



Number 07-44  
May 11, 2007

**ATTENTION:** CHIEF EXECUTIVE OFFICER, MANAGING PARTNER,  
OPERATIONS, TECHNOLOGY, COMPLIANCE AND LEGAL  
DEPARTMENTS

**TO:** ALL MEMBER ORGANIZATIONS

**SUBJECT:** REGULATION NMS

## Introduction

This Information Memo provides an update on upcoming compliance dates with respect to certain provisions of Regulation NMS and will serve as a reminder that, pursuant to NYSE Rule 342 (“Offices—Approval, Supervision and Control”), member organizations will need to assure their ability to comply with Regulation NMS. In particular, firms are reminded that in connection with the implementation of Regulation NMS, they will be required to use appropriate trade reporting modifiers when submitting trade reporting data. Accordingly, firms should develop and maintain appropriate procedures for identifying the proper trade reporting modifier and retain necessary books and records in connection with trade reporting information, particularly where the firm has determined that a trade-through exception or exemption is applicable to a transaction. In addition to this Information Memo, NYSE member organizations that are also members of the National Association of Securities Dealers, Inc. (“NASD”) should review Notice to Members 07-23, which is being issued by the NASD contemporaneously with this Information Memo.

## Background

The Securities and Exchange Commission (“SEC” or “Commission”) published its release announcing the adoption of Regulation NMS under the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> on June 9, 2005.<sup>2</sup> Regulation NMS provides for the re-

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<sup>1</sup> 15 U.S.C. 78a, et al.

<sup>2</sup> Exchange Act Release No. 34-51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (“NMS Release”). See also, NYSE Information Memo 06-70 (September 29, 2006) for guidance on Implementation of the NMS Linkage Plan - NYSE Rules 15 and 15A.

designation of the national market system rules, as well as the passage of new rules designed to modernize and strengthen the regulatory structure of the equity markets.<sup>3</sup>

Among the main provisions of Reg NMS are Rule 610 (“Access Rule”),<sup>4</sup> Rule 611 (“Order Protection Rule”),<sup>5</sup> Rule 612 (“Sub-Penny Rule”),<sup>6</sup> and amendments to the Market Data Rules. In addition, Reg NMS reorganizes the rules governing the national market system under the Exchange Act. The principal elements of Rules 610 and 611 are the display of automated quotations and the operation of automated trading centers.<sup>7</sup>

In order to provide automated trading centers with additional time to finalize development of new or modified trading systems and to allow sufficient time to the securities industry to establish access to the trading systems, the SEC extended the compliance dates for Rules 610 and 611 of Regulation NMS under the Exchange Act.<sup>8</sup>

According to the Sub-Penny Rule, market participants are prohibited from accepting, ranking, or displaying quotations, orders, or indications of interest in amounts less than a penny. The exception to the Sub-Penny rule is for quotations, orders, or indications of interest that have a price less than \$1.00 per share.

Reg NMS amends the requirements regarding market information under the Market Data Rules. Specifically, the amendments include the requirements for consolidating, distributing, and displaying market information. In addition, an Allocation Amendment and Governance Amendment focus on the plans for dissemination of market information that modify the allocating plan revenues formulas and expand the participation in the plan governance.

### **Compliance Dates<sup>9</sup>**

Two key provisions of Regulation NMS, Rules 610 and 611, are fully effective on October 8, 2007.<sup>10</sup> Member organizations will need to assure their ability to comply with these dates as the full implementation of Rules 610 and 611 comes into effect.

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<sup>3</sup> See Footnote 2. See also, Exchange Act Release No. 34-51808 at p. 283 and Exchange Act Release No. 34-51808A (December 28, 2005), 71 FR 232 (January 4, 2006) for a description of the re-designation of the national market system rules.

<sup>4</sup> 17 CFR 240.610.

<sup>5</sup> 17 CFR 240.611.

<sup>6</sup> 17 CFR 240.612.

<sup>7</sup> See Exchange Act Release No. 34-53829 (May 18, 2006), 71 FR 30037 (May 24, 2006). See also, NYSE Information Memo 06-70 (September 29, 2006) for guidance on Implementation of the NMS Linkage Plan - NYSE Rules 15 and 15A. The purpose of the linkage plan is to enable Participant Markets to act jointly in planning, developing, operating and regulating the system that will electronically link them to each other and to facilitate compliance with Rules 610 and 611.

<sup>8</sup> Exchange Act Release No. 34-55160 (January 24, 2007), 72 FR 19 (January 30, 2007).

<sup>9</sup> See Footnote 8.

<sup>10</sup> The initial compliance date for Rules 610 and 611 was June 29, 2006, and has been extended by the Commission. See Footnote 8.

