

All submissions should refer to File Number SR-CBOE-2007-89. 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 a.m. and 3 p.m. Copies of such 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 Number SR-CBOE-2007-89 and should be submitted on or before August 28, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Nancy M. Morris,**

*Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-56172; File No. SR-NASDAQ-2006-065]

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Approving Proposed Rule Change as Modified by Amendments No. 1, 3, and 4 Thereto To Reestablish a Quotation and Trading System, The PORTAL<sup>®</sup> Market, for Securities That Are Designated by Nasdaq as PORTAL Securities

July 31, 2007.

#### I. Introduction

On December 22, 2006, The NASDAQ Stock Market LLC ("Nasdaq" or "Exchange"), filed with the Securities and Exchange Commission ("SEC" or "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 reestablish a quotation and trading system, The PORTAL<sup>®</sup> Market ("PORTAL" or the "PORTAL Market"), for securities that are designated by Nasdaq as PORTAL securities. The system would allow PORTAL Participants<sup>3</sup> to trade with one another in a closed system. On March 6, 2007, Nasdaq filed Amendment No. 1 to the proposed rule change.<sup>4</sup> On April 3, 2007, Nasdaq filed Amendment No. 3 to the proposed rule change. The proposed rule change was published for comment in the **Federal Register** on May 1, 2007.<sup>5</sup> The Commission received seven comment letters on the proposal from six commenters.<sup>6</sup> On July 16, 2007, Nasdaq filed Amendment No. 4 to the proposed rule change.<sup>7</sup> This order

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

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

<sup>3</sup> Defined *infra*.

<sup>4</sup> Amendment No. 2 was filed and withdrawn on April 3, 2007.

<sup>5</sup> See Securities Exchange Act Release No. 55669 (April 25, 2007), 72 FR 23874 (May 1, 2007) (the "Notice").

<sup>6</sup> See letters to Nancy M. Morris, Secretary, Commission, from NYPPEX, dated May 18, 2007; Lezlee Westine, President and CEO, TechNet, dated May 22, 2007; William J. Ginivan, General Counsel, Friedman, Billings, Ramsey & Co., Inc. ("FBR"), dated May 22, 2007 and July 18, 2007; Deborah L. Wince-Smith, President, Council on Competitiveness, dated May 25, 2007; and Mary Kuan, Managing Director and Assistant General Counsel, Securities Industry and Financial Markets Association ("SIFMA"), dated May 30, 2007. In addition, an individual affiliated with Morgan Stanley, John McGuire, submitted a general inquiry with respect to the filing via e-mail on May 9, 2007.

<sup>7</sup> In response to a comment made by SIFMA, in Amendment No. 4, Nasdaq amended proposed Rule 6513 (Compliance with Rules and Registration Requirements) so that it applies only to PORTAL Dealers and PORTAL Brokers. Nasdaq stated that

approves the proposed rule change, as amended.

#### II. Description of the Proposal

The National Association of Securities Dealers, Inc. ("NASD") created the PORTAL Market in 1990,<sup>8</sup> simultaneously with the SEC's adoption of Rule 144A ("Rule 144A") under the Securities Act of 1933 ("Securities Act"),<sup>9</sup> to be a new trading system for the purpose of quoting, trading, and reporting trades in securities eligible for resale by Qualified Institutional Buyers ("QIBs") under Rule 144A.<sup>10</sup>

The PORTAL Market did not develop as anticipated. The Exchange believes this is, in part, because PORTAL securities could only be traded in the PORTAL Market and the original PORTAL rules imposed trade reporting for all transactions in PORTAL securities at a time when there were no trade reporting requirements for privately-placed securities.<sup>11</sup> In addition, Nasdaq believes PORTAL did not develop because it required use of cumbersome technology for access to the PORTAL Market computer system for reporting purposes, which was a stand-alone computer system.

After nearly a decade, NASD filed a proposed rule change to delete many features of the PORTAL Market that had become obsolete including rules governing the registration of PORTAL Dealers, PORTAL Brokers, and PORTAL Qualified Investors and rules that were intended to regulate the quotation and

the inclusion of PORTAL Qualified Investors (defined *infra*) in this rule was an error. In addition, Nasdaq stated that PORTAL would not be operational for debt securities at this time. Once the necessary changes are in place, Nasdaq will file a proposed rule change stating when PORTAL will be available for debt trading. Finally, Nasdaq removed obsolete references in the PORTAL Rules to CINS. This is a technical amendment and is not subject to notice and comment.

