

Room. Copies of such filing also will be available for inspection and copying at the principal office of CBOE. 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-2006-75 and should be submitted on or before September 28, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Nancy M. Morris,

Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54391; File No. SR-NSX-2006-08]

Self-Regulatory Organizations; National Stock Exchange, Inc.; Order Approving a Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 2 and 3 Thereto to Amend Its Trading Rules to Provide for a Price-Time Priority Market and Other Related Changes

August 31, 2006.

I. Introduction

On June 6, 2006, the National Stock Exchange, Inc. ("NSX" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its rules in order to incorporate a price-time priority automatic execution trading system ("System") to replace the Exchange's current system, the National Securities Trading System ("NSTS"). On June 22, 2006, the Exchange filed Amendment No. 1 to the proposed rule change. The proposed rule change, as amended, was published for comment in the **Federal Register** on July 6, 2006.³ The Commission received one comment letter on the proposal.⁴

On August 11, 2006, the Exchange filed Amendment No. 2 to the proposed rule change.⁵ On August 18, 2006, the Exchange filed Amendment No. 3 to the proposed rule change.⁶ This order approves the proposed rule change, as amended by Amendment No. 1. Simultaneously, the Commission is providing notice of filing of Amendment Nos. 2 and 3 and granting accelerated approval of Amendment Nos. 2 and 3.

II. Description

The Exchange proposes to amend its rules in order to implement a new trading System to replace the Exchange's current NSTS. Specifically, the proposed System would provide a new trading platform and structure for the Exchange with price-time priority execution without any priority of execution distinction made for principal or agency orders.⁷ The Exchange proposes to substantially revise Chapter XI (Trading Rules) of its rules in order to incorporate new priority rules and other features within the System. These rules relate to: hours of trading; units of trading; price variations; securities eligible for trading; registration of market makers; obligations of market maker authorized traders; registration of market makers in a security; obligations of market makers; access; authorized traders; orders and modifiers; cross messages; proprietary and agency orders, and modes of order interaction; priority of orders; order execution; trade execution and reporting; clearance and settlement; limitation of liability; clearly erroneous executions; trading halts due to extraordinary market volatility; short sales; locking or crossing quotations in NMS stocks; and riskless principal transactions.⁸

Under proposed NSX Rule 11.11, the System would include a number of new order types, including different types of sweep orders (e.g., Protected Sweep Orders, Full Sweep Orders, Destination Sweep Orders)⁹ that direct the Exchange to route an order, or a relevant portion thereof, to away trading centers. In addition, once the relevant

compliance date for Regulation NMS under the Act ("Regulation NMS")¹⁰ has been reached, the System would permit orders to be marked as intermarket sweep orders ("ISOs") pursuant to Regulation NMS and also permit incoming ISOs from other trading centers.¹¹ Proposed NSX Rule 11.12 sets forth restrictions for cross messages ("Crosses") generally, as well as additional requirements for Midpoint Crosses,¹² Clean Crosses,¹³ and Cross/Sweeps.¹⁴

Proposed NSX Rule 11.13 would permit participation in the System via automatic execution or order delivery. To be eligible for the order delivery functionality, a participant would have to demonstrate to the Exchange that it could automatically process an inbound order and respond immediately. Proposed Interpretation and Policy .01 to Rule 11.13 would define "immediately" as having system response times "that generally meet or exceed industry standards," which NSX believes currently to be 100 milliseconds.¹⁵

In its proposed revisions to Chapter XI of its rules, the Exchange also incorporated a number of provisions relating to Regulation NMS—in addition to ISOs—including proposed NSX Rule 11.22 relating to locking or crossing quotations in NMS stocks. Also, proposed NSX Rule 11.15(d) provides that the System would be operated as an "automated market center" (as defined by Regulation NMS) and would display "automated quotations" (as defined by Regulation NMS) at all times except in the event that a systems malfunction renders the System incapable of displaying automated quotations. In such a case, the Exchange would communicate to ETP Holders its procedures concerning a change from automated to manual quotations.

In addition to substantially revising Chapter XI, the Exchange also made revisions and proposed new rules in other chapters of its rules. Proposed NSX Rule 1.4 details the effective time for certain rules while proposed NSX Rule 1.5 includes new definitions for a number of terms including, among others, "Authorized Trader," "Protected NBBO," "protected quotation," "Sponsored Participants," and "Sponsoring ETP Holder."

