SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57621)

April 4, 2008

Order Exempting Non-Convertible Preferred Securities from Rule 611(a) of Regulation NMS under the Securities Exchange Act of 1934

I. Introduction

Pursuant to Rule 611(d)[1] of Regulation NMS[2] under the Securities Exchange Act of 1934 ("Exchange Act"), the Securities and Exchange Commission ("Commission"), by order, may exempt from the provisions of Rule 611 of Regulation NMS ("Rule 611" or "Rule"), either unconditionally or on specified terms and conditions, any person, security, transaction, quotation, or order, or any class or classes of persons, securities, quotations, or orders, if the Commission determines that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.[3] As discussed below, the Commission is exempting non-convertible preferred securities from Rule 611(a) of Regulation NMS.

II. Background

The Commission adopted Regulation NMS in June 2005.[4] Rule 611 addresses intermarket trade-throughs of displayed quotations in NMS stocks. Rule 611(a)(1) requires a trading center to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs on that trading center of protected quotations in NMS stocks that do not fall within an exception set forth in the Rule.

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1 17 CFR 242.611(d).

2 17 CFR 242.600 et seq.

3 See also 15 U.S.C. 78mm(a)(1) (providing general authority for Commission to grant exemptions from provisions of Exchange Act and rules thereunder).

4 Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) ("Regulation NMS Adopting Release").

The Securities Industry and Financial Markets Association ("SIFMA") has requested that the Commission exempt non-convertible preferred securities from Rule 611(a).[5] According to the SIFMA Exemption Request, Rule 611 applies to certain non-convertible preferred securities that meet the definition of "NMS stock."[6] NMS stock is defined as any security or class of securities, other than options, for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan.[7] The SIFMA Exemption Request notes that some non-convertible preferred securities fall within the definition of an NMS stock because transaction reports for those non-convertible preferred securities are collected, processed, and made available pursuant to the CTA/CQ Plans[8] and the Nasdaq UTP Plan.[9]

The SIFMA Exemption Request states that non-convertible preferred securities are priced like, and trade like, fixed income instruments, not common stocks.[10] In addition, the SIFMA Exemption Request notes that, as a general matter, fixed income securities currently do not fall within the definition of NMS stock. The SIFMA Exemption Request states that, in light of the similarity between non-convertible preferred securities and fixed income securities, and the many differences between non-convertible preferred securities and common stocks, Rule 611 should not apply to non-convertible preferred securities.

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5 Letter to Nancy M. Morris, Secretary, Commission, from Ira D. Hammerman, Senior Managing Director and General Counsel, SIFMA, dated August 16, 2007 ("SIFMA Exemption Request").

6 Id. at 2.

7 Rule 600(b)(46) and (47) of Regulation NMS.

8 See Section VII(a) of the CTA Plan and I(j) of the CQ Plan. The CTA Plan and CQ Plan are available at www.nysedata.com.

9 See Section III(B) of the Nasdaq UTP Plan; Nasdaq Rule 4200(a)(26) and (28); and see, e.g., Nasdaq Rules 4420(k); 4450(h); 4310(c)(4); and 4310(c)(6)(B). The Nasdaq UTP Plan is available at www.utpdata.com.

10 SIFMA Exemption Request at 2.

The SIFMA Exemption Request states that, in contrast to common stocks, the primary purpose for investing in a non-convertible preferred security is the purchase of an income stream, rather than to benefit from fluctuations in the price of the security.[11] Unlike common stocks, most non-convertible preferred securities trade based on yields, which, in turn, move in tandem with the yields of benchmark fixed income securities, such as Treasury securities. The SIFMA Exemption Request states that unless there is a credit event with respect to an issuer, the prices of non-convertible preferred securities have no correlation to price movements of an issuer's common stock. Consequently, the SIFMA Exemption Request states that non-convertible preferred securities generally are viewed as fixed income instruments by investors and securities firms.

The SIFMA Exemption Request states that, in light of their fixed income characteristics and use as an alternative to straight debt securities, non-convertible preferred securities often trade on the fixed income desks of broker-dealers, not their equity desks.[12] The SIFMA Exemption Request states that, given that Rule 611 does not apply to all non-convertible preferred securities nor generally to fixed income instruments, broker-dealers would need to make costly and time-consuming changes to their fixed income trading platforms to accommodate both traditional debt trading and the requirements of Rule 611, including the intermarket sweep order functionality.[13] The SIFMA Exemption Request states that moving the trading of non-convertible preferred securities that are NMS stocks to equity trading systems (which are Rule 611-compliant) would interfere with the presentation of fixed income

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[11] Id.

[12] Id. at 3.