<sup>8</sup> See Securities Exchange Act Release No. 27956 (April 27, 1990), 55 FR 18781 (May 4, 1990) (SR-NASD-88-23). The PORTAL Rules were subsequently amended. See Securities Exchange Act Release Nos. 28678 (December 6, 1990), 55 FR 51194 (December 12, 1990) (SR-NASD-90-50); 33326 (December 13, 1993), 58 FR 66388 (December 20, 1993) (SR-NASD-91-5); 34562 (August 19, 1994), 59 FR 44210 (August 26, 1994) (SR-NASD-94-39); 35083 (December 12, 1994), 59 FR 65104 (December 16, 1994) (SR-NASD-94-65); 40424 (September 10, 1998), 63 FR 49623 (September 16, 1998) (SR-NASD-98-68); 43873 (January 23, 2001), 66 FR 8131 (January 29, 2001) (SR-NASD-99-65); 44042 (March 6, 2001), 66 FR 14969 (March 14, 2001) (SR-NASD-99-66).

<sup>9</sup> See Securities Act Release No. 6862 (April 23, 1990), 55 FR 17933 (April 30, 1990).

<sup>10</sup> 17 CFR 230.144A.

<sup>11</sup> Currently, NASD Rule 6732 requires that transactions in PORTAL equity securities be reported to the OTC Reporting Facility and PORTAL debt securities be reported to the Trade Reporting and Compliance Engine Service ("TRACE").

<sup>16</sup> 17 CFR 200.30-3(a)(12).

trade reporting of PORTAL securities between PORTAL participants using the PORTAL system.<sup>12</sup> Following approval of this proposed rule change, Nasdaq's primary role in the PORTAL Market became designating securities as PORTAL eligible<sup>13</sup> which made those securities eligible for book entry services at The Depository Trust Company ("DTC").<sup>14</sup>

### Nasdaq's PORTAL Proposal

Nasdaq has proposed an updated version of the PORTAL Market, which would operate as a facility of the Exchange.<sup>15</sup> The proposed amendments to the PORTAL rules would: (i) Establish qualification requirements for brokers and dealers that are Nasdaq members, and QIBs<sup>16</sup> that wish to have

access to PORTAL; and (ii) implement quotation, trade negotiation, and trade reporting functions in the PORTAL Market for PORTAL-designated securities. Many of the rules proposed by Nasdaq are substantially the same as those approved by the Commission when the PORTAL Market was first implemented by NASD in 1990.<sup>17</sup> The proposed PORTAL Market, described in detail in the Notice, is summarized below.

**Security Designation:** PORTAL designation is limited to those Rule 144A securities that are initially sold to QIBs by a broker-dealer acting as initial placement agent or initial purchaser. Nasdaq would continue to qualify "restricted securities," as that term is defined in SEC Rule 144(a)(3),<sup>18</sup> and securities that are restricted pursuant to contract or through the terms of the security, for designation as PORTAL securities based on, among other things, the requirements for the resale of a security under Rule 144A(d)(3) and (d)(4).<sup>19</sup> Nasdaq would have authority under the PORTAL Rules to suspend or terminate the designation of a PORTAL security, thus removing the ability to negotiate trades in the security through PORTAL.

**Broker-Dealer Access:** Nasdaq members that meet the PORTAL qualification requirements would be designated as "PORTAL Dealers," who could trade as principal, and "PORTAL Brokers," who would act as agent for customers. PORTAL Dealers and PORTAL Brokers would be permitted to post anonymous one- or two-sided indicative quotations in PORTAL securities. In addition, PORTAL Dealers and PORTAL Brokers would be permitted to negotiate anonymously and execute trades in PORTAL securities.

**QIB Access:** An institution that executes a subscriber agreement, agrees to comply with the PORTAL rules and meets the \$100 million and other standards in Rule 144A to be a QIB would be qualified by Nasdaq as a "PORTAL Qualified Investor." PORTAL Qualified Investors would be permitted to access the PORTAL Market through a password protected linkage and view quotations of PORTAL Dealers and PORTAL Brokers, and confirm transactions when the PORTAL Qualified Investor uses a PORTAL

Dealer or PORTAL Broker to execute a trade in PORTAL. PORTAL Qualified Investors would not be permitted to enter quotations in the PORTAL system or enter orders directly into PORTAL.

**Trade Negotiation/Execution:** PORTAL has electronic negotiation features that allow PORTAL Dealers and PORTAL Brokers to negotiate both openly and anonymously and execute trades in PORTAL securities. All quotes in PORTAL would be indicative. PORTAL Qualified Investors would not be permitted to participate in negotiations. Once an anonymous trade was negotiated in PORTAL, the identity of the counter-parties would be revealed to each other for purposes of comparison, confirmation, and settlement of the trade.

**Trade Reporting:** Trade reports in reportable PORTAL debt and equity securities pursuant to NASD Rule 6732 would be forwarded by Nasdaq to TRACE and the OTC Reporting Facility, respectively.

**Dissemination of PORTAL Trade Report Information:** All trade report information for trades negotiated via PORTAL would be disseminated in PORTAL to PORTAL Brokers, PORTAL Dealers, and PORTAL Qualified Investors ("PORTAL Participants"), but would not include the identity of the parties and, in the case of PORTAL debt, would not aggregate or otherwise follow the dissemination protocols applicable to debt trades reported to TRACE.<sup>20</sup> PORTAL Participants would be prohibited from disclosing any PORTAL Market information, including quotations, transactions, and other information<sup>21</sup> displayed in the PORTAL Market ("PORTAL Market Information"), to any party other than another PORTAL Participant. Nasdaq would not disseminate PORTAL Market Information to the public.

