

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-45156; File No. SR-NASD-2001-90]

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Nasdaq's Proposed Separation From the NASD and the Establishment of the NASD Alternative Display Facility**

December 14, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 7, 2001, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD. The NASD amended the proposed rule change on December 14, 2001.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The NASD is proposing to amend its rules to reflect Nasdaq's separation from the NASD upon its approval as a national securities exchange and to establish rules that would govern trading otherwise than on an exchange, including rules governing the NASD Alternative Display Facility ("ADF"). Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).  
<sup>2</sup> 17 CFR 240.19b-4.  
<sup>3</sup> Letter from Alden S. Adkins, Senior Vice President, NASD Market Operations Administration, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated December 14, 2001 ("Amendment No. 1"). First, Amendment No. 1 revises proposed Rule 4200(a)(12) to (i) clarify that the market where the security is listed, rather than the NASD, determines whether a normal unit of trading should be an amount other than 100 shares and (ii) delete an inadvertent reference to Nasdaq. Second, Amendment No. 1 deletes the phrase "that enters into a contractual relationship with an NASD Market Participant" from the definition of "customer broker/dealer" in proposed Rule 4300(d)(1) and adds the word "not" to the definition of "Indirect electronic access" before the word "affiliates" in the first sentence of proposed Rule 4300(d)(3). Finally, Amendment No. 1 waives the 35-day period for Commission action until such time as the waiver is withdrawn by the NASD.

**0100. General Provisions**

**0120. Definitions.**

- (a) No Change.
- (b) "Association"  
The term "Association" means, collectively, the NASD, NASD Regulation, [Nasdaq,] and NASD Dispute Resolution.
- (c) through (q) No Change.

**0130. Delegation, Authority and Access**

- (a) The National Association of Securities Dealers, Inc., delegates to its subsidiaries (NASD Regulation, Inc. and NASD Dispute Resolution, Inc. [The Nasdaq Stock Market, Inc.], hereinafter "Subsidiaries") the authority to act on behalf of the Association as set forth in a Plan of Allocation and Delegation adopted by the Board of Governors and approved by the Commission pursuant to its authority under the Act.
- (b) No Change.

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**1000. MEMBERSHIP, REGISTRATION AND QUALIFICATION REQUIREMENTS**

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**1022. Categories of Principal Registration**

- (a) through (d) No Change.
- (e) Limited Principal—Direct Participation Programs
  - (1) No Change.
  - (2) For purposes of the Rule 1000 Series, "direct participation programs" shall mean programs [which] *that* provide for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution including, but not limited to, oil and gas programs, cattle programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof. Excluded from this definition are real estate investment trusts, tax qualified pension and profit sharing plans pursuant to Sections 401 and 403(a) of the Internal Revenue Code (Code) and individual retirement plans under Section 408 of the Code, tax sheltered annuities pursuant to the provisions of Section 403(b) of the Code and any company including separate accounts registered pursuant to the Investment Company Act of 1940. Also excluded from this definition is any program [for which quotations are displayed on Nasdaq or which] *that* is listed on a registered national securities exchange or any program for which an application for [quotation on Nasdaq or]

listing on a registered national securities exchange has been made.

- (3) No Change.
- (f) through (g) No Change.

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**2000. BUSINESS CONDUCT**

**2100. GENERAL STANDARDS**

**2110. Standards of Commercial Honor and Principles of Trade**

A member, in the conduct of [his] *its* business, shall observe high standards of commercial honor and just and equitable principles of trade.

**IM-2110-1. "Free-Riding and Withholding"**

- (a) No Change.
- (b) Violations of Rule 2110

Except as provided herein, it shall be inconsistent with high standards of commercial honor and just and equitable principles of trade and a violation of Rule 2110 for a member, or a person associated with a member, to fail to make a bona fide public distribution at the public offering price of securities of a public offering which trade at a premium in the secondary market whenever such secondary market begins regardless of whether such securities are acquired by the member as an underwriter, a selling group member or from a member participating in the distribution as an underwriter or selling group or otherwise. Therefore, it shall be a violation of Rule 2110 for a member, or a person associated with a member, to:

- (1) through (8) No Change.
- (9) Sell any of the securities to any person, or to a member of the immediate family of such person who is supported directly or indirectly to a material extent by such person, who owns or has contributed capital to a broker/dealer, other than solely a limited business broker/dealer as defined in paragraph (c) of this interpretation, or the account in which any such person has a beneficial interest, provided, however, that:

(A) The prohibition shall not apply to any person who directly or indirectly owns any class of equity securities of, or who has made a contribution of capital to, a member, and whose ownership or capital interest is passive and is less than 10% of the equity or capital of a member, as long as:

- (i) Such person purchases hot issues from a person other than the member in which it has such passive ownership and such person is not in a position by virtue of its passive ownership interest to direct the allocation of hot issues, or

(ii) such member's shares or shares of a parent of such member are publicly traded on a[n] *registered national securities exchange* [or Nasdaq].