Execution Services Holdings, Inc. ("OES"), to Nancy M. Morris, Secretary, Commission, dated July 19, 2006 ("OES Letter").

⁵ The text of Amendment No. 2 is available on NSX's Web site (<http://www.nsx.com>), at the principal office of NSX, and at the Commission's Public Reference Room. See Section II, *infra*, for a discussion of Amendment No. 2.

⁶ The text of Amendment No. 3 is available on NSX's Web site (<http://www.nsx.com>), at the principal office of NSX, and at the Commission's Public Reference Room. See Section II, *infra*, for a discussion of Amendment No. 3.

⁷ See proposed NSX Rules 11.13 and 11.14.

⁸ See proposed NSX Rules 11.1–11.23.

⁹ See proposed NSX Rule 11.11(c)(7).

¹⁰ 17 CFR 242.600 *et seq.* See 17 CFR 242.610 and 17 CFR 242.611.

¹¹ See proposed NSX Rule 11.11(c)(7)(iv) and (c)(8).

¹² See proposed NSX Rule 11.12(c).

¹³ See proposed NSX Rule 11.12(d).

¹⁴ See proposed NSX Rule 11.12(f).

¹⁵ See Amendment No. 2, *supra*, note 5.

⁹ 17 CFR 200.30–3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b–4.

³ See Securities Exchange Act Release No. 54044 (June 26, 2006), 71 FR 38452 ("Trading Rules Notice").

⁴ See letter from Michael A. Barth, Senior Vice President, Exchanges and Market Centers, Order

The Trading Rules Notice also included a request by the Exchange for the Commission to approve its wholly-owned subsidiary, NSX Securities, LLC ("NSX Securities"), as a facility of the Exchange. NSX Securities' only function would be to route orders to other securities exchanges, facilities of securities exchanges, automated trading systems, electronic communications networks ("ECNs"), or other brokers or dealers (collectively, "Trading Centers") from the Exchange (such function referred to as the "Outbound Router"). Proposed NSX Rule 2.11 contains the undertakings of NSX Securities including, among other things, that: NSX would regulate the Outbound Router as a facility of the Exchange that is subject to Section 6 of the Act, and would be responsible for filing with the Commission rules and fees relating to the Outbound Router; the NASD would be responsible for regulatory oversight and enforcement as the Outbound Router's Designated Examining Authority ("DEA") pursuant to Rule 17d-1 of the Act; use of NSX Securities by ETP Holders would be optional; and NSX Securities would not engage in any business other than its Outbound Router function, unless approved by the Commission.

On August 11, 2006, the Exchange filed Amendment No. 2 to the proposed rule change, which made certain revisions to the original proposal, as amended by Amendment No. 1. NSX revised proposed NSX Rule 11.13's requirements for order delivery functionality eligibility. Under subsection (b)(2), a User (*i.e.*, an ETP Holder or Sponsored Participant) must demonstrate to the Exchange that the User's system can automatically process inbound orders and respond immediately; new Interpretation and Policy .01 to proposed NSX Rule 11.13 would define "immediately" as having system response times "that generally meet or exceed industry standards," which NSX believes currently to be 100 milliseconds. NSX also amended its rules to make certain revisions relating to cross messages. The Exchange revised proposed NSX Rule 11.12(d) to delete the requirement that a Clean Cross be executed only if neither side of the Cross is for the account of the User entering the Cross, and amended proposed NSX Rule 11.3(b) to permit Cross executions in subpenny increments so long as they improve the Exchange's top of book ("Top of Book") by at least a penny per share, as well as Clean Cross executions in subpenny increments. In addition, the Exchange clarified that its customer priority rules

found in NSX Rule 12.6 applied to Cross/Sweep messages.

In Amendment No. 2, NSX also stated that it would review its current regulatory allocation plan with NASD (as permitted by Rule 17d-2 under the Act¹⁶) to ensure that the NASD, and not the Exchange, has responsibility for such regulatory functions for NSX Securities. NSX also added new proposed NSX Rule 2.11(b) which states that the books, records, premises, officers, agents, directors and employees of NSX Securities as a facility of the Exchange would be deemed to be the books, records, premises, officers, agents, directors and employees of the Exchange for purposes of, and subject to oversight pursuant to, the Act, and that the books and records of NSX Securities as a facility of the Exchange would be subject at all times to inspection and copying by the Exchange and the Commission.

