to Section 19(b)(3)<sup>3</sup> and Rule 19b-4(f)(6) thereunder.<sup>4</sup> The proposed rule change will become operative 30 days after the date of the filing.

The text of the proposed rule change is below. The proposed new language is italicized.

\* \* \* \* \*

#### 4611. Nasdaq Market Center Participant Registration

(a)-(c) No change.

(d) *Members may provide sponsored access in accordance with the provisions below:*

(1) *Definition. Sponsored Access is the practice by a member firm ("Sponsoring Member") of providing access to the Nasdaq Execution System ("Nasdaq") on an agency basis to another firm or customer ("Sponsored Firm"). Sponsored access can be of two forms: (a) pass-through access, whereby a Sponsored Firm enters orders that pass through the Sponsoring Member's systems and then into Nasdaq ("Pass-through Sponsored Access"), and (b)*

*direct access, whereby the Sponsored Firm enters orders directly into Nasdaq ("Direct Sponsored Access").*

(2) *Sponsoring Members that provide Sponsored Access to Nasdaq shall be responsible for complying with the obligations in Rule 4611 with respect to any activity conducted by a Sponsored Firm using a market participant identifier ("MPID") assigned to the Sponsoring Member.*

(3) *A Sponsoring Member that provides Direct Sponsored Access to Nasdaq shall execute and file with Nasdaq the Addendum to the Nasdaq Services Agreement for Sponsored Access to Nasdaq ("Sponsored Access Agreement") and any other such agreements as specified by Nasdaq. Sponsored Firms shall also execute and file with Nasdaq a Sponsored Access Agreement and any other such agreements as specified by Nasdaq.*

#### Interpretive Material 4611-1—Sponsored Access

##### (1) Compliance with Nasdaq Supervision and Customer Protection Requirements

*Sponsoring Members have responsibility for the conduct of their Sponsored Firms as if the conduct were their own. Sponsoring Members that provide Sponsored Access, whether Pass-through or Direct, have a continuing obligation to comply with all Nasdaq rules and procedures and the federal securities laws and rules, and must, in accordance with Rule 3010, have supervisory systems and written procedures reasonably designed to achieve compliance with these obligations. For example, Sponsoring Members must have systems and written procedures to supervise the activity of Sponsored Firms, including obligations with respect to the Nasdaq and SEC short sale rules (Rule 3350 and SEC Rule 10a-1 and Regulation SHO), and the requirements articulated in Rule 3370. Further, Sponsoring Members must satisfy their obligations under IM-2110-2 or Rule 6440 to not trade ahead of customers. Similarly, a limit order from a Sponsored Firm is subject to the SEC limit order display rule (Rule 604 under Regulation NMS) and the order must be handled in compliance with the rule. Sponsoring Members also must possess sufficient information about their Sponsored Firms to satisfy the "know your customer" obligation that is embedded in the Nasdaq Conduct Rules.*

##### (2) Compliance With Other Nasdaq Requirements

*(a) Rule 8210. Sponsoring Members are responsible for complying with all*

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3).

<sup>4</sup> 17 CFR 240.19b-4.(f)(6).

<sup>15</sup> 17 CFR 200.30-3(a)(12).

requests for information pursuant to Rule 8210. The Sponsored Access Agreement described in Rule 4611(d)(3) shall provide that Sponsored Firms and Sponsoring Members must comply with Rule 8210.

(b) *Fees.* Sponsoring Members are responsible for paying all Nasdaq fees accrued under their MPIDs, irrespective of the fact that particular charges may be associated with orders entered by Sponsored Firms.

(c) *Services Agreement; Termination.* The fact that a member is providing Sponsored Access does not alter Nasdaq's rights with regard to the Sponsoring Member that are articulated in Nasdaq's agreements with members (e.g., the Nasdaq Services Agreement). In particular, if the Sponsoring Member's provision of Sponsored Access threatens the integrity of Nasdaq systems, Nasdaq reserves the right under the Nasdaq Services Agreement to unilaterally and immediately terminate the Sponsoring Member's access.

(d) *Examinations.* Sponsoring Members are reminded that, as a self-regulatory organization responsible for examining the activity of a member, Nasdaq may examine the Sponsoring Member's books, records, and facilities to determine whether a violation of Nasdaq rules and/or federal securities laws, rules, and regulations have occurred. Such examination may include an examination of the Sponsoring Member's internal systems, as well as the member's records regarding its customers and their activity.