**Settlement:** Trades in equity securities that have been compared and confirmed will be forwarded automatically to an appropriate subsidiary of Depository Trust & Clearing Corporation ("DTCC") for settlement. Nasdaq also intends, at a future date, to provide the ability to forward all PORTAL trades in debt securities to an appropriate subsidiary of DTCC for settlement.

**Regulatory Surveillance:** NASD currently provides and would continue

<sup>12</sup> See Securities Exchange Act Release No. 44042 (March 6, 2001), 66 FR 14969 (March 14, 2001) (order approving SR-NASD-99-66). In this order, the Commission also approved rules replacing NASD's trade reporting requirements with a requirement that NASD members submit trade reports of secondary market transactions in PORTAL-designated equity securities through the Automated Confirmation Transaction Service (now known as the OTC Reporting Facility) and in PORTAL U.S. high-yield debt securities through TRACE.

<sup>13</sup> Nasdaq staff historically had responsibility for review of PORTAL Market applications to determine the eligibility of securities and of PORTAL Participants (including broker-dealers and investors). Upon the separation of Nasdaq from the NASD and the approval of Nasdaq as a registered national securities exchange under Section 6 of the Act, the review functions for PORTAL Market eligibility were retained by Nasdaq, and the PORTAL Market rules in the NASD Rule 5300 Series became the Nasdaq Rule 6500 Series. See Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006).

<sup>14</sup> Securities Exchange Act Release No. 33327 (December 13, 1993), 58 FR 67878 (December 22, 1993) (order approving a proposed rule change that authorized DTC to make securities sold pursuant to Rule 144A depository eligible provided that such securities are designated for inclusion in a system of a self-regulatory organization ("SRO") approved by the Commission for the reporting of quotation and trade information on Rule 144A transactions).

<sup>15</sup> Because the PORTAL Market is a facility of Nasdaq, trades done on the PORTAL Market could be considered trades done on a national securities exchange and thus would be subject to Section 12(a) of the Exchange Act. This section provides that it "shall be unlawful for any member, broker or dealer to effect any transaction in any security (other than an exempted security) on a national securities exchange unless a registration is effective as to such security." 15 U.S.C. 78l(a). Section 12(b) of the Act provides all equity and debt securities must be registered before such securities may be traded on a national securities exchange, unless they are "exempted securities" or are otherwise exempt from Exchange Act registration requirements. In order to trade unregistered 144A securities on the PORTAL Market, Nasdaq requested, and the Commission provided, exemptive relief pursuant to Section 36 of the Exchange Act from Section 12(a) of the Exchange Act to permit Nasdaq members to trade PORTAL-designated securities that are not registered under Section 12(b) of the Exchange Act. See note 55, *infra*.

<sup>16</sup> The requirements for QIBs are set forth in Rule 144A.

<sup>17</sup> See note 8, *supra*.

<sup>18</sup> 17 CFR 230.144(a)(3).

<sup>19</sup> 17 CFR 230.144A(d)(3) and (d)(4). Nasdaq has represented that in the future, it will consider allowing Regulation D securities to participate in PORTAL so long as PORTAL Market Information would continue to be available only to PORTAL Participants. See Response to Comments, *infra* note 29, at 3.

<sup>20</sup> See Notice, 72 FR at 23877. To quote, execute, and view trade report information on any Rule 144A investment-grade debt security in PORTAL, the security must be qualified as a PORTAL security. Trade report information on Rule 144A investment-grade debt that is not a PORTAL security cannot be viewed in PORTAL.

<sup>21</sup> "Other information" may include information such as which other PORTAL Participants are in the system, for example.

to provide surveillance of the trade reports in PORTAL securities that are submitted through TRACE and the OTC Reporting Facility. Real-time surveillance of quoting and trading activity in PORTAL will be conducted by Nasdaq's MarketWatch Department.

**SEC Exemptions:** Nasdaq has requested exemptions and no-action relief so that the PORTAL Market can operate as described in this filing.<sup>22</sup> In summary, Nasdaq requested the following exemptions: Rule 15c2-11 under the Act to allow broker-dealers to post quotations in PORTAL securities without gathering the information required by that rule;<sup>23</sup> Section 12(a)<sup>24</sup> of the Act which requires securities traded on a national securities exchange to be registered, to permit Nasdaq members to trade securities that are not registered under section 12(b) of the Act;<sup>25</sup> and staff no-action relief from Section 12(g) of the Act<sup>26</sup> to permit foreign private issuers to continue to be eligible for the exemption under Rule 12g3-2(b) under the Exchange Act.<sup>27</sup>