In addition, in Amendment No. 2, NSX revised its rules to reflect the extension of certain compliance dates relating to Regulation NMS. NSX proposed to modify certain rules such that their effectiveness would coincide with the Regulation NMS compliance dates announced by the Commission. The Exchange also modified other rules to include different rule provisions applicable prior to and following the relevant Regulation NMS compliance dates.¹⁷ NSX also proposed a new NSX Rule 11.16(b) which requires the Exchange to, following the compliance date for Rule 611 of Regulation NMS, "identify all trades executed pursuant to an exception or exemption from Rule 611 of Regulation NMS in accordance with specifications approved by the operating committee of the relevant national market system plan for an NMS stock." In addition, the Exchange revised proposed NSX Rule 11.15 to indicate that it intends to take advantage

of the self-help provisions of Regulation NMS.

In Amendment No. 2, the Exchange also described its proposed phase-in plan for the new System. According to the Exchange, the System is currently undergoing testing and is scheduled to become operational on or about September 5, 2006. NSX stated that it plans to phase-in the System as follows: first, beginning the week of September 5, 2006, a small group of Nasdaq-listed stocks would be transitioned to the System from NSTS. Several additional groups of Nasdaq-listed stocks would be transitioned to the System over the following five weeks, so that all Nasdaq-listed stocks would have been transitioned to the System by approximately mid-October, 2006. Following the transition of Nasdaq-listed stocks, NSX plans to transition all non-Nasdaq-listed securities to the System. NSX stated that it plans to monitor implementation and adjust the schedule as needed to maintain an orderly transition. Amendment No. 2 also contained a number of non-substantive changes and technical corrections to clarify the original proposal, as amended by Amendment No. 1. Finally, Amendment No. 2 contained a response to the comment letter received on the original proposal, as amended by Amendment No. 1.¹⁸

On August 18, 2006, the Exchange filed Amendment No. 3 to the proposed rule change. Amendment No. 3 revised proposed NSX Rule 11.16(b) to clarify that trades executed pursuant to both the intermarket sweep order exception of Rule 611(b)(5) or (6) of Regulation NMS and the self-help exception of Rule 611(b)(1) of Regulation NMS would be identified as executed pursuant to the intermarket sweep order exception.

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange¹⁹ and, in particular, the requirements of Section 6 of the Act²⁰ and the rules and regulations thereunder. The Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act²¹ in that it is designed to prevent fraudulent and manipulative acts and practices, to

¹⁶ 17 CFR 240.17d-2.

¹⁷ For example, NSX revised the proposed definition of "protected quotation" to mean, prior to the compliance date for Rule 611 of Regulation NMS, a bid or offer in a stock that is the best bid or best offer of a national securities exchange or association; provided, however, that the term "protected quotation" would not include a bid or offer in a stock that is subject to the ITS Plan if trading through such bid or offer would be permitted under NSX Rule 14.9(b) or by an exemption available under the securities laws or otherwise granted by the Commission or its staff. Following the compliance date for Rule 611 of Regulation NMS, the definition of "protected quotation" would mean a bid or offer in a stock that (i) is displayed by an automated trading center; (ii) is disseminated pursuant to a national market system plan approved by the Commission; and (iii) is an automated quotation that is the best bid or best offer of a national securities exchange or association.

¹⁸ See Section III.B., *infra*.

¹⁹ The Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

²⁰ 15 U.S.C. 78f.

²¹ 15 U.S.C. 78f(b)(5).

promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

As previously stated, NSX proposes to replace its current trading system, NSTS, with a new trading System that would provide for price-time priority execution. The Exchange proposes to revise its rules, including Chapter XI (relating to trading rules), in connection with this new market structure.

A. Order Types

Pursuant to proposed NSX Rule 11.11, Users would be able to enter market orders and limit orders into the System with various time-in-force terms and other modifiers. Specific order types permitted by the System include: ITS Orders, Reserve Orders, Odd Lot Orders, Mixed Lot Orders, Post Only Orders, NSX Only Orders, Sweep Orders (including Protected Sweep Orders, Full Sweep Orders, and Destination Sweep Orders), Destination Specific Orders, and, following the compliance date for Rule 611 of Regulation NMS, Incoming Intermarket Sweep Orders.