### (3) *Obligation To Ensure Accuracy of Orders Entered into Nasdaq*

Sponsoring Members have an obligation under Nasdaq Rule 3010 to have in place a supervisory system and written supervisory procedures reasonably designed to ensure that orders placed by Sponsored Firms into Nasdaq are not entered in error or in a manner inconsistent with Nasdaq rules. Sponsoring Members should consider the following factors when developing a supervisory system and written supervisory procedures:

(a) *Sponsoring Member order management systems should include controls that limit the use of such systems to authorized persons, check for order accuracy, prevent orders that exceed preset credit- and order-size parameters from being transmitted to Nasdaq, and prevent the unwanted generation, cancellation, repricing, resizing, duplication, or re-transmission of orders.*

(b) *Safeguards should be in place to ensure that the operation, testing, or maintenance of a Sponsoring Member's order management system does not result in the inadvertent disabling of Nasdaq, mistaken executions, errors, or other trading problems.*

(c) *Sponsoring Members and Direct Sponsored Access Sponsored Firms should ensure that they do not test their systems' connectivity to Nasdaq by sending orders that are not executable, such as by sending orders during normal market hours that are priced far outside a security's current price. Firms must test pursuant to established protocols and test messages should be clearly denoted as such.*

(d) *Before sponsoring access to Nasdaq, a Sponsoring Member must have a supervisory system and written supervisory procedures in place reasonably designed to ensure that such orders are not entered in error or in a manner inconsistent with Nasdaq rules (including, but not limited to, Rule 3310 and IM-3310) or with the Nasdaq Services Agreement.*

(e) *Procedures that are available to adjudicate clearly erroneous transactions are to be used only in cases of clear or obvious errors and should not be used as a proxy for proper system use or trading procedures. Other errors, whether as a result of a system problem or human error, will not be dealt with through the rules applicable to clearly erroneous transactions.*

\* \* \* \* \*

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

In its filing with the Commission, Nasdaq 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. Nasdaq 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

Nasdaq proposes to amend the rules governing Nasdaq to update and codify the requirements applicable to Nasdaq members that provide access to other firms and customers to the Nasdaq execution system ("Sponsored Access"). With one exception, members will be

subject to the requirements articulated in NASD Notice to Members 98-66 ("Notice to Members" or "Notice") and which were reiterated and updated by the NASD in Notice to Members 04-66.<sup>5</sup>

Notice to Members 98-66, which was filed with the Commission as an interpretation of the NASD rules and the Nasdaq subscriber agreement, clarified that members could provide Sponsored Access and remain in compliance with their rule and contract obligations to safeguard Nasdaq equipment and to prevent unauthorized access to Nasdaq systems.<sup>6</sup> In addition, the Notice re-emphasized members' existing obligations to monitor the trading activity by their customers, including those being provided Sponsored Access, and to have written procedures governing customer trading. Notice to Members 04-66 also re-asserted that members are responsible for all trading conducted in their name, and that the member is responsible for the fees associated with that trading.

The proposed rule change amends the Nasdaq rules governing Nasdaq's execution system to articulate specifically that members providing Sponsored Access are responsible for all activity conducted using their market participant identifier ("MPID"). In addition, the proposal adds an Interpretive Material to Rule 4611 (IM-4611-1—Sponsored Access) that discusses members' ongoing responsibilities to comply with all Nasdaq rules and operating procedures, as well as the federal securities laws and rules, and to have systems and written procedures reasonably designed to achieve compliance with these obligations. For example, IM-4611-1 discusses that members must continue to comply with the Nasdaq and SEC short sale rules, including the requirements of Rule 3370, when a firm sells securities under a Sponsored Access arrangement, and that members also must fulfill their "know your customer" obligations that are embedded in the Nasdaq Conduct Rules. The interpretive material also states that members must continue to satisfy any limit order protection and display obligations that arise from limit orders submitted by sponsored firms.

The interpretive material also reminds members that they remain responsible for all Nasdaq fees accrued under their MPID, irrespective of the fact that some of the fees may be attributable to orders submitted by sponsored firms.

