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Regulation NMS; Final Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 242

[Release No. 34–53829; File No. S7–10–04]

Regulation NMS

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; extension of compliance dates.

SUMMARY: The Commission is extending the compliance dates for Rule 610 and Rule 611 of Regulation NMS under the Securities Exchange Act of 1934 (''Exchange Act''). Rule 610 requires fair and non-discriminatory access to quotations, establishes a limit on access fees, and requires each national securities exchange and national securities association to adopt, maintain, and enforce written rules that prohibit their members from engaging in a pattern or practice of displaying quotations that lock or cross protected quotations. Rule 611 requires trading centers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution of trades at prices inferior to protected quotations displayed by other trading centers, subject to an applicable exception. The Commission is extending the compliance dates to give automated trading centers additional time to finalize development of their new or modified trading systems, and to give the securities industry sufficient time to establish the necessary access to such trading systems.

DATES: The effective date for Rule 610 and Rule 611 remains August 29, 2005. The initial compliance date for Rule 610 and Rule 611 has been extended from June 29, 2006 to a series of five dates, beginning on October 16, 2006, for different functional stages of compliance that are set forth in section II.A of this release. The effective date for this release is May 24, 2006.

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SUPPLEMENTARY INFORMATION:

I. Introduction

On June 29, 2005, the Commission published its release adopting Regulation NMS (''NMS Release'').[1] The adopted regulatory requirements include: (1) New Rule 610 of Regulation NMS, which addresses access to markets and locking or crossing quotations; (2) new Rule 611 of Regulation NMS, which provides intermarket protection against trade-throughs (*i.e.*, trades at inferior prices) for certain displayed quotations that are automated and accessible; and (3) an amendment to the joint industry plans for disseminating market information to the public that modifies the formulas for allocating plan revenues to the self-regulatory organization (''SRO'') participants in the plans (''Allocation Amendment'').

The effective date for all of the initiatives in the NMS Release was August 29, 2005. The compliance dates for Rule 610, Rule 611, and the Allocation Amendment have not yet arrived. Phase 1 of compliance with Rule 610 and Rule 611 for 250 NMS stocks was set for June 29, 2006, and Phase 2 for all NMS stocks was set for August 31, 2006. The compliance date for the Allocation Amendment is September 1, 2006. For the reasons discussed below, the Commission has determined that the SROs and securities industry participants need additional time to implement these new NMS regulatory requirements. It therefore has decided to extend the compliance dates for Rule 610 and Rule 611 as set forth in this release. In addition, the Commission has today, by separate order, exempted the SRO participants in the joint industry plans from compliance with the Allocation Amendment until April 1, 2007.[2]

II. Extension of Compliance Dates

One of the primary Exchange Act objectives for the national market system (''NMS'') is to promote the efficient execution of securities transactions by capitalizing on advances in communications and processing technologies.[3] Two of the core elements of Rule 610 and Rule 611 are the display of automated quotations, as defined in Rule 600(b)(3), and the operation of automated trading centers, as defined in Rule 600(b)(4). Automated trading centers displaying automated quotations must, among other things, immediately respond to incoming orders seeking to access the quotations and immediately update the quotations. Under Rule 611, only automated quotations displayed by automated trading centers will qualify as ''protected quotations'' under Rule 600(b)(58) and thereby receive intermarket protection against trade-throughs. In addition, Rule 610(d) requires SROs to adopt rules requiring their members reasonably to avoid displaying quotations that lock or cross protected quotations. Finally, the Allocation Amendment allocates market data revenues to SROs based partially on the extent to which they display quotations that equal the national best bid or offer in an NMS stock, but only if the quotations are automated.

Given the new regulatory framework created by Regulation NMS and the desire of investors and other market participants for more automated and efficient trading services, many SROs have announced major revisions of their trading systems. For example, the New York Stock Exchange LLC (''NYSE'') is implementing its Hybrid Market, which is designed to integrate aspects of an auction market with automated trading.[4] The American Stock Exchange LLC (''Amex'') has proposed to adopt a new trading platform that would offer both an electronic marketplace and floor-based trading.[5] The Boston Stock Exchange, Inc. (''BSE'') plans to launch a new electronic trading system.[6] The Chicago Stock Exchange (''CHX'') has proposed to no longer operate a physical trading floor and instead to adopt a new fully-automated matching system.[7] The Nasdaq Stock Market LLC (''Nasdaq'') has proposed to integrate three different matching systems into a single, integrated matching system.[8] Finally, to qualify quotations displayed in the Alternative Display Facility (''ADF'') as protected quotations,[9] the NASD must modify the ADF to designate a single participant for the ADF best bid and a single participant for the ADF best offer, because the ADF does not provide a single point of connectivity to ADF quotations. ADF participants, in turn,

[1] Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

[2] Securities Exchange Act Release No. 53828 (May 18, 2006) (order exempting SROs from compliance with the Allocation Amendment until April 1, 2007). *See* section II.B below.