(B) and (C) No Change.

(c) through (m) No Change.

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### IM-2110-2. Trading Ahead of Customer Limit Order

#### (a) General Application

To continue to ensure investor protection and enhance market quality, the Association's Board of Governors is issuing an interpretation to the Rules of the Association dealing with member firms' treatment of their customer limit orders in *Nasdaq-listed securities*. This interpretation, which is applicable from 9:30 a.m. to 6:30 p.m. Eastern Time, will require members acting as market makers to handle their customer limit orders with all due care so that market makers do not "trade ahead" of those limit orders. Thus, members acting as market makers that handle customer limit orders, whether received from their own customers or from another member, are prohibited from trading at prices equal or superior to that of the limit order without executing the limit order. [, provided that, prior to September 1, 1995, this prohibition shall not apply to customer limit orders that a member firm receives from another member firm and that are greater than 1,000 shares. Such orders shall be protected from executions at prices that are superior but not equal to that of the limit order. In the interests of investor protection, the Association is eliminating the so-called disclosure "safe harbor" previously established for members that fully disclosed to their customers the practice of trading ahead of a customer limit order by a market-making firm.]<sup>1</sup>

[Rule 2110 of the Association's Rules states that:]

[A member, in the conduct of [his] its business, shall observe high standards of commercial honor and just and equitable principles of trade.]

[Rule 2320, the Best Execution Rule, states that:]

[In any transaction for or with a customer, a member and persons

associated with a member shall use reasonable diligence to ascertain the best inter-dealer market for the subject security and buy or sell in such a market so that the resultant price to the customer is as favorable as possible to the customer under prevailing market conditions.]

#### Interpretation

The following interpretation of Rule 2110 has been approved by the Board:

A member firm that accepts and holds an unexecuted limit order from its customer (whether its own customer or a customer of another member) in a *Nasdaq-listed security* and that continues to trade the subject security for its own market-making account at prices that would satisfy the customer's limit order, without executing that limit order, shall be deemed to have acted in a manner inconsistent with just and equitable principles of trade, in violation of Rule 2110, provided that, [until September 1, 1995, customer limit orders in excess of 1,000 shares received from another member firm shall be protected from the market maker's executions at prices that are superior but not equal to that of the limit order, and provided further, that] a member firm may negotiate specific terms and conditions applicable to the acceptance of limit orders only with respect to limit orders that are: (a) For customer accounts that meet the definition of an "institutional account" as that term is defined in Rule 3110(c)(4); or (b) 10,000 shares or more, unless such orders are less than \$100,000 in value. Nothing in this interpretation, however, requires members to accept limit orders from any customer.

[By rescinding the safe harbor position and adopting this interpretation,] [t]he Association wishes to emphasize that members may not trade ahead of their customer limit orders in their market-making capacity even if the member had in the past fully disclosed the practice to its customers prior to accepting limit orders. The Association believes that, pursuant to Rule 2110, members accepting and holding unexecuted customer limit orders owe certain duties to their customers and the customers of other member firms that may not be overcome or cured with disclosure of trading practices that include trading ahead of the customer's order. The terms and conditions under which institutional account or appropriately sized customer limit orders are accepted must be made clear to customers at the time the order is accepted by the firm so that trading ahead in the firm's market making capacity does not occur. For purposes of

this interpretation, a member that controls or is controlled by another member shall be considered a single entity so that if a customer's limit order is accepted by one affiliate and forwarded to another affiliate for execution, the firms are considered a single entity and the market making unit may not trade ahead of that customer's limit order.

The Association also wishes to emphasize that all members accepting customer limit orders owe those customers duties of "best execution" regardless of whether the orders are executed through the member's market making capacity or sent to another member for execution. [As set out above, the Best Execution Rule] Rule 2320 requires members to use reasonable diligence to ascertain the best inter-dealer market for the security and buy or sell in such a market so that the price to the customer is as favorable as possible under prevailing market conditions. The Association emphasizes that order entry firms should continue to routinely monitor the handling of their customers' limit orders regarding the quality of the execution received.