### III. Comments

Seven comment letters were received on the proposal. The letters from NYPPEX, TechNet, and the Council on Competitiveness expressed general support for the proposal.<sup>28</sup> The letters from SIFMA and FBR raised questions and issues discussed below. Nasdaq responded to those comments.<sup>29</sup>

#### A. SIFMA

In its comment letter, SIFMA sought clarification on numerous points, including: trade reporting (the scope of information that would be reported,

who would be responsible for submitting the information, and the timing of submission); the information that would be disseminated to PORTAL Participants; the role of third-party vendors in the dissemination of PORTAL Market Information; the extent to which PORTAL Qualified Investors would have direct access to the trading and negotiation functionality of PORTAL; and the rationale for limiting order size. In its Response to Comments, Nasdaq provided further explanation and details regarding these points.<sup>30</sup>

SIFMA expressed concern regarding dissemination of PORTAL Market Information. SIFMA requested that Nasdaq consider whether dissemination of any trade information regarding PORTAL securities is necessary or beneficial and whether such dissemination would negatively affect liquidity and the willingness of investors to commit capital in unregistered securities. Nasdaq responded, in part, that it believes dissemination of information to PORTAL Participants is likely to increase their ability to make better informed decisions, thereby increasing confidence and liquidity in the market for 144A securities.

SIFMA also suggested that if trade report information is to be disseminated to PORTAL Participants, dissemination should follow protocols currently applicable to trade report information provided to TRACE<sup>31</sup> and the OTC Reporting Facility to avoid immediately exposing "trading patterns and intentions of market participants." Nasdaq responded that it disagrees and does not believe dissemination of transaction information should be restricted based on limits or time periods applicable to TRACE or the OTC Reporting Facility, because participation in PORTAL is voluntary, and PORTAL Participants know that their trades will be immediately disseminated to other PORTAL Participants and, if required, reported for regulatory purposes.<sup>32</sup>

SIFMA also raised concerns with respect to regulatory jurisdiction. First, SIFMA encouraged Nasdaq, the NASD, and the SEC to work together with respect to PORTAL to avoid overlapping and potentially inconsistent regulation. Nasdaq stated it agrees that regulatory inconsistencies should be avoided where possible, and noted that the proposal is not expected to materially increase any such burdens.

Next, SIFMA took issue with the requirement that access to the system as a PORTAL Broker or PORTAL Dealer is limited to Nasdaq members and sought clarification of Nasdaq's scope of authority over PORTAL Qualified Investors under proposed Rule 6513 (Compliance with Rules and Registration Requirements). Nasdaq noted that since PORTAL is a trading facility of the Nasdaq exchange, execution access to its system must be limited to Nasdaq members registered as PORTAL Brokers and PORTAL Dealers. Nasdaq has limited authority over non-members.

With regard to SIFMA's request for clarification regarding the appropriate scope of Nasdaq's authority over PORTAL Qualified Investors, Nasdaq acknowledged that its regulatory authority over those participating in PORTAL is limited to PORTAL Brokers and PORTAL Dealers, as these would be the only PORTAL Participants that are required to be Nasdaq members and thus subject to Nasdaq's regulatory jurisdiction. Nasdaq stated that it had included PORTAL Qualified Investors in the rule in error. In Amendment No. 4, Nasdaq amended Rule 6513 to reflect that Nasdaq's authority to discipline a participant for failure to comply with any of the rules or requirements applicable to the PORTAL Market extends only to PORTAL Brokers and PORTAL Dealers. Nasdaq does not have authority to discipline PORTAL Qualified Investors that are not Nasdaq members. It can enforce, however, the PORTAL rules through its ability to approve, deny, suspend or terminate the registration of an investor as a PORTAL Qualified Investor.<sup>33</sup>

Finally, SIFMA argued that the subscriber and related agreements should be included in the proposal. Nasdaq stated that the SEC does not routinely require commercial agreements of an SRO to be filed, and Nasdaq believes that nothing in the present proposal should require inclusion of these agreements. SIFMA commented that Nasdaq should make its exemptive requests public so that its members may review the legal analysis

<sup>22</sup> In connection with its approval of PORTAL in 1990 (see note 8, *supra*), the Commission issued similar exemptions. See letter to Frank J. Wilson, Executive Vice President and General Counsel, NASD ("Wilson"), from Mary E.T. Beach, Associate Director, Division of Corporation Finance, Commission, dated January 16, 1990, and letter to Wilson from Jonathan G. Katz, Secretary, Commission, dated April 27, 1990.

<sup>23</sup> 17 CFR 240.15c2-11. See letter from Thomas P. Moran, Associate General Counsel, Nasdaq, to James A. Brigagliano, Assistant Director, Division of Market Regulation, Commission, dated June 28, 2007.

<sup>24</sup> 15 U.S.C. 78l(a).

<sup>25</sup> 15 U.S.C. 78l(a) and 15 U.S.C. 78l(b). See letter to Nancy M. Morris, Secretary, Commission, from Thomas P. Moran, Associate General Counsel, Nasdaq, dated June 28, 2007.