The Exchange's proposed Sweep Orders would allow a User to "sweep" the market by matching the order for execution in the NSX Book, and simultaneously converting the order into one or more limit orders and routing such orders to away trading centers for execution against quotations in accordance with the terms of the Sweep Order. Specifically, a Protected Sweep Order would only execute against orders in the NSX Book and protected quotations at away trading centers. A Full Sweep Order would execute against the best available quotations in the NSX Book and at away trading centers (automated and manual quotations). A Destination Sweep Order would first be matched for execution against the NSX Book and then routed to a User-specified trading center for execution. The Commission believes that the proposed order types are consistent with the Act. The Commission notes that a number of the proposed order types will have different definitions prior to and following the relevant Regulation NMS compliance dates, which should enable Users to make use of the trading and routing strategies of such order types prior to when full compliance with Rules 610 and 611 of Regulation NMS is required.

Pursuant to proposed NSX Rule 11.12, Users may post a Cross on the System if the price of such trade is better than the best bid and offer on NSX, and (following the compliance date for Rule

611 of Regulation NMS) if it is equal to or better than the Protected NBBO. Crosses must improve each side of the Top of Book by at least one penny a share, except in the cases of Midpoint Crosses and Clean Crosses. A Midpoint Cross may improve the Top of Book by as little as one-half the minimum increment provided in NSX Rule 11.3(a), if it is priced at the midpoint of the Protected NBBO (or, prior to the compliance date for Rule 611 of Regulation NMS, if it is priced at the midpoint of the best bid and offer on the Exchange).²² A Clean Cross may be executed on the System at a price equal to or better than the Top of Book if (i) it is for at least 5,000 shares and has an aggregate value of at least \$100,000, (ii) the size of the Cross is greater than the size of the total interest on NSX at the Cross price, and (iii) following the compliance date for Rule 611 of Regulation NMS, it is at a price equal to or better than the Protected NBBO.²³

Proposed NSX Rule 11.12(e) requires that all Users entering a Proprietary Cross comply with the Exchange's Customer Priority rule (*i.e.*, the price of the Cross must be better than any customer order the User is holding by at least \$0.01). A User may also post a "Cross/Sweep" message that enters a Sweep Order for the account of the User sweeping all protected quotations that are superior to the Cross price, and simultaneously executes the Cross. In connection with any Cross/Sweep, the User must fully disclose the material facts relating to the Sweep Order to any customer for whose account either side of the Cross is being executed.²⁴ In addition, proposed NSX Rule 11.12(f) makes clear that NSX Rule 12.6, which restricts trading ahead of customer orders, applies to the entire Cross/Sweep transaction. The Commission notes that the User must provide the customer with the benefit of any superior price received by executing such Sweep Order against NSX quotations for the corresponding portion of the Cross.

The Commission finds that the proposed rules relating to cross messages are consistent with the Act and should provide Users flexibility in executing transactions which meet the specified requirements of each type of Cross, while still ensuring that customer priority principles are upheld. The Commission notes that it has approved rules substantially similar to those

proposed by the Exchange relating to Clean Crosses.²⁵

B. Order Interaction and Order Delivery

Pursuant to proposed NSX Rule 11.13, the System offers two modes of order interaction: (1) Automatic execution and (2) order delivery and automated response. Every User would be eligible to use the automatic execution mode to participate in the System, in which the System would match and execute like-priced orders. However, to be eligible for the order delivery functionality, a User would have to demonstrate to the Exchange that it could automatically process an inbound order and respond immediately. In new Interpretation and Policy .01 to proposed NSX Rule 11.13, NSX defines "immediately" as having system response times "that generally meet or exceed industry standards," which NSX believes currently to be 100 milliseconds. In addition, if the Exchange does not receive a response to an inbound order within 500 milliseconds, the User's displayed order will be cancelled.

The industry standard for such response times will undoubtedly change over time and become shorter and, therefore, the Commission notes that NSX must periodically review inbound order response time to determine what constitutes the current industry standard and update its parameters accordingly. The Commission believes that the Exchange's order delivery functionality, as proposed, is consistent with the Act.