(b) No Change.

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### IM-2110-3. Front Running Policy

It shall be considered conduct inconsistent with just and equitable principles of trade for a member or person associated with a member, for an account in which such member or person associated with a member has an interest, for an account with respect to which such member or person associated with a member exercises investment discretion, or for certain customer accounts, to cause to be executed:

(a) No Change.

(b) an order to buy or sell an underlying security when such member or person associated with a member causing such order to be executed has material, non-public market information concerning an imminent block transaction in an option overlying that security, or when a customer has been provided such material, non-public market information by the member or any person associated with a member; prior to the time information concerning the block transaction has been made publicly available.

The violative practice noted above may include transactions [which] *that* are executed based upon knowledge of less than all of the terms of the block transaction, so long as there is knowledge that all of the material terms of the transaction have been or will be agreed upon imminently.

<sup>1</sup> FN1 For purposes of the pilot program expanding the operation of certain Nasdaq transaction and quotation reporting systems and facilities in SR-NASD-99-57 during the period from 4 p.m. to 6:30 p.m. Eastern Time, members may generally limit the life of a customer limit order to the period of 9:30 a.m. to 4 p.m. Eastern Time. If a customer does not formally assent ("opt-in") to processing of their limit order(s) during the extended hours period commencing after the normal close of the Nasdaq market, limit order protection will not apply to that customer's order(s).

The general prohibitions stated above shall not apply to transactions executed by member participants in automatic execution systems in those instances where participants must accept automatic executions.

These prohibitions also do not include situations in which a member or person associated with a member receives a customer's order of block size relating to both an option and the underlying security. In such cases, the member and person associated with a member may position the other side of one or both components of the order. However, in these instances, the member and person associated with a member would not be able to cover any resulting proprietary position(s) by entering an offsetting order until information concerning the block transaction involved has been made publicly available.

The application of this front running policy is limited to transactions that are required to be reported on the last sale reporting systems administered by Nasdaq, Consolidated Tape Association (CTA), or Option Price Reporting Authority (OPRA). Information as to a block transaction shall be considered to be publicly available when it has been disseminated via the tape or high speed communications line of one of those systems or of a third-party news wire service.

A transaction involving 10,000 shares or more of an underlying security or options covering such number of shares is generally deemed to be a block transaction, although a transaction of less than 10,000 shares could be considered a block transaction in appropriate cases. A block transaction that has been agreed upon does not lose its identity as such by arranging for partial executions of the full transaction in portions [which] *that* themselves are not of block size if the execution of the full transaction may have a material impact on the market. In this situation, the requirement that information concerning the block transaction be made publicly available will not be satisfied until the entire block transaction has been completed and publicly reported.

#### **IM-2110-4. Trading Ahead of Research Reports**

The Board of Governors, under its statutory obligation to protect investors and enhance market quality, is issuing an interpretation to the Rules regarding a member firm's trading activities that occur in anticipation of a firm's issuance of a research report regarding a security. The Board of Governors is concerned with activities of member

firms that purposefully establish or adjust the firm's inventory position in [Nasdaq-listed securities,] an exchange-listed security traded *otherwise than on an exchange* [in the OTC market,] or a derivative security based primarily on a specific [Nasdaq or] exchange-listed security in anticipation of the issuance of a research report in that same security. For example, a firm's research department may prepare a research report recommending the purchase of a particular Nasdaq-listed security. Prior to the publication and dissemination of the report, however, the trading department of the member firm might purposefully accumulate a position in that security to meet anticipated customer demand for that security. After the firm had established its position, the firm would issue the report, and thereafter fill customer orders from the member firm's inventory positions.

The Association believes that such activity is conduct [which] *that* is inconsistent with just and equitable principles of trade, and not in the best interests of the investors. Thus, this interpretation prohibits a member from purposefully establishing, creating or changing the firm's inventory position in [a Nasdaq-listed security,] an exchange-listed security traded *otherwise than on an exchange* [in the third market] or a derivative security related to the underlying equity security, in anticipation of the issuance of a research report regarding such security by the member firm.

[Rule 2110 states that:

A member in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.]

In accordance with Article VII, Section 1(a)(ii) of the NASD By-Laws, the Association's Board of Governors has approved the following interpretation of Rule 2110:

Trading activity purposefully establishing, increasing, decreasing, or liquidating a position in [a Nasdaq security,] an exchange-listed security traded *otherwise than on an exchange* [in the over-the-counter market] or a derivative security based primarily upon a specific [Nasdaq or] exchange-listed security, in anticipation of the issuance of a research report in that security is inconsistent with just and equitable principles of trade and is a violation of Rule 2110.