<sup>5</sup> The Notice to Members described Sponsored Access as "electronic pass-through services."

<sup>6</sup> Securities Exchange Act Release No. 40354 (Aug. 24, 1998), 63 FR 46264 (Aug. 31, 1998).

Similarly, the interpretive material states that Nasdaq's rights with regard to the Sponsoring Member that are articulated in Nasdaq's agreements with members (e.g., the Nasdaq Services Agreement) are not altered by fact that a member is providing Sponsored Access.

As stated earlier, with one exception, members will continue to be subject to the same requirements as imposed by the Notice to Members when providing Sponsored Access. Specifically, Nasdaq is eliminating the requirement that orders must be entered into a member's system (or a service bureau's system provided by the member) before being transmitted to Nasdaq (i.e., the electronic pass-through requirement). Nasdaq does not expect many members to provide such "direct access" to Nasdaq. Nasdaq stresses, however, that eliminating this requirement does not diminish a member's responsibility for ensuring that trading occurring under its MPID is in compliance with Nasdaq's rules and procedures and the federal securities laws. For example, members considering providing such direct access must, in accordance with Rule 3010, have systems and written procedures to supervise the activity of a sponsored firm with direct access to Nasdaq.<sup>7</sup> In addition, members also must fulfill their "know your customer" obligations that are embedded in the Nasdaq Conduct Rules.

To limit its exposure in commercial disputes and to protect its intellectual property when a sponsored firm can submit orders to Nasdaq directly, Nasdaq is proposing to require sponsored firms with this type of access to execute an agreement ("Sponsored Access Agreement") that will require them to abide by the Nasdaq Services Agreement, which is executed by all members accessing Nasdaq's systems.<sup>8</sup> Requiring the Sponsored Access Agreement ensures that Nasdaq has an agreement with the party actually submitting orders to Nasdaq, although the member remains responsible for the trading, including compliance with Nasdaq rules and procedures and the federal securities laws and rules.

An executed Sponsored Access Agreement will not be necessary when a sponsored firm does not enter orders directly into Nasdaq Market Center (i.e., submits orders utilizing an electronic pass-through), because the orders are entering Nasdaq through a system

provided by a party with whom Nasdaq already has an agreement: A member.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of section 6 of the Act,<sup>9</sup> in general and with section 6(b)(5) of the Act,<sup>10</sup> in particular, in that it is designed to promote just and equitable principles of trade and to protect investors and the public interest. The proposal is consistent with these obligations because it updates the standards for providing Sponsored Access, and clearly articulates the obligations in the Nasdaq's rules.

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

Nasdaq 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

The foregoing rule change has become effective pursuant to section 19(b)(3)(A) of the Act and subparagraph (f)(6)(iii) of rule 19b-4 thereunder in that it effects a change that does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that the self-regulatory organization has given the Commission written notice of intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The proposed rule change will become operative 30 days after the date of the filing.

At any time within 60 days of the filing of a rule change pursuant to section 19(b)(3)(A) of the Act, the Commission may summarily abrogate the rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors,

or otherwise in furtherance of the purposes of the Act.

## 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](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2006-061 on the subject line.

### Paper Comments

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

All submissions should refer to File Number SR-NASDAQ-2006-061. 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 Nasdaq. 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-NASDAQ-2006-061 and should be submitted on or before February 7, 2007.

<sup>7</sup> A member's system and procedures would need to be reasonably designed to achieve compliance with, for example, the requirements of Rule 3370.

<sup>8</sup> The Sponsoring Member also would be required to execute the Sponsored Access Agreement.

<sup>9</sup> 15 U.S.C. 78f.

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> 17 CFR 200.30-3(a)(12).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

[FR Doc. E7-543 Filed 1-16-07; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-55078; File No. SR-NASD-2006-136]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Make Technical and Grammatical Corrections to Rule 10308

January 10, 2007.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 28, 2006, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by NASD. NASD has filed this proposal pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder<sup>4</sup> which renders the proposal effective upon filing with the Commission.<sup>5</sup> 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 paragraph (a)(5)(B) of Rule 10308 of the NASD Code of Arbitration Procedure to delete unnecessary cross references in the definition of “immediate family member,” and to correct a grammatical error.<sup>6</sup> The text of the proposed rule change is below. Proposed new

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> NASD informed the Commission staff that a clerical error was made in its filing and the word “individual’s” in paragraph (a)(5)(B)(iii) of Rule 10308 should be lowercase. Telephone conversation between Jean Feeney, Vice President, NASD; and Michael Hershaf, Special Counsel, Commission (Jan. 9, 2006). Because this is a non-substantive change, this amendment to the proposed rule change will not toll the 60-day abrogation period.