<sup>26</sup> 15 U.S.C. 78l(g).

<sup>27</sup> 17 CFR 240.12g3-2(b). See letter to Paul Dudek, Chief Counsel, Division of Corporation Finance, Commission, from Thomas P. Moran, Associate General Counsel, Nasdaq, dated July 24, 2007.

<sup>28</sup> Mr. McGuire submitted a one-line, non-substantive e-mail regarding the proposal.

<sup>29</sup> See letters to Nancy M. Morris, Secretary, Commission, from Thomas P. Moran, Associate General Counsel, Nasdaq, dated June 28, 2007 and July 23, 2007 ("Response to Comments").

<sup>30</sup> See Response to Comments, *supra* note 29, at 2-4 and 7-8.

<sup>31</sup> SIFMA states that TRACE provides that the volumes for investment grade securities are capped at five million, and volumes for non-investment grade securities are capped at one million.

TRACE does not provide information on mortgage- or asset-backed securities or collateralized mortgage obligations. See NASD Rule 6710. NASD Rule 6230 requires that trades be reported with 15 minutes.

<sup>32</sup> Nasdaq stated that it is willing to consider modifying the dissemination parameters of PORTAL debt trades in the system to follow current TRACE standards where the quantity for individual debt trades disseminated is capped at five million for investment-grade securities, and one million for non-investment grade securities. See Response to Comments, *supra* note 29, at 3.

<sup>33</sup> See Proposed Rule 6506(c).

and policy basis for those requests. Nasdaq declined and noted that it is not the general practice of the SEC to seek public comment on exemptions, and Nasdaq does not believe that the Commission needs to do so for this proposal.

#### B. FBR

FBR's comments focused on three areas: The PORTAL Qualified Investor concept; accredited investors; and depository eligibility.

First, FBR argues that limiting participation in the PORTAL Market to PORTAL Qualified Investors, and limiting access to PORTAL Market Information to those participants, will create a hidden market. FBR believes that PORTAL Brokers and PORTAL Dealers should be permitted to share PORTAL Market Information with anyone who is eligible to sell restricted shares pursuant to Rule 144A, including Accredited Investors and all QIBs. FBR states that its inability to share PORTAL Market Information with its customers is in conflict with its obligations under the securities laws and rules and NASD Rules, to treat customers, who are qualified to buy and sell under Rule 144A, fairly.

Nasdaq responds that nothing in its proposal prevents FBR from sharing PORTAL Market Information with its QIB customers so long as those customers are qualified as PORTAL Qualified Investors by Nasdaq. Nasdaq states that the limitation exists to ensure that Nasdaq has reasonable procedures to prevent pricing information from reaching non-QIBs, given that it is an SRO responsible for enforcing its rules. Further, Nasdaq notes that the dissemination by PORTAL Dealers and PORTAL Brokers of PORTAL Market quotations and last sale report information of other PORTAL Dealers and PORTAL Brokers to investors not qualified by Nasdaq could constitute a prohibited general solicitation under Rule 144A.

Nasdaq does, however, agree that restrictions on dissemination of PORTAL Market Information could prohibit a PORTAL Dealer from sharing its own quote in a PORTAL security with its own customers.<sup>34</sup> Nasdaq stated it would consider how to modify the rules before PORTAL is operational so that restrictions on transmission of PORTAL information do not apply to a PORTAL Dealer's provision of its proprietary quote information to an

established customer of that dealer,<sup>35</sup> however, FBR argues that this is not an acceptable modification because it could result in a situation in which a PORTAL Broker or PORTAL Dealer is permitted to disclose to its customers certain prices that are available but are not the best price if the PORTAL Broker or PORTAL Dealer is not itself quoting at the best price. Further, FBR notes, the modification would not permit disclosure of last sale information. FBR believes that such a result would not be in the best interest of investors and could violate a broker-dealer's duty of fair dealing and subject them to liability under Rule 10b-5 under the Exchange Act.

FBR also believes that Nasdaq's proposed requirement that QIBs be approved by Nasdaq in order to have access to PORTAL Market Information is a departure from the PORTAL Rules that were approved by the Commission when the PORTAL Market was first established.<sup>36</sup> Nasdaq notes that PORTAL will operate under uniform, explicit standards governing access and information receipt, and a QIB would incur only modest costs to become a PORTAL Qualified Investor if it wants access to PORTAL Market Information. Further, Nasdaq points out that the original PORTAL Market was intended to be an entirely "closed" system. Investors were only permitted to execute a transaction in a PORTAL security if the investor registered as a PORTAL Qualified Investor and then executed the transaction through a PORTAL Dealer or PORTAL Broker through the PORTAL system. Therefore, Nasdaq argues, there was no need in the original PORTAL system to restrict the dissemination of PORTAL Market Information outside of the PORTAL Market.