For purposes of this interpretation, a "purposeful" change in the firm's inventory position means any trading activities undertaken with the intent of altering a firm's position in a security in anticipation of accommodating investor interest once the research report has

been published. Hence, the interpretation does not apply to changes in an inventory position related to unsolicited order flow from a firm's retail or broker/dealer client base or to research done solely for in-house trading and not in any way used for external publication.

Under this interpretation, the Board recommends, but does not require, that member firms develop and implement policies and procedures to establish effective internal control systems and procedures that would isolate specific information within research and other relevant departments of the firm so as to prevent the trading department from utilizing the advance knowledge of the issuance of a research report. Firms that choose not to develop "Chinese Wall" procedures bear the burden of demonstrating that the basis for changes in inventory positions in advance of research reports was not purposeful.

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#### **IM-2110-5. Anti-Intimidation/Coordination**

The Board of Governors is issuing this interpretation to codify a longstanding policy. It is conduct inconsistent with just and equitable principles of trade for any member or person associated with a member to coordinate the prices (including quotations), trades, or trade reports of such member with any other member or person associated with a member; to direct or request another member to alter a price (including a quotation); or to engage, directly or indirectly, in any conduct that threatens, harasses, coerces, intimidates, or otherwise attempts improperly to influence another member or person associated with a member. This includes, but is not limited to, any attempt to influence another member or person associated with a member to adjust or maintain a price or quotation, whether displayed on any [automated system] *facility* operated by the *NASD* [The Nasdaq Stock Market, Inc. (Nasdaq),] or otherwise, or refusals to trade or other conduct that retaliates against or discourages the competitive activities of another market maker or market participant. Nothing in this interpretation respecting coordination of quotes, trades, or trade reports shall be deemed to limit, constrain, or otherwise inhibit the freedom of a member or person associated with a member to:

(1) Set unilaterally its own bid [and] or ask in any [Nasdaq] security, the prices at which it is willing to buy or sell any [Nasdaq] security, and the quantity of shares of any [Nasdaq] security that it is willing to buy or sell;

(2) set unilaterally its own dealer spread, quote increment, or quantity of shares for its quotations (or set any relationship between or among its dealer spread, inside spread, or the size of any quote increment) in any [Nasdaq] security;

(3) communicate its own bid or ask, or the prices at or the quantity of shares in which it is willing to buy or sell any [Nasdaq] security to any person, for the purpose of exploring the possibility of a purchase or sale of that security, and to negotiate for or agree to such purchase or sale;

(4) communicate its own bid or ask, or the price at or the quantity of shares in which it is willing to buy or sell any [Nasdaq] security, to any person for the purpose of retaining such person as an agent or subagent for the member or for a customer of the member (or for the purpose of seeking to be retained as an agent or subagent), and to negotiate for or agree to such purchase or sale;

(5) through (7) No Change.

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## 2200. Communications with Customers and the Public

### 2210. Communications with the Public

(a) and (b) No Change.

(c) Filing Requirements and Review Procedures

(1) through (6) No Change.

(7) The following types of material are excluded from the foregoing filing requirements and (except for research reports under paragraph (G)) spot-check procedures:

(A) No Change.

(B) Advertisements or sales literature [which] *that* do no more than identify the [Nasdaq] symbol of the member and/or of a security in which the member is a [Nasdaq] registered market maker;

(C) through (G) No Change.

(8) and (9) No Change.

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## 2300. TRANSACTIONS WITH CUSTOMERS

2310. No Change.

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### IM-2310-1. Possible Application of SEC Rules 15g-1 through 15g-9

Members should be aware that, effective January 1, 1990, any transaction [which] *that* involves a [non-Nasdaq,] non-exchange-listed equity security trading for less than five dollars per share may be subject to the provisions of SEC Rules 15g-1 through 15g-9, and those Rules should be reviewed to determine if an executed customer suitability agreement is required.

Accounts opened, and recommendations made, prior to January 1, 1991 remain subject to former Article III, Sections 2 and 21(c) of the Rules of Fair Practice as previously in effect, as set forth in Notice to Members 90-52 (August 1990).

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### IM-2310-2. Fair Dealing with Customers

(a) through (d) No Change.