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 applicable exceptions.

On March 5, 2007, electronic communication networks (ECNs) and exchanges were to begin complying with the Trading Phase of Regulation NMS.<sup>11</sup> This Trading Phase date is the final date for full operation of Regulation NMS-compliant trading systems of all automated trading centers that intend to qualify their quotations for trade-through protection under Rule 611 during the Pilot Stocks Phase and the All Stocks Phase (see below). The period from March 5 until July 9, 2007 is the Trading Phase.

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 Rules 610 and 611 before any liability attaches under the Rules.

#### July 9, 2007 – Pilot Stocks Phase Date

This will be the start of full industry compliance with Rules 610 and 611 for 250 NMS stocks (100 NYSE stocks, 100 NASDAQ stocks, and 50 Amex stocks). The revised Pilot Stocks Phase will extend from July 9, 2007 until August 20, 2007.

The particular pilot stocks will be chosen by the primary listing market, in consultation with the SEC, to be reasonably representative securities. The primary purpose of the Pilot Stocks Phase is to allow market participants to verify the functionality of their policies, procedures and systems that are necessary to comply with the Rules.

#### August 20, 2007 – All Stocks Phase Date

This marks the start of full industry compliance with Rules 610 and 611 for all remaining NMS stocks. The revised All Stocks Phase will extend from August 20, 2007 until October 8, 2007.

#### October 8, 2007 – Completion Date

This will mark the completion of phased-in compliance with Rules 610 and 611. Member organizations must assure that all necessary operational and compliance measures are in place to meet the SEC's phase-in dates.

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<sup>11</sup> See also, SEC Press Release 2007-29 (March 2, 2007).

## Best Execution Obligations

Reg NMS and the trade-through provision of Rule 611 supplement, but do not supplant, the requirement that member organizations comply with their best execution obligation. Member organizations must continue to provide best execution of customer market orders. Reasonable diligence must be used to obtain the best price when a trade is executed on behalf of a customer. Member organizations must continue to review and evaluate which markets would be best for routing customer orders.<sup>12</sup> Furthermore, member organizations that execute customer orders internally are responsible for executing orders at the best price.

## Intermarket Sweep Orders

An Intermarket Sweep Order (“ISO”) is a limit order for an NMS stock that is identified as an ISO when routed to a trading center and, simultaneously with the routing of the limit order, one or more additional limit orders are routed to execute against all better-priced protected quotations displayed by other trading centers up to their displayed size.<sup>13</sup> Under this exception to the Order Protection Rule (Reg NMS Rule 611), a trading center may execute an order that has been identified as an ISO regardless of better-priced protected quotations at other trading centers because it is premised on the condition that the trading center or broker-dealer responsible for routing the ISO will have attempted to access all better-priced protected quotations. According to the Commission, this exception facilitates the execution of certain types of orders, such as large block orders.<sup>14</sup>

## Record-Keeping Requirements

Reg NMS requires that any policies and procedures created by firms as part of the requirements under Reg NMS must be preserved.<sup>15</sup> Firms are reminded of the obligation to retain records relating to their business and to make such records accessible to regulators.<sup>16</sup>

## Supervision

In order to comply with Rules 610 and 611, and pursuant to NYSE Rule 342, member organizations will need to assure their ability to comply with these dates as the full implementation of Rules 610 and 611 comes into effect. Also, member

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<sup>12</sup> See also, Rule 605 (“Disclosure of Order Execution Information”) 17 CFR 240.605 (renumbered from Exchange Act Rule 11Ac1-5). Rule 605 requires, among other things, that markets make available reports of statistical information concerning order executions. See also, Rule 606 (“Disclosure of Order Routing Information”) 17 CFR 240.606 (renumbered from Exchange Act Rule 11Ac1-6). Rule 606 requires, among other things, that broker-dealers make available a report on their routing of non-directed orders in covered securities. In addition, if requested by a customer, broker-dealers must disclose the venue to which the customer’s orders were routed for execution and the execution time of the transactions that resulted from the orders.

<sup>13</sup> See Rule 600(b)(30).

<sup>14</sup> See Footnote 2.

<sup>15</sup> See Footnote 2. See also, Rule 611.

<sup>16</sup> See Exchange Act Rules 17a-3 and 17a-4. See also, NYSE Rule 440 (“Books and Records”).

organizations will still be required to consider all displayed quotations during the review of the quality of execution of the market centers for routed orders. It is important to note that member organizations must consider all quotations, which would include non-automated quotations.<sup>17</sup>

Questions regarding this Information Memo may be directed to Peter Bon Viso at (212) 656-5621 or David De Gregorio at (212) 656-4166.

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<sup>17</sup> See Footnote 4.