C. Priority of Orders and Order Execution

Proposed NSX Rules 11.14 and 11.15 set forth the priority and execution parameters of the System. Pursuant to NSX Rule 11.14, orders are prioritized on a price-time basis, first by price and then by time.²⁶ Incoming orders (other than Sweep Orders) are first matched for execution against orders in the NSX Book.²⁷ Proposed NSX Rule 11.15 reflects the requirements of Rule 611 of Regulation NMS²⁸ by requiring that, for any execution on NSX to occur during Regular Trading Hours (*i.e.*, between 8:30 a.m. and 3 p.m. Central Time), the price must be equal to or better than the Protected NBBO unless the order is marked as an intermarket sweep order or unless another exception to Rule 611(b) of Regulation NMS is available. Orders that cannot be executed within

²⁵ See, e.g., Securities Exchange Act Release No. 46568 (September 27, 2002), 67 FR 62276 (October 4, 2002) (approving File No. SR-Amex-2002-23).

²⁶ See proposed NSX Rule 11.14(a).

²⁷ See proposed NSX Rule 11.15(a)(i).

²⁸ 17 CFR 242.611.

²² See proposed NSX Rule 11.12(c).

²³ See proposed NSX Rule 11.12(d).

²⁴ See proposed NSX Rule 11.12(f).

these parameters are eligible for routing to away trading centers for execution at the Protected NBBO.

Unless the terms of the order direct otherwise, any order other than a Sweep Order that cannot be executed on the Exchange would be converted into one or more limit orders, as necessary, to match the price of each protected quotation at the Protected NBBO available at away markets, and these limit orders would be routed to the applicable market for execution against the applicable protected quotation at the Protected NBBO.²⁹ Unless the terms of the order direct otherwise, any order not executed in full on the Exchange which by its terms is not eligible for routing away, or which is not executed in full when routed away, would be ranked in the NSX Book in accordance with order priority rules of proposed NSX Rule 11.14.³⁰

Sweep Orders would be matched for execution in the NSX Book, and simultaneously converted into one or more limit orders and routed to away markets to be matched for execution against quotations in accordance with the terms of the Sweep Order.³¹ In addition, pursuant to proposed NSX Rule 11.15(d), NSX intends to operate the System as an "automated market center" within the meaning of Regulation NMS, such that the System would display automated quotations at all times except in the event that a systems malfunction renders it incapable of displaying automated quotations. The Exchange would communicate to its ETP Holders its procedures relating to any change from automated to manual quotations in the event of such a systems malfunction.

The Commission believes that the proposed rules relating to order priority and order execution are consistent with the Act. The Commission believes that the System's price-time priority and automatic execution functionality may encourage Users to participate in the new System, which should promote competition and efficiencies on the new System and in the national market system in general.

D. Outbound Router

In the Trading Rules Notice, NSX requested that the Commission approve its wholly-owned subsidiary, NSX Securities, as a facility of the Exchange. NSX Securities would be subject to several conditions and undertakings which are reflected in proposed NSX Rule 2.11. First, the Exchange would

regulate the Outbound Router function of NSX Securities as a facility, subject to Section 6 of the Act. In particular, and without limitation, under the Act, the Exchange would be responsible for filing with the Commission rule changes and fees relating to the Outbound Router function of NSX Securities and NSX Securities would be subject to exchange non-discrimination requirements. Second, NASD, a self-regulatory organization unaffiliated with the Exchange or any of its affiliates, would carry out oversight responsibilities as the Designated Examining Authority designated by the Commission pursuant to Rule 17d-1 of the Act with the responsibility for examining NSX Securities for compliance with the applicable financial responsibility rules.³² In addition, NSX has stated that it would review its current regulatory allocation agreement with NASD to ensure that the NASD, and not the Exchange, has responsibility for regulatory functions for NSX Securities under such regulatory allocation agreement, including the responsibility to receive regulatory reports from NSX Securities, to examine NSX Securities for compliance, and to enforce compliance by NSX Securities with, specified provisions of the Act, the rules and regulations thereunder, and the rules of the Exchange and the NASD, and to carry out other specified regulatory functions with respect to NSX Securities. Third, an ETP Holder's use of NSX Securities to route orders to another Trading Center would be optional. Any ETP Holder that does not wish to use NSX Securities would be able to utilize other routers to route orders to other trading centers.³³ Fourth, NSX Securities would not engage in any business other than (1) its Outbound Router function and (2) any other activities it may engage in as approved by the Commission. Finally, the books, records, premises, officers, agents, directors and employees of NSX Securities as a facility of the Exchange would be deemed to be the books, records, premises, officers, agents, directors and employees of the

Exchange for purposes of, and subject to oversight pursuant to, the Act, and the books and records of NSX Securities as a facility of the Exchange would be subject at all times to inspection and copying by the Exchange and the Commission.