[3] *See, e.g.*, Exchange Act section 11A(a)(1)(B), 11A(a)(1)(C)(i), and 11A(a)(1)(D); *see also* NMS Release, 70 FR at 37497.

[4] *See* Securities Exchange Act Release No. 53539 (March 22, 2006), 71 FR 16353 (March 31, 2006) (approval of NYSE rules establishing the Hybrid Market). Information concerning NYSE's Hybrid Market also is available at *http://www.nyse.com.*

[5] Information concerning Amex's proposed Auction and Electronic Market Integration (AEMI) platform, including a proposed rule change to establish the AEMI platform (SR–Amex–2005–104), is available at *http://www.amex.com.*

[6] Information concerning BSE's planned electronic equities trading market is available at *http://www.bostonstock.com.*

[7] Information concerning CHX's proposed rule change to establish the new trading market (SR–CHX–2006–05) is available at *http://www.chx.com.*

[8] Information concerning Nasdaq's proposed rule change to establish an integrated matching system (SR–NASDAQ–2006–001) is available at *http://www.nasdaq.com.*

[9] *See* NMS Release, 70 FR at 37534 (ADF best bid or offer must be accessible by routing to a single ADF participant).

must meet the new automated trading center requirements discussed above to qualify their quotations for trade-through protection, as well as the new access standards of Rule 610(b)(1).

The SROs currently are in varying stages of development of their new or modified trading systems. The ongoing nature of these changes to SRO trading systems has seriously complicated the efforts of securities industry participants to comply with the new NMS regulatory requirements. The SROs intend that their new or modified SRO systems would be automated trading centers and therefore sources of protected quotations. In addition, the current participants in ADF, as well as potentially new participants, have indicated their intent to be sources of protected quotations when they represent the ADF best bid or offer. To comply with Regulation NMS, industry participants must have clarity concerning all sources of protected quotations. For example, any industry participants that wish to rely on the exceptions in Rule 611(b)(5) and (6) for intermarket sweep orders (''ISOs'') must have access to all sources of protected quotations to assure that they can meet the ISO requirements of Rule 600(b)(30).[10]

Industry participants therefore must develop policies, procedures, and systems that will enable them to route orders to access the protected quotations displayed by all of the new or modified SRO trading systems and ADF participants. To establish the connectivity and interfaces necessary to perform this function, industry participants must receive final technical specifications for all automated trading centers well in advance of the initial compliance date for trade-through protection. In addition, given the novel features of many of the new SRO trading systems, industry participants have indicated that they need a period in time in which to gain practical experience trading on the new systems, also in advance of the initial compliance date for trade-through protection. Finally, all of these changes must be implemented while trading continues in the most active equity markets in the world. Each day, the U.S. equity markets handle trading volume in NMS stocks of more than 3.9 billion shares and 120 billion dollars. The implementation of Regulation NMS must be managed appropriately so that it does not risk any disruption to the functioning of our equity markets.

The Commission fully supports the SROs' plans to develop more fully automated trading systems. These SRO systems would represent a major upgrade in the NMS that could benefit investors and all market participants by providing platforms for more efficient trading. The Commission also understands the need for industry participants to have sufficient time to establish the necessary access to these new SRO trading systems as they become operational. It therefore has decided to extend substantially the original compliance dates for Rule 610 and Rule 611. To provide the SROs and industry participants with greater certainty concerning the phase-in of NMS implementation, the Commission is adopting a series of revised compliance dates that incorporate the major functional steps required to achieve full implementation of Regulation NMS. The revised dates provide additional time for SROs to develop and install their new trading systems, but also impose firm deadlines for these functional steps to be completed. This systematic approach to implementation should give all industry participants an enhanced opportunity to complete their compliance preparations in the least disruptive and most cost-effective manner possible.