[13] See Rule 611(b)(6) and Rule 600(b)(30) of Regulation NMS (providing intermarket sweep order exception from Rule 611).

investment choices to clients and trading synergies gained by trading non-convertible preferred securities with other like securities (i.e., debt).

The SIFMA Exemption Request notes that the Commission, on several occasions, has recognized the differences between common stocks and non-convertible preferred securities.[14] For example, the Commission granted an exemption for non-convertible preferred securities from the requirement in Exchange Act Rule 11Ac1-1 (now Rule 602 of Regulation NMS -- the "Quote Rule") that a member of an association that acts in the capacity of an over-the-counter market maker must provide to its association continuous two-sided quotations for any exchange-traded security in which that market maker, during the most recent calendar quarter, comprised more than 1% of the aggregate trading volume for such security as reported in the consolidated system.[15] The SIFMA Exemption Request states that the Commission provided the exemption based on representations regarding the trading activities of the requesting firms and the trading patterns of preferred stock.[16] Specifically, the requesting firms represented

> that preferred stock shares many of the characteristics of debt securities, which are exempt from the Order Execution Rules. In particular, [they] noted that prices for preferred stock are generally based on yield, which in turn is based on prevailing interest rates in the debt markets, as well as perceived credit quality of the issuer and any special features of the particular preferred stock.[17]

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14 SIFMA Exemption Request at 3.

15 See Rule 602(b) and Rule 600(b)(73) of Regulation NMS; letter from Richard R. Lindsey, Director, Division of Market Regulation, Commission, to Roger D. Blanc, Willkie, Farr & Gallagher, Re: Exemption from, and Temporary No-Action Position Under, the Order Execution Rules for Trading in Preferred Securities, dated July 31, 1997 ("Blanc Letter").

16 Blanc Letter at 3.

17 Id.

The SIFMA Exemption Request states that, because the Commission did not apply the Quote Rule to debt securities, and preferred stock trades like debt securities, the Commission exempted preferred stock from the Quote Rule. In addition, the SIFMA Exemption Request notes that the Commission also excepted "non-participatory preferred stocks" from the definition of NMS stock for the purposes of Regulation ATS.[18] As a result, the order display and execution access provisions of Regulation ATS[19] do not apply to non-participatory preferred securities.

III. Discussion

The Commission has decided to exempt non-convertible preferred securities from Rule 611(a). Non-convertible preferred securities have characteristics analogous to fixed income instruments. Given these characteristics, non-convertible preferred securities typically are priced based on yield and trade more like fixed income instruments than like common stocks. Due to these similarities to fixed income instruments, non-convertible preferred securities often are handled by the fixed income desks of broker-dealers rather than equity desks. As a general matter, fixed income instruments are not NMS stocks and not subject to Rule 611. Therefore, the systems of fixed income desks of broker-dealers are not designed to comply with Rule 611. In addition, if broker-dealers were to shift trading of non-convertible preferred securities to their equity desks, which have systems designed to comply with Rule 611, investors would be less able to benefit from the experience of broker-dealer personnel with expertise in trading in debt and debt-like securities. In sum, the exemption will promote efficiency because the benefits of applying Rule 611(a) to non-convertible preferred securities would not justify the additional costs of compliance, including broker-dealer costs to program systems to comply with Rule 611.

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18 SIFMA Exemption Request at 4.

19 17 CFR 242.301(b)(3).

The Commission notes that it has previously recognized the similarities between non-convertible preferred securities and fixed income instruments, and, in doing so, has treated non-convertible preferred securities differently than common stock. In 1997, the Commission exempted non-convertible preferred securities from certain requirements in the Quote Rule due to the similarity of its trading patterns with debt securities.[20] In addition, the Commission excepted "non-participatory preferred stocks" from the definition of NMS stock in Regulation ATS.[21] The Commission believes that its decision to exempt non-convertible preferred securities from Rule 611(a) is consistent with its prior actions.

The Commission also believes that the exemption for non-convertible preferred securities is consistent with the protection of investors in such securities. The exemption applies solely to Rule 611(a). Transactions in non-convertible preferred securities will remain subject to all other applicable regulatory requirements.

For the foregoing reasons, the Commission finds that granting the foregoing exemption is necessary and appropriate in the public interest, and is consistent with the protection of investors.

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20 See Blanc Letter.

21 17 CFR 242.300(d) and (g).

IV. Conclusion

IT IS HEREBY ORDERED, pursuant to Rule 611(d) of Regulation NMS, that non-convertible preferred securities are exempted from Rule 611(a) of Regulation NMS.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[22]

Florence E. Harmon
Deputy Secretary

22 17 CFR 200.30-3(a)(82).