The Commission received one comment letter regarding the proposed rule change, as amended.³⁴ In its comment letter, OES questioned whether NSX Securities' routing functionality should be part of the Exchange.³⁵ In addition, OES believed that the Exchange, through its direct affiliation with NSX Securities, would be in direct competition with other broker-dealer participants of NSX that provide similar routing services and would "potentially be positioned to hold unfair competitive advantages through its regulatory and operational positions as a [self-regulatory organization] and an exchange."³⁶

In Amendment No. 2, NSX responded to the OES Letter. NSX stated that the undertakings set forth in proposed NSX Rule 2.11 are specifically designed to mitigate potential conflicts of interest the Exchange might have with regard to NSX Securities. NSX noted that, under its proposed rules, an ETP Holder's use of NSX Securities to route orders to another trading center would be optional, and the only function of NSX Securities would be to act as an outbound router unless the Commission approves otherwise. In addition, NSX noted that the Commission has previously approved a similar arrangement between an exchange and an affiliated broker-dealer for outbound routing with substantially similar undertakings.³⁷

The Commission notes that, because NSX Securities is a facility of the Exchange, the operation of the router is a function of the Exchange. Although the Commission is concerned about potential unfair competition and conflicts of interest between an exchange's self-regulatory obligations and its commercial interests when the exchange is affiliated with one of its members, the Commission believes that it is appropriate and consistent with the Act to permit NSX to own NSX Securities in its capacity as a facility of NSX that routes orders from NSX to other trading centers, in light of the protections afforded by the conditions

³² NSX has stated that NSX Securities is in the process of registering as a broker-dealer, has applied for membership in the NASD, and is applying to become an ETP Holder. See Trading Rules Notice at 38479. The Commission expects NSX to complete this process prior to beginning operation of its new System.

³³ For example, an ETP Holder may choose to enter an Immediate-or-Cancel Order, which provides that, if the order is not executable on the System, the order would be cancelled and returned to the ETP Holder, at which time the ETP Holder could choose to route the order to another market. See proposed NSX Rule 11.11(b)(1).

³⁴ 34 OES Letter, *supra* note 4.

³⁵ *Id.* at 1.

³⁶ *Id.*

³⁷ See Securities Exchange Act Release No. 52497 (September 22, 2005), 70 FR 56949 (September 29, 2005) (relating to the use of Archipelago Securities, LLC as an outbound router for NYSE Arca, Inc. (f/k/a the Pacific Exchange, Inc.)).

²⁹ See proposed NSX Rule 11.15(a)(ii).

³⁰ See proposed NSX Rule 11.15(a)(iii).

³¹ See proposed NSX Rule 11.15(b).

described above. Accordingly, the Commission approves the proposed rules regarding NSX Securities.

E. Transition to New System

NSX proposes to phase the new System into its market structure as follows: First, beginning the week of September 5, 2006, a small group of Nasdaq-listed stocks would be transitioned to the System from NSTS. Several additional groups of Nasdaq-listed stocks would be transitioned to the System over the following five weeks, so that all Nasdaq-listed stocks would have been transitioned to the System by mid-October 2006. Following the transition of Nasdaq-listed stocks, NSX would transition all non-Nasdaq-listed securities (*i.e.*, securities listed on the New York Stock Exchange, American Stock Exchange, and other exchanges) to the System. NSX has stated that it plans to monitor this implementation and adjust the schedule as needed to maintain an orderly transition. The Commission believes that the Exchange's phased approach to transitioning from NSTS to the new System should provide it with time to test its System in a real trading environment while only trading a limited number of securities. The Commission believes that this approach is appropriate and should help maintain an orderly transition to the System.

F. Regulation NMS

The Commission believes that the proposed rule change is consistent with the requirements of Regulation NMS.³⁸ In proposed NSX Rule 11.22, NSX proposes to adopt a rule with regard to locked and crossed markets, as required by Rule 610(d) of Regulation NMS.³⁹ The Exchange has also designed its proposed rules relating to orders, modifiers, and order execution⁴⁰ rules to comply with the requirements of Regulation NMS. These proposed rules include marking certain orders meeting the requirements of Rule 600(b)(30) of Regulation NMS⁴¹ as intermarket sweep orders and accepting orders marked as intermarket sweep orders, which would allow orders so designated to be automatically matched and executed without reference to protected quotations at other trading centers. In addition, as mentioned above in Section III.B., NSX has designed its trading rules so that the Exchange would display only automated quotations and qualify as an automated trading center under Rule

600(b)(3) of Regulation NMS.⁴² The Commission believes that NSX's proposed immediate-or-cancel functionality⁴³ is consistent with Rule 600(b)(3) of Regulation NMS. The Commission also notes that proposed NSX Rule 11.15(d) addresses situations where NSX has reason to believe it is not capable of displaying automated quotations, including communicating to ETP Holders its procedures concerning a change from automated to manual quotations.