A. Rule 610 and Rule 611 Compliance Dates

The extended compliance dates for Rule 610 and Rule 611 are as follows:

October 16, 2006 (''Specifications Date''): Final date for publication on Internet Web sites of applicable SROs (*i.e.*, the exchange for SRO trading facilities and the NASD for ADF participants) of final technical specifications for interaction with Regulation NMS-compliant trading systems of all automated trading centers (both SRO trading facilities and ADF participants) that intend to qualify their quotations for trade-through protection under Rule 611 during the Pilots Stocks Phase and All Stocks Phase (as defined below).

February 5, 2007 (''Trading Phase Date''): Final date for full operation of Regulation NMS-compliant trading systems of all automated trading centers (both SRO trading facilities and ADF participants) that intend to qualify their quotations for trade-through protection under Rule 611 during the Pilots Stocks Phase and All Stocks Phase (as defined below). The period from February 5, 2007 till May 21, 2007 is the ''Trading Phase.''

May 21, 2007 (''Pilot Stocks Phase Date''): Start of full industry compliance with Rule 610 and Rule 611 for 250 NMS stocks (100 NYSE stocks, 100 Nasdaq stocks, and 50 Amex stocks). The period from May 21, 2007 till July 9, 2007 is the ''Pilot Stocks Phase.''

July 9, 2007 (''All Stocks Phase Date''): Start of full industry compliance with Rule 610 and Rule 611 for all remaining NMS stocks. The period from July 9, 2007 till October 8, 2007 is the ''All Stocks Phase.''

October 8, 2007 (''Completion Date''): Completion of phased-in compliance with Rule 610 and Rule 611.

Each of these compliance dates represents an essential functional step on the way to full implementation of Rules 610 and 611. It is particularly important that all automated trading centers meet the October 16 Specifications Date and the February 5 Trading Phase Date. These new dates give automated trading centers more than seven additional months beyond the original June 29, 2006 Phase 1 compliance date to bring their new Regulation NMS-compliant trading systems into full operation. The seven-month extension is in addition to the one-year period originally provided when Regulation NMS was published. Accordingly, the extended dates are designed to provide all automated trading centers intending to display protected quotations during the Pilot Stocks Phase and the All Stocks Phase with sufficient time to meet the new intermediate compliance dates for posting final technical specifications and commencing full operation of the specified trading systems.

The Commission believes that industry participants need certainty concerning the protected quotations for which they will be required to afford trade-through protection under Rule 611 during the Pilot Stocks Phase and All Stocks Phase. Moreover, to prevent potentially serious disruption to implementation efforts, the industry needs this certainty well in advance of the Pilot Stocks Phase Date. Industry participants should not be placed in a position where they would be unexpectedly required to access the additional protected quotations of an automated trading center that had not posted its final technical specifications and commenced operation of its new trading system in a timely manner.

Accordingly, the Commission may consider, after the Specifications Date, whether to issue an exemptive order identifying those automated trading centers that met the Specifications Date and exempting all industry participants from trade-through and locking/crossing responsibilities with respect to the quotations of any trading center not identified as having met the Specifications Date. The Commission also may consider updating any

[10] *See* NMS Release, 70 FR at 37523.

previously-issued exemptive order to remove any trading center that failed to meet the Trading Phase Date by commencing full operation of its Regulation NMS-compliant trading system in accordance with its final technical specifications posted on the Specifications Date.

In addition to completing the functional steps that have been assigned specific compliance dates, the consolidated data streams need to be modified in several respects. As discussed in the NMS Release,[11] consolidated quotation and trade data in NMS stocks is disseminated to the public through three Networks jointly operated by the SROs—Network A for stocks listed on the NYSE, Network C for stocks listed on Nasdaq, and Network B for stocks listed on the Amex and other national securities exchanges. To facilitate compliance with Rule 610 and Rule 611, the Network quotation feeds must identify automated and manual quotations, as well as any types of quotations (such as ''non-firm'' quotations) that do not qualify as protected quotations. In addition, the Network quotation feeds must identify a single participant in the NASD's ADF for its best bid and for its best offer.[12] Finally, the Network trade feeds need to be modified to identify trades that are executed pursuant to exceptions set forth in Rule 611(b).[13] The Commission understands that the Networks have made substantial progress toward modifying their data feeds to reflect Regulation NMS. Given this progress, the Commission expects that appropriately modified Network data feeds will be fully operational in advance of the Specifications Date. It will consider further action in the future if necessary to assure that the Networks meet this timeframe.

