

**MEMO# 16102**

May 21, 2003

# **SEC CONCEPT RELEASE REGARDING THE REGULATION OF NASDAQ-LISTED SECURITIES**

[16102] May 21, 2003 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 9-03 SEC RULES COMMITTEE No. 48-03 RE: SEC CONCEPT RELEASE REGARDING THE REGULATION OF NASDAQ-LISTED SECURITIES The Securities and Exchange Commission has issued a request for comment on a petition submitted by the Nasdaq Stock Market concerning the regulation of Nasdaq-listed securities.<sup>1</sup> Specifically, Nasdaq requests that the SEC amend the rules of all markets that trade Nasdaq-listed securities to establish uniform trading rules; order that the exchanges' costs of regulation be aggregated and deducted from the market data revenue collected pursuant to the Nasdaq Unlisted Trading Privileges Plan ("UTP Plan"); and prohibit the launch or continuation of Nasdaq trading by any market that fails to protect investors as required under the Securities Exchange Act of 1934. In addition, the SEC requests comment on whether these same actions would be appropriate for the regulation and trading of exchange-listed securities. The most significant aspects of the Release are summarized below. Comments on the Release are due to the SEC no later than June 19, 2003. We have scheduled a conference call to discuss the Release and the Institute's comment letter for Thursday, May 29 at 4:15 pm Eastern. If you would like to participate on the call, please contact Monica Carter-Johnson by e-mail at [mcarter@ici.org](mailto:mcarter@ici.org). The dial-in number for the call will be 877-546-1565 and the passcode will be NASDAQ. A. Uniform Trading Rules Nasdaq requests that the SEC act immediately to establish uniform trading rules for all markets that trade Nasdaq-listed securities and to ensure equal surveillance and enforcement of those rules. 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 regulatory disparities. Nasdaq therefore requests that the UTP Plan be amended to prohibit certain conduct including any activity that is prohibited by any provision of the Exchange Act or rule adopted under that Act, market manipulation, illegal short selling, insider trading, fraud, front running, marking the open or the close, and non-

<sup>1</sup> Securities Exchange Act Release No. 47849 (May 14, 2003) ("Release"). The Release can be found on the SEC's website at <http://www.sec.gov/rules/concept/34-47849.htm>. The Nasdaq petition can be found on the SEC's website at <http://www.sec.gov/rules/petitions/petn4-479.htm>.<sup>2</sup> compliance with the limit order display rule and the firm quote rule. Nasdaq requests that the SEC, at a minimum, add to the rules of all SROs that trade Nasdaq-listed securities, rules requiring an electronic audit trail identical to the NASD's OATS Rules and short-sale restrictions similar to NASD Rule 3350. The SEC requests comments on several aspects of the proposal to establish uniform trading rules including, among other things: whether commenters agree with Nasdaq that there is unequal regulation of trading in Nasdaq

securities; whether all exchanges and associations trading Nasdaq securities should have rules requiring detailed audit trail information, be required to automate their surveillance and examination of Nasdaq trading on their markets, and have similar rules to regulate short selling; what other trading rules should be uniform across all markets; and how the SEC should address any regulatory gaps that can arise when trading in the same security is fragmented across different SROs. B. Allocation of Regulatory Costs Nasdaq requests that the SEC equitably allocate regulatory costs across all markets that trade Nasdaq-listed securities. Nasdaq believes that the fairest way to allocate these costs is to aggregate the exchanges' costs of regulation, which include costs associated with surveillance and enforcement, and to deduct that amount from the market data revenue collected pursuant to the Nasdaq UTP Plan. The SEC specifically requests comment on several aspects of the proposal to reallocate regulatory costs including whether the proceeds from the Nasdaq UTP Plan should be withheld to pay for regulatory costs and whether other methods of fairly allocating regulatory costs should be considered. C. Prohibition of Trading in Nasdaq-Listed Securities Nasdaq requests that the SEC identify the markets that trade Nasdaq-listed securities without approved rules, order audit trails, surveillance, and examination programs sufficient to protect investors. For those markets that in Nasdaq's view do not have adequate regulatory protections, Nasdaq requests that the SEC exercise its authority to prohibit the launch or continuation of Nasdaq trading by any market that fails to protect investors as required under the Exchange Act. D. Exchange-Listed Securities The SEC notes that exchange-listed securities may be traded on more than one market and, therefore, the same regulatory issues raised by Nasdaq could arise. The SEC therefore requests comment on whether the same regulatory concerns raised by Nasdaq for Nasdaq securities, such as regulatory fragmentation and arbitrage, exist for exchange-listed stocks. Specifically, the SEC requests comment on whether commenters believe that there is unequal regulation of exchange-listed securities among the markets trading such securities; if so, whether commenters believe that the proposals made by Nasdaq with respect to Nasdaq securities would address such unequal regulation in the listed markets; and, if not, what other approaches commenters recommend. Ari Burstein Associate Counsel