G. Other Rules

In addition to the rules described in detail above, the proposed rule change would amend a number of other Exchange rules that address, among other things, the effective time of certain rules, hours of trading, units of trading, price variations, securities eligible for trading, market makers, authorized traders, access, trade execution and reporting, clearance and settlement, limitation of liability, clearly erroneous executions trading halts, short sales, and riskless principal transactions. The Commission believes that these rules are appropriate and consistent with the Act.

IV. Accelerated Approval of Amendment Nos. 2 and 3

As set forth below, the Commission finds good cause to approve Amendment No. 2 to the proposed rule change prior to the thirtieth day after Amendment No. 2 is published for comment in the **Federal Register** pursuant to Section 19(b)(2) of the Act.⁴⁴ Many of the revisions in Amendment No. 2 are modeled on existing rules of other exchanges or are intended to clarify the proposal. The Commission believes that accelerating approval of these rules is appropriate because the revisions do not raise new regulatory issues.

In Amendment No. 2, NSX modifies the proposed rule language to reflect the Commission's extension of certain compliance dates relating to Regulation NMS. Specifically, NSX is modifying proposed rules to reflect that such rules would not become effective until the compliance date for the applicable sections of Regulation NMS. The Commission notes that February 5, 2007 represents the beginning of the "Trading Phase" and the final date for full operation of Regulation NMS-compliant trading systems of all automated trading centers, including SRO trading facilities, that intend to qualify their quotations for trade-through protection under Rule

611 of Regulation NMS during the Pilots Stock Phase and All Stocks Phase.⁴⁵ Such rules include proposed NSX Rule 1.4(c) (pertaining to the effective time of certain NSX rules, including order execution, locking and crossing quotations in NMS stocks, and display of automated quotations), and proposed NSX Rule 1.5(P)(3) (pertaining to protected quotations). The Commission finds good cause to accelerate approval of these changes prior to the thirtieth day after publication in the **Federal Register**. The Commission believes this is a reasonable approach in light of the extension of Regulation NMS compliance dates and should help to ensure that the appropriate NSX rules are in place at the time that Regulation NMS compliance is required.

In Amendment No. 2, NSX modifies the proposed rule language regarding the requirements for order delivery functionality eligibility. Specifically, NSX is modifying proposed NSX Rule 11.13 to require Users to demonstrate to the Exchange that the User's system can automatically process inbound orders and respond immediately; new Interpretation and Policy .01 to proposed NSX Rule 11.13 would define "immediately" as having system response times "that generally meet or exceed industry standards," which NSX believes currently to be 100 milliseconds. The Commission finds good cause to accelerate approval of this change prior to the thirtieth day after publication in the **Federal Register**. The Commission notes that NSX had originally proposed a response time of 500 milliseconds for Users using the Exchange's order delivery functionality. In Amendment No. 2, NSX modifies its proposal to require immediate responses.

In Amendment No. 2, NSX modifies certain proposed rule language relating to cross messages. Specifically, NSX deletes the requirement from proposed NSX Rule 11.12(d) that a Clean Cross be executed only if neither side of the Cross is for the account of the User entering the Cross, and amends proposed NSX Rule 11.3(b) to permit Cross executions in subpenny increments so long as they improve the Top of Book by at least a penny per share, as well as Clean Cross executions in subpenny increments. In Amendment No. 2, NSX also clarifies that its customer priority rules found in NSX Rule 12.6 applies to Cross/Sweep messages. The Commission finds good cause to accelerate approval of these changes prior to the thirtieth day after

³⁸ See *supra* note 10.

³⁹ 17 CFR 242.610(d).

⁴⁰ See proposed NSX Rules 11.11 and 11.15.

⁴¹ 17 CFR 242.600(b)(30).

⁴² 17 CFR 242.600(b)(3).

⁴³ See proposed NSX Rule 11.11(b)(1).