Finally, FBR argues that depository eligibility of a security should not be premised on PORTAL eligibility. FBR argues that DTC's rule requiring Rule 144A securities to be included in an SRO system for the reporting of quotation and trade information of resale transactions, in order for those securities to be eligible for DTC's depository services is unnecessary and could impede competition between Nasdaq and alternative trading systems ("ATSS"). Currently, PORTAL is the only facility that satisfies the eligibility standard. Nasdaq disagrees and points out that nothing in DTC's rules would preclude another SRO from establishing and operating a system for quoting,

trading, and reporting Rule 144A securities and thereby be eligible to obtain DTC's depository services on behalf of such securities.

#### IV. Discussion and Commission Findings

##### A. Sections 6 and 11A(a)(1) of the Act

After careful consideration of the proposal, the comment letters, and Nasdaq's Response to Comments, the Commission finds that the proposed rule change is consistent with the provisions of section 6 of the Act,<sup>37</sup> in general and with section 6(b)(5) of the Act,<sup>38</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to a free and open market and a national market system, and, in general, to protect investors and the public interest. The PORTAL Market will facilitate the trading of Rule 144A securities and will provide a centralized system for the display of interest in Rule 144A securities. Rule 144A(d) conditions the exemption from registration of securities pursuant to Section 5 of the Securities Act<sup>39</sup> on offering and selling the securities only to QIBs. Consequently, Nasdaq structured the PORTAL Market as a closed system for trading of Rule 144A securities among QIBs. Nasdaq has implemented procedures to qualify QIBs under its rules. In light of Nasdaq's procedures as described in the proposed rule change, PORTAL Participants may rely on Nasdaq's procedures for establishing a reasonable belief that a prospective purchaser is a QIB.<sup>40</sup>

In addition, the Commission believes that the proposed rule change is consistent with the goals of section 11A(a)(1) of the Act.<sup>41</sup> Section 11A(a)(1) articulates the Congressional findings and policy goals and objectives respecting the development of a national market system. Essentially, Congress found that new data processing and communication techniques should be applied to improve the efficiency of market operations, broaden the distribution of market information, enhance opportunities to achieve best execution

<sup>37</sup> 15 U.S.C. 78f.

<sup>38</sup> 15 U.S.C. 78f(b)(5).

<sup>39</sup> 15 U.S.C. 77e.

<sup>40</sup> If all the conditions in Rule 144A(d) are not met, transactions in restricted securities may be deemed distributions and persons offering or selling such securities may be deemed underwriters within the meaning of Sections 2(a)(11) and 4(1) of the Securities Act or a participant in a distribution of securities with the meaning of Section 4(3)(C) of the Securities Act. See discussion at nn. 9-13, *supra*.

<sup>41</sup> 15 U.S.C. 78k-1(a)(1).

<sup>34</sup> See Response to Comments, *supra* note 29, at 10.

<sup>35</sup> *Id.* Any such change must be filed as a proposed rule change with the Commission.

<sup>36</sup> See note 6, *supra*.

and promote competition among market participants. That provision stresses the importance of implementing communication enhancements that will advance the efficiency and effectiveness of a securities market in servicing the needs of investors. The Commission believes that the changes to the PORTAL Market contained in this proposed rule change should provide these benefits and help to enhance the efficiency of the market for Rule 144A-eligible securities.

#### *B. Rule 144A Under the Securities Act*

Because Nasdaq has designed the amendments to the PORTAL Market to facilitate compliance with Rule 144A, section 6(b)(1) of the Act<sup>42</sup> also requires a determination as to whether it is reasonably designed to accomplish this purpose.<sup>43</sup> The Commission believes that the PORTAL system is designed so that participants who comply with its requirements will also be in compliance with the requirements of Rule 144A, assuming they also provide information upon request in compliance with Rule 144A(d)(4).

Rule 144A is available only to institutional investors meeting the definition of QIB in Rule 144A(a)(1). A seller is required to form a reasonable belief that a purchaser is a QIB as the term is defined in Rule 144A(a)(1). With the exception of broker-dealers, a QIB is required to, in the aggregate, own and invest on a discretionary basis at least \$100 million in securities of non-affiliated issuers. The proposed amendments to the PORTAL rules require that any investor applying to qualify as a PORTAL Qualified Investor meet the Rule 144A standards for QIBs.

Rule 144A(d)(2) requires that the seller of 144A securities take reasonable steps to ensure that the purchaser is aware that the seller may rely on Rule 144A. To meet this requirement of Rule 144A, the proposed amendments to the PORTAL rules also provide in the designation requirements for PORTAL Qualified Investors that applicants sign an undertaking in a subscriber agreement that states that they are aware that they may purchase a PORTAL security from another QIB who may rely on an exemption from the provisions of section 5 of the Securities Act<sup>44</sup> pursuant to Rule 144A.

