

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-56917; File No. SR-NASDAQ-2007-085)

December 6, 2007

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Approving Proposed Rule Change, As Modified By Amendment No. 1 Thereto, Amending Nasdaq's Membership Application Rules

I. Introduction

On October 30, 2007, The NASDAQ Stock Market LLC ("Nasdaq") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule change to modify Nasdaq's membership application procedures. The proposed rule change was published for comment in the Federal Register on November 6, 2007.<sup>3</sup> On December 4, 2007, Nasdaq filed Amendment No. 1 to the proposed rule change.<sup>4</sup> The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change, as modified by Amendment No. 1 thereto.

II. Description of the Proposal

Nasdaq is proposing to amend its 1000 Series rules governing its membership application process to tailor the rules to proprietary trading firms. Under the proposed rule, a "proprietary trading firm" is defined as an applicant: (1) that is not required to

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

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

<sup>3</sup> See Securities Exchange Act Release No. 56722 (October 31, 2007), 72 FR 62709 ("Notice").

<sup>4</sup> In Amendment No. 1, Nasdaq corrected typographical errors and clarified that in Rule 1013(a)(1), an applicant should file an amendment to its membership application no later than 15 days after the applicant "knew or should have known" about facts and circumstances that gave rise to the need for the amendment. Because Amendment No. 1 is technical in nature, it is not subject to notice and comment.

become a member of the Financial Industry Regulatory Authority (“FINRA”) by Section 15(b)(8) of the Act<sup>5</sup> but is a member of another registered securities exchange not registered solely under Section 6(g) of the Act; (2) whose source of funds or proposed source of funds to be used for trading are the applicant’s own capital, traded through the applicant’s own accounts; (3) that does not, and will not have “customers”<sup>6</sup>; and (4) whose principals and representatives acting or to be acting in the capacity of a trader must be owners of, employees of, or contractors to the applicant.<sup>7</sup>

A. Required Information in the Application

Under the new application process, an applicant would be required to submit certain information in its application.<sup>8</sup> This information includes the following:

- a copy of the applicant’s current Form BD;
- an original Nasdaq-approved fingerprint card for each Associated Person who will be subject to Rule 17f-2 under the Act and for whom a fingerprint card has not been filed with another SRO;
- Nasdaq’s application fee;
- a description of the applicant’s proposed trading activities on Nasdaq;
- a copy of the applicant’s most recent audited financial statements and a description of any material changes in the applicant’s financial condition since the date of the financial statements;

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<sup>5</sup> 15 U.S.C. 78o(b)(8).

<sup>6</sup> The term “customer” does not include a broker or dealer. See Nasdaq Rule 0120(g).

<sup>7</sup> See proposed Nasdaq Rule 1011(o).

<sup>8</sup> See proposed Nasdaq Rules 1013(a)(1)(A) – (V). A more detailed description of the required information is described in the Notice, supra note 3.

- an organizational chart;
- the intended location of the applicant's principal place of business and all other offices, if any, whether or not such offices would be required to be registered under the Nasdaq Rules, and the names of the persons who will be in charge of each office;<sup>9</sup>
- a description of the communications and operational systems the applicant will employ to conduct business and the plans and procedures the applicant will employ to ensure business continuity;
- a copy of any decision or order by a federal or state authority or SRO taking permanent or temporary adverse action with respect to a registration or licensing determination regarding the applicant or an Associated Person;
- a statement indicating whether the applicant is currently or has recently been the subject of any investigation or disciplinary proceeding;
- a statement indicating whether any person listed on Schedule A of the applicant's Form BD (i.e., the direct owners and executive officers of the applicant) is currently or has recently been the subject of any investigation or disciplinary proceeding;
- a copy of any contract or agreement with another broker-dealer, a bank, a clearing entity, a service bureau or a similar entity to provide the applicant with services regarding the execution or clearance and settlement of transactions effected on Nasdaq;

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<sup>9</sup> Nasdaq believes that most proprietary trading firms will only have one office.

