

(1) In transactions between two members, only the member representing the sell side shall report.

(2) In transactions between a member and a customer, the member shall report.

(3) *In transactions conducted through an ACT ECN (as defined in Rule 6110), the ACT ECN shall ensure that the transactions are reported in accordance with Rule 6130(c); provided that for purposes of Rule 6130(c)(5)(B) and (C), the party with the reporting obligation shall be as set forth in Rule 6130(c)(3) and the term "Order Entry Firm" as used in such rule shall be construed to refer to any member.*

(c)-(e) No change.

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq 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. Nasdaq 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

Nasdaq is proposing to adopt rules to define with greater clarity the reporting obligations applicable to transactions executed through ECNs that are reported to ACT. The proposal is based on Nasdaq's understanding of the different methods used by ECNs today to report trades, and in general, the rule filing is not intended to require ECNs to modify their current trade reporting practices. Rather, the purpose of the filing is to codify these practices in the form of clear, enforceable rules that will provide greater guidance to market participants.⁴ The proposed rule change would apply to transactions in all securities that are executed through an ECN and reported to ACT.

Reporting of transactions executed through ECNs is complex because ECNs

conduct transactions on an "agency" basis, with the ECN standing as a central contra party to two offsetting transactions with ECN subscribers. However, the substance of the transaction is the transference of shares from one ECN subscriber to another, and therefore only one transaction is reported to the tape for public dissemination.

Current practices of ECN trade reporting have developed over time in conjunction with the growth of the number of ECNs. As each new ECN entered the market, it registered with Nasdaq under NASD Rule 4623 and informed Nasdaq and NASD of its planned method for reporting transactions. Although Nasdaq believes that the use of different reporting methodologies by different ECNs has generally allowed ECNs to fulfill reporting obligations while tailoring their methodology to their own business needs and those of their subscribers, the absence of clearly defined rules has, in some circumstances, created confusion as to the trade reporting responsibilities of ECNs and their subscribers. Nasdaq believes that the proposed rule change will provide members greater certainty concerning their trade reporting responsibilities, while allowing ECNs to continue using the various methods of trade reporting that have developed over time.

The proposed rule change permits ECNs to use any of three methods for reporting transactions.⁵ Each ECN would inform NASD which method it would use for reporting trades to ACT for each of its subscribers, but it could change its method at any time by providing advance notice to NASD.⁶ First, an ECN may assume sole responsibility for reporting transactions executed through its facilities and identify itself as the reporting party. Second, an ECN may assume sole responsibility for transaction reporting, but identify a subscriber as the reporting party. In that case, the identified reporting party would be determined in accordance with the existing rules for allocating trade reporting responsibility.

⁵ As discussed earlier, the three methods are based on ECN trade reporting practices. Nasdaq also understands that, at any given time, an ECN may utilize more than one of these methods and the choice of the method varies depending on the needs of particular subscribers. For example, ECN A may use one method for subscriber B and another method for subscriber C. This proposal is not intended to limit this flexibility. Accordingly, an ECN will be permitted to use more than one of the methods described in Rule 6130(c), as long as it provides NASD written notice concerning the methods that it will use for each subscriber.

⁶ Notices must be filed with Nasdaq's Market Watch Department and NASD's Market Regulation Department.

Thus, if the subscribers conducting a transaction through the ECN were both market makers or both order entry firms, the selling party would be identified as the reporting party; if the transaction were between a market maker and an order entry firm, the market maker would be identified as the reporting party; and if the transaction were between a member (*i.e.*, a broker-dealer) and a non-member (such as an institutional investor), the member would be identified as the reporting party.

Third, the ECN may impose some or all of the responsibility for reporting on its subscribers. In that case, the ECN would notify the appropriate reporting party, determined in accordance with the existing rules of priority for trade reporting, that it had an obligation to submit a report concerning the trade.

In each case, the party submitting a trade report is responsible for ensuring its accuracy and completeness.⁷ In addition, when an ECN submits a trade report identifying another party as the reporting party, both the ECN and the identified reporting party are responsible for ensuring the accuracy and completeness of the report.

The proposed rule change also addresses procedures for reporting transactions in several unique circumstances associated with ECNs. First, the rule provides that when the parties to a transaction executed through an ECN are both non-members, the ECN must submit all required trade reports and identify itself as the reporting party. This is the case because as non-members, the parties to the transaction would not be eligible to report trades through ACT. Second, in circumstance where one ECN routes an order to another ECN that executes the order, the ECN that executes the order would be responsible for reporting the transaction, or requiring a subscriber to report the transaction, in accordance with one of the three basic methods for trade reporting described above. For purposes of the rules for allocating trade reporting responsibility between ECN subscribers, the routing ECN would be deemed to be a market maker. Thus, if the executing ECN uses the second method of trade reporting, and it receives an order from a routing ECN that is matched against the order of an order entry firm or a non-member customer, the routing ECN would be identified as the reporting party. If the executing ECN matched the routed order against the order of a market maker or another ECN, however, the sell

⁷ Rule 6130(d) specifies the information that is required to be included in each ACT report.

⁴ The proposed rules are intended to provide greater certainty while Nasdaq remains a subsidiary of the NASD, and do not impact the trade reporting rules filed by Nasdaq in its application to register as an exchange, which are different from the current proposal.