

section 12(f)(2) and (f)(3) of the Act¹⁸ to prohibit the launch or continuation of Nasdaq trading by any market that fails to protect investors as required under the Act.

Each of Nasdaq's proposals is set forth in great detail below.

A. Uniform Trading Rules

Nasdaq requests that the Commission act immediately to establish uniform trading rules and ensure equal surveillance and enforcement of those rules because of its concern that investors are potentially harmed by the lack of uniform trading rules and from unequal surveillance and enforcement of rules.¹⁹ Nasdaq states that it attempted, unsuccessfully, to persuade the other exchanges that trade Nasdaq stocks to act jointly to adopt uniform market rules and surveillance and enforcement mechanisms to eliminate these regulatory disparities.

Specifically, Nasdaq asked that the UTP Plan be amended to prohibit certain defined conduct. Under that proposal, so-called Prohibited Conduct would have included, without limitation: any activity that is prohibited by any provision of the Act or rule adopted under the Act, market manipulation, illegal short selling, insider trading, fraud, front running, marking the open or the close, and non-compliance with the limit order display rule, and firm quote rule.²⁰ Nasdaq believes that to prevent regulatory arbitrage all SROs' rulebooks should contain uniform rules on these matters, and that each SRO should vigorously surveil and enforce those uniform rules.

For example, Nasdaq claims that although it has a short-sale rule, several UTP Exchanges trade Nasdaq issues with no short-sale price test. Nasdaq asserts that industry participants route short-sale orders to exchanges without short-sale rules specifically to avoid NASD and Nasdaq rule restrictions. Nasdaq claims that certain exchanges publicize this disparity to attract order flow to their markets.

In addition, Nasdaq concludes, after review of the rulebooks of various markets, that no other market currently executing trades in Nasdaq-listed securities has rules requiring its members to report order audit trail information or operates a Commission-approved order audit trail. Nasdaq

collects order audit trail information through its Order Audit Trail System ("OATS") and through its Automated Confirmation Transaction service ("ACT"). Nasdaq asserts that the NASD uses this data to create a fully integrated audit trail of quotes, trades, and orders to run its surveillance programs to detect insider trading, fraud, best execution violations, spoofing, purposeful late trade reporting, short-sale violations, untimely execution of market orders, and a wide variety of other potential rule violations.

For transactions reported away from Nasdaq, Nasdaq states that the NASD eventually receives the quotes and trade reports of the regional exchanges through the ISG. However, Nasdaq claims that the ISG audit trail only provides trade information at the clearing firm level (as opposed to both the clearing firm and the executing firm levels). In addition, according to Nasdaq, the time fields in the data are not generated by clocks subject to uniform synchronization protocols, as is the case with OATS data. Moreover, Nasdaq states that ISG data is not provided in a format that is conducive to integration into NASD's automated surveillance systems. As a result, manually processing this information can be time-intensive; furthermore, Nasdaq states that this data is not received until two days after the trade date. Nasdaq believes that such a delay can significantly hinder NASD's ability to investigate unlawful trading activity on a real-time basis and can prevent NASD from obtaining non-stale regulatory information in an ongoing investigation. The NASD uses this information to detect violations involving wash sales, fraud, insider trading, marking the close, best execution, riskless principal trade reporting, Regulation M, firm quote compliance, and limit order protection, among others.²¹

At a more fundamental level, Nasdaq believes that consolidated regulation protects investors better than the coordinated regulation that ISG facilitates. In addition, Nasdaq believes that consolidated regulation should be crafted by the entities that will be governed. ISG is a voluntary organization whose membership includes SROs (only some of which trade Nasdaq-listed securities) and certain foreign entities that are not regulated as SROs by the Commission.

²¹ Nasdaq states that on an average day, OATS processes 65 million order reports and that NASD currently has six full time staff members dedicated to OATS compliance.

To combat these perceived problems, Nasdaq asks the Commission, at a minimum, to add to the rules of all SROs that trade Nasdaq-listed securities, rules requiring an electronic audit trail identical to the NASD's OATS Rules²² and short-sale restrictions similar to NASD Rule 3350. Nasdaq also asks that, if the Commission's review of other markets' rules, surveillance, or enforcement reveals inequalities that can be addressed through the adoption of uniform rules, the Commission add those rules as well, to ensure that there are no regulatory inconsistencies among SROs that trade Nasdaq-listed securities.

Request for Comments on the Need for Uniform Trading Rules and Surveillance

The Commission welcomes comment on all aspects of Nasdaq's petition, including the following matters:

Q1. Do commenters agree with Nasdaq that there is unequal regulation of trading in Nasdaq securities?

Q2. Should all exchanges and associations trading Nasdaq securities have rules requiring detailed audit trail information?

Q3. Should all exchanges and associations trading Nasdaq securities be required to automate their surveillance and examination of Nasdaq trading on their markets?

Q4. Should all exchanges and associations trading Nasdaq securities have similar rules to regulate short selling?

Q5. What other trading rules should be uniform across all markets?

Q6. How should the Commission address any regulatory gaps that can arise when trading in the same security is fragmented across different SROs?

Q7. To what extent is ISG a useful mechanism for coordinating intermarket regulatory efforts? Does ISG fully address the regulatory gaps Nasdaq contends exist? Does the fact that the Commission does not have direct oversight of ISG limit the sufficiency of the ISG framework in ensuring adequate regulation of violative conduct in the trading of Nasdaq securities that can occur across markets, such as insider trading or certain market manipulations?

Q8. Are there models sufficient to address potential concerns raised by fragmentation of regulation by multiple SROs trading Nasdaq securities?

Q9. Are there advantages or disadvantages to a single market regulator with regulatory oversight across all markets trading Nasdaq securities?

²² See NASD Rules 6951 through 6957.

¹⁸ 15 U.S.C. 78l(f)(2), (f)(3).

¹⁹ Nasdaq discussed in greater details its views about the harmful regulatory arbitrage that occurs when markets apply different trading rules to the same conduct in its Regulation White Paper.

²⁰ Most members of the UTP Operating Committee asserted that the Nasdaq UTP Plan was not the proper forum for resolving regulatory issues.