The PORTAL rules also have eligibility requirements for admitting

securities into PORTAL that parallel the Rule 144A eligibility requirements for securities. The PORTAL rules require that the security be eligible to be sold pursuant to Rule 144A under the Securities Act. The application for designation of a PORTAL security requires the submission of specific information to Nasdaq necessary to support the applicant's claim that the security meets the requirements of Rule 144A.

Furthermore, Rule 144A conditions the availability of the exemption on certain information being available to holders and prospective purchasers. Rule 144A(d)(4) provides that, with respect to securities of an issuer that is not subject to section 13 of the Act,<sup>45</sup> section 15(d) of the Act,<sup>46</sup> exempt from reporting pursuant to Rule 12g3-2(b) under the Act,<sup>47</sup> or a foreign government eligible to register securities under Schedule B of the Securities Act, the holder and a prospective purchaser designated by the holder must have the right to obtain from the issuer, upon request of the holder, and the purchaser must have received at or prior to the time of sale, upon such purchaser's request to the holder, certain information about the issuer. Nasdaq has designed PORTAL to comply with this aspect of Rule 144A because the PORTAL rules currently require that a security meet these Rule 144A requirements and that the issuer undertake to provide the information required by Rule 144A(d)(4) where applicable.

PORTAL is designed to be a trading market in restricted securities limited to highly sophisticated investors. In adopting Rule 144A, the Commission noted that "[t]he transactions covered by the safe harbor are private transactions" that do not require the protections of section 5 of the Securities Act.<sup>48</sup> The Commission believes that broad dissemination of trading information in this limited context is not desirable. Nasdaq's restricting the information to PORTAL Qualified Investors to allow Nasdaq to prevent PORTAL Market Information from reaching non-QIBs in this context is reasonable.

In addition to designing the PORTAL rules to facilitate compliance with the requirements of Rule 144A, the proposed rule change would structure PORTAL to limit the possibility that restricted securities enter the U.S. retail market by requiring that PORTAL-

designated securities be assigned a CUSIP<sup>49</sup> number that is different than the CUSIP number assigned to any securities of the same class that do not satisfy the eligibility requirements for PORTAL securities. The security explanation protocol employed by Standard & Poor's related to the CUSIP number assigned to PORTAL securities specifically distinguishes those securities from all other publicly-traded and restricted securities by using the words "Rule 144A" and "PORTAL." For these reasons, the Commission believes that PORTAL, as proposed, is reasonably designed to facilitate compliance with Rule 144A, so long as there is compliance with the PORTAL rules and procedures.<sup>50</sup>

#### *C. Exemptions and No-Action Relief Requests*

The Commission has granted Nasdaq exemptions from Rule 15c2-11 under the Act<sup>51</sup> to allow brokers and dealers to post quotations in PORTAL securities without first gathering information required by that rule<sup>52</sup> and Section 12(a)<sup>53</sup> of the Act to permit trading of securities not registered under section 12(b)<sup>54</sup> of the Act;<sup>55</sup> and the staff has granted no-action relief with respect to section 12(g)<sup>56</sup> of the Act to permit foreign private issuers to continue to be eligible for the exemption under Rule 12g3-2(b)<sup>57</sup> of the Act.<sup>58</sup>

#### *D. Impact on Competition, Efficiency and Capital Formation*

Section 3(f) of the Act requires that the Commission consider whether Nasdaq's proposal will promote efficiency, competition, and capital

<sup>49</sup> Committee on Uniform Securities Identification Procedures.

<sup>50</sup> The Commission notes that information shall still be provided on request, regardless of the exemption for PORTAL securities, as applicable, pursuant to Rule 144A(d)(4). Further, Rule 6502 authorizes Nasdaq to suspend or terminate a security's PORTAL designation if a holder or prospective purchaser did not receive information as required by Rule 144A(d)(4).

<sup>51</sup> 17 CFR 240.15c2-11.

<sup>52</sup> See letter from James A. Brigagliano, Associate Director, Division of Market Regulation, Commission, to Thomas P. Moran, Associate General Counsel, Nasdaq, dated July 31, 2007.

<sup>53</sup> 15 U.S.C. 78(b)(a).

<sup>54</sup> 15 U.S.C. 78(b)(b).

<sup>55</sup> See Securities Exchange Act Release No. 56176, (July 31, 2007), Order Granting The NASDAQ Stock Market, LLC's Application for an Exemption Pursuant to Section 36 of the Securities Exchange Act of 1934 ("Exemption Order").

<sup>56</sup> 15 U.S.C. 78(g).

<sup>57</sup> 17 CFR 240.12g3-2(b).

<sup>58</sup> See letter from Paul Dudek, Chief, Office of International Corporate Finance, Division of Corporation Finance, Commission, to Thomas P. Moran, Associate General Counsel, Nasdaq, dated July 31, 2007.

<sup>42</sup> 15 U.S.C. 78f(b)(1).

<sup>43</sup> Section 6(b)(1) of the Act requires that Nasdaq, as a national securities exchange, be so organized and have the capacity to enforce compliance with, among other things, the federal securities laws. See 15 U.S.C. 78f(b)(1).