The extended compliance dates established in this release, as well as the potential consequences for automated trading centers of failing to meet such dates, are discussed in greater detail below.

1. Specifications Date

By no later than October 16, 2006, all trading centers (both SRO trading facilities and ADF participants) intending to qualify their quotations for trade-through protection during the Pilot Stocks Phase and All Stocks Phase must post final technical specifications on the Internet Web site of the applicable SRO (*i.e.*, the exchange for SRO trading facilities and the NASD for ADF participants). The purpose of posting these specifications is to enable industry participants to plan their NMS compliance and modify their systems to interface with the systems of the automated trading centers. Given this purpose, the specifications must, at a minimum, address: (1) The identification of quotations as automated or manual to meet the requirements of Rule 600(b)(4); (2) an immediate-or-cancel functionality that meets the requirements of an automated quotation in Rule 600(b)(3); (3) an ISO functionality that allows industry participants to meet the requirements of Rule 600(b)(30); and (4) any other basic functionalities necessary to trade on the system. In addition, the specifications must be final with respect to these basic Regulation NMS functions and must remain so at least through the Completion Date. A significant alteration of the specifications prior to completion of the phase-in periods would defeat the purpose of giving the industry certainty concerning the quotations for which they will have trade-through and locking/crossing responsibilities.

The Commission recognizes that automated trading centers cannot produce final technical specifications until all relevant SRO proposed rule changes necessary for Regulation NMS-compliant trading systems have been filed, published for public comment, and approved by the Commission. Accordingly, it anticipates working closely with the SROs to address any issues raised by the filings and to take appropriate action by no later than October 1, 2006.

After the Specifications Date, the Commission intends to consider whether to issue an exemptive order pursuant to Rule 610(e) and Rule 611(d). Such an order could identify those trading centers that complied with the Specifications Date, and could exempt all industry participants from trade-through requirements under Rule 611 and locked/crossed requirements under Rule 610 for the quotations displayed by any trading center that is not identified in the exemptive order as having complied with the Specifications Date. This exemption could continue in effect at least through the Completion Date.[14]

2. Trading Phase Date

By no later than February 5, 2007, all trading centers (both SRO trading facilities and ADF participants) intending to qualify their quotations for trade-through protection must bring a Regulation NMS-compliant trading system into full operation for all NMS stocks intended to be traded during the phase-in period (*i.e.*, through the Completion Date). The trading system must operate in accordance with the specifications that were posted by the Specifications Date. The Trading Phase is designed to provide industry participants with an opportunity to gain experience with the new or modified systems of all automated trading centers that will display protected quotations during the phase-in periods. For example, industry participants will be able to test the effectiveness of their policies and procedures under Rule 610 and Rule 611, prior to any liability attaching under the Rules.

After the Trading Phase Date, the Commission may consider whether to update any exemptive order issued after the Specifications Date to remove any trading centers that failed to meet the Trading Phase Date. Any updated order could continue in effect at least through the Completion Date.

3. Pilot Stocks Phase Date

May 21, 2007 is the initial, all-industry compliance date for Rule 610 and Rule 611 with respect to 250 pilot stocks—100 for Network A, 100 for Network C, and 50 for Network B. The particular stocks will be chosen by the primary listing market, in consultation with Commission staff, to be reasonably representative of the range of each Network's securities. The primary purpose of the Pilot Stocks Phase is to allow all market participants to verify the functionality of their policies, procedures, and systems that are necessary to comply with the Rules.

The Pilot Stocks Phase is analogous to Phase 1 of the original implementation schedule set forth in the NMS Release.[15] May 21, 2007, therefore, provides the securities industry a nearly eleven-month extension of the original Phase 1 compliance date. In addition, the revised date gives all industry participants a seven-month period to complete their implementation efforts after the public posting of final technical specifications for automated

[11] 70 FR at 37558.

[12] *See* NMS Release, 70 FR at 37534 (ADF best bid or offer must be accessible by routing to a single ADF participant).

[13] *See* NMS Release, 70 FR at 37535 n. 317 (need for transparency concerning Rule 611 exceptions).