⁴⁴ 15 U.S.C. 78s(b)(2).

⁴⁵ See Securities Exchange Act Release No. 53829 (May 18, 2006), 71 FR 30038 (May 24, 2006).

publication in the **Federal Register** because they clarify the application of NSX Rule 12.6 to Cross, Clean Cross, and Cross/Sweep messages, all of which were published for comment in the Trading Rules Notice.

In Amendment No. 2, NSX states that it would review its current regulatory allocation plan with NASD (as permitted by Rule 17d-2 under the Act⁴⁶) to ensure that NASD, and not the Exchange, would be responsible for such regulatory functions with respect to NSX Securities. In addition, NSX adds new subsection (b) to proposed NSX Rule 2.11 regarding the Exchange's relationship with NSX Securities for purposes of the Act. The Commission finds good cause to accelerate approval of these changes prior to the thirtieth day after publication in the **Federal Register** because allocation of NSX's regulatory functions with regard to NSX Securities to NASD would be an extension of this current plan permitted under Rule 17d-2 of the Act. In addition, NSX modified its proposed rule language to provide that the books, records, premises, officers, agents, directors and employees of NSX Securities as a facility of the Exchange would be deemed to be the books, records, premises, officers, agents, directors and employees of the Exchange for purposes of, and subject to oversight pursuant to, the Act, and that the books and records of NSX Securities as a facility of the Exchange would be subject at all times to inspection and copying by the Exchange and the Commission. The Commission finds good cause to accelerate approval of these changes prior to the thirtieth day after publication in the **Federal Register** because they are substantially similar to rules relating to the administration of facilities of other national securities exchanges.

In Amendment No. 2, NSX describes a phase-in plan for the new System. The Exchange states that the System is currently undergoing testing and is scheduled to become operational on or about September 5, 2006. NSX would initially transition a small group of Nasdaq-listed stocks to the System, followed by several additional groups of Nasdaq-listed stocks over the next five weeks, leading to the inclusion of all Nasdaq-listed stocks by mid-October. Following the transition of Nasdaq-listed stocks, NSX would transition all non-Nasdaq-listed securities (*i.e.*, New

York Stock Exchange, American Stock Exchange, and regional exchange-listed stocks) to the System. The Commission finds good cause to accelerate approval of this change prior to the thirtieth day after publication in the **Federal Register** because the phase-in period should help to ensure that there is an orderly transition to the new System.

In Amendment No. 2, NSX also makes technical corrections to the proposed rule change, for example, fixing incorrect rule citations. These changes are non-substantive and technical in nature and are necessary to clarify the proposal. The Commission finds good cause to accelerate approval of these changes prior to the thirtieth day after publication in the **Federal Register** because they better clarify NSX's proposal.

The Commission also finds good cause to approve Amendment No. 3 to the proposed rule change prior to the thirtieth day after Amendment No. 3 is published for comment in the **Federal Register** pursuant to Section 19(b)(2) of the Act.⁴⁷ Amendment No. 3 revises proposed NSX Rule 11.16(b) to clarify that trades executed pursuant to both the intermarket sweep order exception of Rule 611(b)(5) or (6) of Regulation NMS and the self-help exception of Rule 611(b)(1) of Regulation NMS would be identified as executed pursuant to the intermarket sweep order exception. The Commission finds good cause to accelerate approval of this change prior to the thirtieth day after publication in the **Federal Register** because it clarifies the identification of trades which are executed pursuant to both the intermarket sweep order and self-help exceptions of Rule 611(b) of Regulation NMS.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 2 and 3, including whether Amendment Nos. 2 and 3 are consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NSX-2006-08 on the subject line.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NSX-2006-08. 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. Copies of the filing also will be available for inspection and copying at the principal office of NSX. 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-NSX-2006-08 and should be submitted on or before September 28, 2006.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁴⁸ that the proposed rule change (File No. SR-NSX-2006-08), as amended by Amendment No. 1, be, and hereby is, approved, and that Amendment Nos. 2 and 3 to the proposed rule change be, and hereby are,⁴⁹ approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.

Nancy M. Morris,
Secretary.

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⁴⁶ 17 CFR 240.17d-2.

⁴⁷ 15 U.S.C. 78s(b)(2).

⁴⁸ 15 U.S.C. 78s(b)(2).

⁴⁹ 17 CFR 200.30-3(a)(12).