<sup>44</sup> 15 U.S.C. 77(e).

<sup>45</sup> 15 U.S.C. 78m.

<sup>46</sup> 15 U.S.C. 78o(d).

<sup>47</sup> 17 CFR 240.12g3-2(b).

<sup>48</sup> See note 9, *supra*.

formation.<sup>59</sup> The Commission has considered the merits of the issues raised by each of the commenters and has concluded that the PORTAL rules, as proposed, are consistent with the Act.

The Commission notes that in its response to comments, Nasdaq provided SIFMA with additional information regarding the operation of the PORTAL Market and believes Nasdaq sufficiently responded to SIFMA's comments. The Commission agrees with Nasdaq, in particular, that the prompt and complete dissemination of PORTAL Market Information to PORTAL Participants should allow PORTAL Participants to better evaluate their decisions regarding trading in the PORTAL Market and should result in increased investor confidence and liquidity in the PORTAL Market. The Commission also notes that if a PORTAL Participant does not want its trade information disseminated to other PORTAL Participants, there is no requirement that the Participant utilize Nasdaq's system for effecting its trade; use of the PORTAL Market is voluntary. Furthermore, the Commission agrees that Nasdaq need not make the subscriber and related agreements part of this proposal, nor does Nasdaq need to make its exemption requests public.

The Commission does not believe that Nasdaq's proposal is anti-competitive because of the eligibility standard in DTC's rules. Nasdaq does not have any authority with respect to DTC's rules. DTC's rules provide that DTC is authorized to make 144A securities eligible for deposit, book-entry delivery, and other depository services, *provided that* any such Rule 144A securities are designated for inclusion in a system of an SRO approved by the Commission for the reporting of quotation and trade information of Rule 144A transactions.<sup>60</sup> In approving the proposed rule change establishing the DTC eligibility requirement that Rule 144A securities must be included in an SRO Rule 144A System, such as the PORTAL Market, the Commission noted a crucial feature of any such system would be a requirement that the SRO's members report trades involving securities using the system on a routine basis to the SRO, along with information that will facilitate detection of securities law violations.<sup>61</sup>

The Commission believes that re-establishing the PORTAL Market as a quoting and trading system is a reasonable effort by Nasdaq to enhance the quality of the Rule 144A market by providing a centralized market and information to QIBs, promoting greater efficiency in executions, and increasing overall market transparency. While the PORTAL Market will provide a system for quoting and trading Rule 144A securities, it does not represent an exclusive means for selling or purchasing Rule 144A securities, nor does it prevent broker-dealers from seeking alternative trading venues for such transactions.

## V. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>62</sup> that the proposed rule change (SR-NASDAQ-2006-065), as amended, be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>63</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

[FR Doc. E7-15288 Filed 8-6-07; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-56175; File No. SR-NASD-2007-055]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc. (n/k/a Financial Industry Regulatory Authority, Inc.); Notice of Filing of Proposed Rule Change Relating to Interpretative Material 9216, Violations Appropriate for Disposition Under Plan Pursuant to SEC Rule 19d-1(c)(2)

July 31, 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 July 24, 2007, 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, II, and III below, which Items have been substantially prepared by NASD.<sup>3</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 Interpretative Material 9216 (Violations Appropriate for Disposition Under Plan Pursuant to SEC Rule 19d-1(c)(2)) ("IM-9216") to expand the list of violations eligible for disposition under NASD's Minor Rule Violation Plan ("MRVP"). The proposed rule change also would delete from IM-9216 references to NASD rules that have been rescinded. The text of the proposed rule change is available at NASD, the Commission's Public Reference Room, and <http://www.finra.org>.

### 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

On November 28, 2006, NASD and the NYSE Group, Inc. ("NYSE Group") announced a plan to consolidate their member regulation operations into a combined organization (the "Transaction") that will be the sole U.S. private-sector provider of member firm regulation for securities firms that do business with the public.<sup>4</sup> This consolidation will streamline the broker-dealer regulatory system, combine technologies, permit the establishment of a single set of rules and group examiners with complementary

name change to the Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Securities Exchange Act Release No. 56146 (July 26, 2007).

<sup>4</sup> On July 26, 2007, the Commission approved amendments to NASD's By-Laws to implement governance and related changes to accommodate the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Securities Exchange Act Release No. 56145 (July 26, 2007).

<sup>59</sup> 15 U.S.C. 78c(f).

<sup>60</sup> See Securities Exchange Act Release No. 33327 (December 13, 1993); 58 FR 57878 (December 22, 1993) (SR-DTC-90-06).

<sup>61</sup> Given the evolution in the market for these securities since DTC's rule was adopted, the Commission believes it would be reasonable for DTC to review this requirement.

<sup>62</sup> 15 U.S.C. 78s(b)(2).

<sup>63</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD's Certificate of Incorporation to reflect its