<sup>6</sup> The Commission recently approved amendments to Rule 10308, effective Jan. 15, 2007. Securities Exchange Act Release No. 54607 (Oct. 16, 2006), 71 FR 62026 (Oct. 20, 2006) (file No. SR-NASD-2005-094).

language is in italics; proposed deletions are in brackets.

#### 10308. Selection of Arbitrators

(a) Definitions

(1) through (4) No change.

(5) “public arbitrator”

(A) No change.

(B) For [the] purposes of this Rule, the term “immediate family member” means:

(i) [The] *a person’s* parent, stepparent, child, or stepchild[, of a person engaged in the conduct or activities described in paragraphs (a)(4)(A) through (D)];

(ii) A member of [the] *a person’s* household [of a person engaged in the conduct or activities described in paragraphs (a)(4)(A) through (D)];

(iii) *An individual to whom* a person [who receives] *provides* financial support of more than 50 percent of *the individual’s* annual income [from a person engaged in the conduct or activities described in paragraphs (a)(4)(A) through (D)]; or

(iv) A person who is claimed as a dependent for federal income tax purposes [by a person engaged in the conduct or activities described in paragraphs (a)(4)(A) through (D)].

(6) through (7) No change.

(b) through (f) 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

NASD believes that the cross-references to “a person engaged in the conduct or activities described in paragraph (a)(4)(A) through (D)” in the definition of immediate family member in paragraphs (a)(5)(B)(i)–(iv) of Rule 10308 are redundant when read in conjunction with other provisions of the rule. For example, Rule 10308(a)(5)(A)(vii) provides that a person may be a public arbitrator if he or she “is not the spouse or immediate

family member of a person who is engaged in the conduct or activities described in paragraphs (a)(4)(A) through (D).” The definition of “immediate family member” in Rule 10308(a)(5)(B) states, in part, “For the purpose of this Rule, the term “immediate family member” means \* \* \* (i) the parent, stepparent, child, or stepchild, of a person engaged in the conduct or activities described in paragraphs (a)(4)(A) through (D).” Thus, both the rule and the definition refer redundantly to “a person [who is] engaged in the conduct or activities described in paragraphs (a)(4)(A) through (D).”

Moreover, new paragraphs (a)(5)(A)(v) and (vi) of Rule 10308 were recently added to provide that persons who are otherwise qualified may not serve as public arbitrators if they have certain family members who are employed by, or serve as officers or directors of, entities in a control relationship with a broker-dealer.<sup>7</sup> In these instances, there is no need to refer to paragraphs (a)(4)(A) through (D) as those paragraphs are not at issue. Rather, what is important is the family relationship itself.

For these reasons, NASD proposes to amend the examples of family relationships in the definition of “immediate family member” in paragraphs (a)(5)(B)(i)–(iv) of Rule 10308 in a non-substantive way to retain the relationships themselves but omit the references to paragraphs (a)(4)(A) through (D) of the rule. As noted above, because this reference is in Rule 10308(a)(5)(A)(vii), arbitrators who have an immediate family member engaged in the conduct or activities described in paragraphs (a)(4)(A) through (D) of the rule will continue to be ineligible to serve as public arbitrators. Arbitrators, who do not have immediate family members engaged in the conduct or activities described in paragraphs (a)(4)(A) through (D) of the rule, still may be subject to new paragraphs (a)(5)(A)(v) and (vi) of Rule 10308, which governs public arbitrators.

In deleting the references to paragraphs (a)(4)(A) through (D), discussed above, NASD has rearranged phrases to provide additional clarity. In so doing, NASD does not intend to make any change in the substance of the definitions or in how they are construed.

Finally, NASD proposes to correct a grammatical error in Rule 10308(a)(5)(B) by replacing the term “for the purpose of” with the more common phrase “for

<sup>7</sup> *Id.*