[14] Any exemptive order would address trade-through and locked/crossed responsibilities, but would not preclude the quotations displayed by a trading center not identified in the order from meeting the definition of an ''automated quotation'' under Rule 600(b)(3). Industry participants would need to include such quotations in their best execution analyses, and would be able particularly to assess whether their ability to access such quotations made them reasonably available when considered in the context of the ongoing challenges of meeting the compliance dates for Rule 610 and Rule 611.

[15] *See* NMS Release, 70 FR at 37576.

trading centers. The revised date also provides securities firms a more than three-month period to gain experience in actual trading with the new or modified systems of automated trading centers. These extended time periods are designed to facilitate a non-disruptive and cost-effective initiation of trade-through protection and locked/crossed quotation restrictions under Rule 610 and Rule 611.

4. All Stocks Phase Date

July 9, 2007 is the all-industry compliance date for Rules 610 and 611 with respect to all remaining NMS stocks. This All Stocks Phase will last three months and is intended to provide a final period for industry participants to gain significant experience complying with the Rules.

5. Completion Date

On October 8, 2007, the phase-in of compliance with Rules 611 and 610 will be complete. As of this date, any exemptive order issued after the Specifications Date, or updated after the Trading Phase Date, could be modified so that industry participants would have trade-through and locked/crossed requirements for the quotations of an automated trading center that may have failed to meet the Specifications Date or the Trading Phase Date. The quotations of any such automated trading center must be commenced pursuant to an approved SRO proposed rule change or other established SRO procedure that provides sufficient notice to the industry, as well as all necessary information (such as final technical specifications), that will enable industry participants to meet their regulatory responsibilities.[16]

B. Allocation Amendment Exemption

The Allocation Amendment modifies the existing formulas for allocating revenues to the SRO participants in the market data plans.[17] One of the most significant changes is the introduction of ''Quoting Shares''—the allocation of revenues based on the extent to which automated quotations displayed by SROs equal the national best bid or offer in NMS stocks. Under the old formulas, no revenues are allocated for quotations. Under the new formula, 50% of revenues will be allocated for Quoting Shares. Due to the extension until February 5, 2007 of the deadline for automated trading centers to commence full operation of NMS-compliant trading systems, the Commission believes that the SRO participants in the joint industry plans for disseminating market information should be exempted from complying with the Allocation Amendment until after the Trading Phase Date. Accordingly, the Commission, by separate order, has exempted the SRO participants in the plans from complying with the Allocation Amendment until April 1, 2007.[18] The exemption gives trading centers additional time to implement systems that are capable of displaying automated quotations and thereby qualify for Quoting Shares.

[16] SRO trading facilities would be subject to the proposed rule change requirements of section 19(b) of the Exchange Act. ADF participants would be subject to procedures adopted by the NASD, after approval by the Commission, to assure appropriate access to the ADF participants. *See* NMS Release, 70 FR at 37543.

[17] *See* NMS Release, 70 FR at 37568.

[18] *See* note 2 above.

III. Conclusion

For the reasons cited above, the Commission, for good cause, finds that notice and solicitation of comment regarding the extension of the compliance dates set forth herein are impractical, unnecessary, or contrary to the public interest.[19] All industry participants will receive substantial additional time to comply with Rule 610 and Rule 611 beyond the compliance dates originally set forth in the NMS Release. In addition, the Commission recognizes that industry participants urgently need notice of the extended compliance dates so that they do not expend unnecessary time and resources in meeting the original June 29, 2006 compliance date, such as by developing interfaces with trading systems that could change substantially prior to the extended compliance dates. Providing immediate effectiveness upon publication of this release will allow industry participants to adjust their implementation plans accordingly.[20]

By the Commission.

Dated: May 18, 2006.

J. Lynn Taylor,

Assistant Secretary.

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[19] *See* section 553(b)(3)(B) of the Administrative Procedure Act (5 U.S.C. 553(b)(3)(B)) (''APA'') (an agency may dispense with prior notice and comment when it finds, for good cause, that notice and comment are ''impractical, unnecessary, or contrary to the public interest'').

[20] The compliance date extensions set forth in this release are effective upon publication in the **Federal Register**. Section 553(d)(1) of the APA allows effective dates that are less than 30 days after publication for a ''substantive rule which grants or recognizes an exemption or relieves a restriction.'' 5 U.S.C. 553(d)(1).