- if the applicant proposes to make markets on Nasdaq, a description of the source and amount of applicant's capital to support its market making activities on Nasdaq, and the source of any additional capital that may become necessary;
- a description of the financial controls to be employed by the applicant with respect to Nasdaq Rule 3011, which governs anti-money laundering controls;
- a copy of the applicant's written supervisory procedures with respect to the applicant's proposed trading activities on Nasdaq;
- a list of the persons conducting the applicant's market making and other trading activities, and a list of the persons responsible for such persons' supervision, together with the CRD number (if applicable) or a copy of Form U4 for each such person;
- unless previously provided to FINRA, a FINRA Entitlement Program Agreement and Terms of Use and an Account Administration Entitlement Form;
- a copy of the applicant's most recent "FOCUS Report" (Form X-17A-5) filed with the Commission;
- all examination reports and corresponding responses regarding the applicant for the previous two years from the SROs of which it is a member;
- an agreement to comply with the federal securities laws, the rules and regulations thereunder, the Nasdaq Rules, and all rulings, orders, directions, and decisions issued and sanctions imposed under the Nasdaq Rules;
- an agreement to pay such dues, assessments, and other charges; and

- other reasonable information with respect to the applicant as Nasdaq may require.

Applicants must keep their application current by submitting amendments if facts and circumstances change.<sup>10</sup> Nasdaq proposes to amend Rule 1013(a)(1) to require applicants to file amendments with Nasdaq no later than 15 business days after the applicant or Nasdaq member knew or should have known about the facts or circumstances giving rise to the need for the amendment. Nasdaq also amended Rule 1013(a)(1) to add that an applicant must promptly notify the Nasdaq Membership Department (“Department”)<sup>11</sup> of any material adverse change in financial condition.

B. Membership Admission Standard

Nasdaq proposes to amend the admission standard in Rule 1014. Currently, the Department must make specific findings in order to admit an applicant as a Nasdaq member. The proposed rule would allow the Department to approve an application unless there is a basis for denying or conditioning approval.<sup>12</sup> The proposed rule further provides that the Department may deny (or condition) approval of an applicant for the same reasons that the Commission may deny or revoke a broker-dealer’s registration and for those reasons required or allowed under the Act. The proposed rule lists specific bases upon which the Department may deny (or condition) approval of an applicant which include:<sup>13</sup> (1) inability of the applicant to satisfactorily demonstrate the capacity to

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<sup>10</sup> See Nasdaq Rule 1013(a)(1).

<sup>11</sup> The term includes FINRA staff acting on Nasdaq’s behalf.

<sup>12</sup> A similar change would be made in Nasdaq Rule 1017(g)(1)(A), providing that an application for a material change in business operations will be approved unless there is a basis for denying it under the standards in Rule 1014.

<sup>13</sup> See proposed Nasdaq Rule 1014(a)(2).

adhere to applicable Nasdaq and Commission policies, rules, and regulations, including, those concerning record-keeping, reporting, finance, and trading procedures; (2) past rule violations by the applicant and a reasonable likelihood that the applicant will again engage in acts or practices that violate any Nasdaq or Commission policies, rules, or regulations; (3) behavior in which the applicant engaged and the existence of a reasonable likelihood that the applicant will again engage in, acts or practices inconsistent with just and equitable principles of trade; (4) factors indicative of financial difficulties, such as not being in compliance with the Commission's net capital rule or having financial difficulties involving an amount that is more than 5% of the applicant's net worth; (5) the applicant is the subject of a current or recent bankruptcy proceeding; (6) the applicant has an established pattern of failure to pay just debts; (7) failure to have required governmental and SRO registrations; or (8) inability to demonstrate reasonably adequate systems capability and capacity.

The proposed rule would provide the Department with the discretion to conduct a membership interview if it determines an interview is necessary to clarify aspects of an application.<sup>14</sup> The proposed rule change also reduces the time allotted for various aspects of review, both for initial applications and for changes of ownership, control and business operations under Nasdaq Rule 1017.

C. Material Change in Business Operations

Currently, Nasdaq Rule 1017(a) provides that if there is a material change in business operations, the member will be required to file an application for approval that describes in detail the change in ownership, control, or business operations and include a

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<sup>14</sup> See proposed Nasdaq Rule 1013(b) (1).

business plan, pro forma financials, an organizational chart, and written supervisory procedures reflecting the change. The proposed rule change amends the definition of “material change in business operations” in Nasdaq Rule 1011(g) to include “adding business activities that would cause a proprietary trading firm no longer to meet the definition of that term...” If a proprietary trading firm seeks to expand its activities to include dealings with customers, the member would be required to undergo an assessment and obtain approval of this change under Nasdaq Rule 1017.

If a firm is required to become a FINRA member due to a change in ownership, control, or business operations, the amended rule provides that the Department is not required to take action on an application for approval under Rule 1017 until FINRA has acted on the application under its rule or the firm has become a FINRA member, as applicable.<sup>15</sup>

E. Other Changes

In addition, Nasdaq proposes to (1) amend Rule 1021 to provide that a proprietary trading firm with 25 or fewer registered representatives is required to have only one, rather than two registered principals; (2) eliminate the requirement that traders for proprietary trading firms register as equity traders under Nasdaq Rule 1032(f); (3) amend Rule 1150 to require that a firm’s executive representative under Nasdaq rules be the same as its executive representative under FINRA rules; and (4) amend Nasdaq Rule 1130 to provide that the names and addresses of executive representatives will not be available to members or the general public. Finally, the proposed rule change also makes

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<sup>15</sup> See proposed Nasdaq Rule 1017(g)(4).

conforming changes to provisions of Nasdaq rules 1014, 1015, and 1017 that refer to the standards for admission in Nasdaq Rule 1014.

### III. Discussion and Commission Findings

After careful consideration, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>16</sup> and, in particular, the requirements of Section 6 of the Act.<sup>17</sup> Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>18</sup> which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission has reviewed the provisions of the proposed rule change and believes that they are consistent with the requirements of the Act. In particular, the Commission believes that the proposed rule under which Nasdaq may deny or condition membership is reasonable and consistent with section 6(b)(5) of the Act in that it promotes just and equitable principles of trade and, in general, serves to protect investors and the public interest, and is also consistent with the grounds upon which an exchange

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<sup>16</sup> In approving this proposed rule change the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>17</sup> 15 U.S.C. 78f.

<sup>18</sup> 15 U.S.C. 78f(b)(5).



may deny or condition membership under section 6(c)(3) of the Act. The circumstances described in the proposed rule under which the Exchange may deny or condition membership address situations in which an applicant has failed to demonstrate the ability to comply with the financial and regulatory responsibilities necessary for Exchange membership. The Commission notes that these bases for denial of membership are similar to those of NYSE Arca, Inc. (“NYSE Arca”) and the International Securities Exchange, LLC (“ISE”) which were approved by the Commission.<sup>19</sup> The Commission also notes that an applicant who has been denied membership would always have the right to appeal that decision.<sup>20</sup>

In addition, the Commission believes that the proposal to amend the current membership application requirements which focus on a member’s relationship with its customers is appropriate because a proprietary trading firm, by definition, does not handle customer orders. Because Nasdaq’s rules provide that all applicants must already be a member either of FINRA, if they transact business with the public, or of another national securities exchange, which acts as an Examining Authority for purposes of Rule 15c3-1 under the Act<sup>21</sup>, the Commission believes the level of information required in the amended membership application is reasonable. As stated in the Nasdaq rules, if a Nasdaq member undergoes a material change in ownership, control, or business operations, the member will be required to file an application for approval and may need

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<sup>19</sup> See Securities Exchange Act Release Nos. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000); and 49718 (May 17, 2004), 69 FR 29611 (May 24, 2004). See also ISE Rule 302 (Denial or and Conditions of Becoming a Member); NYSE Arca Equities Rule 2.4 (Denial of or Conditions to ETPs).

<sup>20</sup> See 15 U.S.C. 78s(f).

<sup>21</sup> 17 CFR 240.15c3-1.

to register as a member of FINRA. Further, based on Nasdaq's representation that the proposal to reduce time allotted to review applications (for both initial applications and for changes of ownership, control and business operations) is due to centralizing the review of applications as well as the less complex nature of the applicant firms (i.e., proprietary trading firms and members of other SROs), the Commission believes that the reduction in review time is reasonable.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>22</sup> that the proposed rule change (File No. SR-NASDAQ-2007-085), as modified by Amendment No. 1 thereto, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>23</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>22</sup> 15 U.S.C. 78s(b)(2).

<sup>23</sup> 17 CFR 200.30-3(a)(12).