(e) Fair Dealing with Customers with Regard to Derivative Products or New Financial Products.

The Board emphasizes members' obligations for fair dealing with customers when making recommendations or accepting orders for new financial products. As new products are introduced from time to time, it is important that members make every effort to familiarize themselves with each customer's financial situation, trading experience, and ability to meet the risks involved with such products and to make every effort to make customers aware of the pertinent information regarding the products. Members must follow specific guidelines, set forth below, for qualifying the accounts to trade the products and for supervising the accounts thereafter.

(1) Index Warrants

Members are obliged to comply with the Rules, regulations and procedures applicable to index warrants and foreign currency warrants contained in the Rule 2840 Series.

(2) Hybrid Securities and Selected Equity-Linked Debt Securities ("SEEDS") Designated as Nasdaq National Market Securities [Pursuant to the Rule 4400 Series]

*With respect to Hybrid Securities and Selected Equity-Linked Debt Securities ("SEEDS") that have been designated as Nasdaq National Market Securities, [M]embers are obligated to comply with any Rules, regulations, or procedures applicable to such securities [pursuant to the Rule 4420 Series], including those of Nasdaq, as well as any other applicable Rule, regulation, or procedure of the Association. Prior to the commencement of trading of a particular SEEDS, Nasdaq or the Association will distribute a circular providing guidance regarding member firm compliance responsibilities (including suitability recommendations and account approval) when handling transactions in SEEDS.*

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### 2320. Best Execution and Interpositioning

(a) through (f) No Change.

(g) (1) Unless two or more priced quotations for a [non-Nasdaq] *non-exchange-listed* security (as defined in the Rule [6700] 6600 Series) are displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis, in any transaction for or with a customer pertaining to the execution of an order in a [non-Nasdaq] *non-exchange-listed* security, a member or person associated with a member[,] shall contact and obtain quotations from three dealers (or all dealers if three or less) to determine the best inter-dealer market for the subject security.

(2) Members that display priced quotations on a real-time basis for a [non-Nasdaq] *non-exchange-listed* security in two or more quotation mediums that permit quotation updates on a real-time basis must display the same priced quotations for the security in each medium.

(3) through (5) No Change.

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### 2340. Customer Account Statements

(a) through (b) No Change.

(c) Definitions.

For purposes of this Rule, the following terms will have the stated meanings:

(1) through (2) No Change.

(3) direct participation program or direct participation program security refers to the publicly issued equity securities of a direct participation program as defined in Rule 2810 (including limited liability companies), but does not include securities on deposit in a registered securities depository and settled regular way, securities listed on a national securities exchange [or The Nasdaq Stock Market], or any program registered as a commodity pool with the Commodities Futures Trading Commission.

(4) "real estate investment trust" or "real estate investment trust security" refers to the publicly issued equity securities of a real estate investment trust as defined in Section 856 of the Internal Revenue Code, but does not include securities on deposit in a registered securities depository and settled regular way or securities listed on a national securities exchange [or The Nasdaq Stock Market].

(5) No Change.

(d) No Change.

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### 2520. Margin Requirements

(a)-(e) No Change.

(f) Other Provisions

(1) Determination of Value for Margin Purposes

Active securities dealt in on a national securities exchange [or OTC Marginable securities listed on Nasdaq] shall, for margin purposes, be valued at current market prices provided that, whether or not dealt in on an exchange [or listed on Nasdaq], only those options contracts on a stock or stock index, or a stock index warrant, having an expiration that exceeds nine months and that are listed or guaranteed by the carrying broker-dealer, may be deemed to have market value for the purposes of Rule 2520. Other securities shall be valued conservatively in view of current market prices and the amount [which] *that* might be realized upon liquidation. Substantial additional margin must be required in all cases where the securities carried in “long” or “short” positions are subject to unusually rapid or violent changes in value, or do not have an active market [on Nasdaq or] on a national securities exchange, or where the amount carried is such that the position(s) cannot be liquidated promptly.

(2)–(9) No Change.

(10) Margin For Index/Currency Warrants

(A) This subparagraph (10) sets forth the minimum amount of margin [which] that must be deposited and maintained in margin accounts of customers having positions in index warrants, currency index warrants or currency warrants dealt in on [Nasdaq or] a national securities exchange. The Association may at any time impose higher margin requirements in respect of such positions when it deems such higher margin requirements to be advisable. The initial deposit of margin required under this Rule must be made within five full business days after the date on which a transaction giving rise to a margin requirement is effected. The margin requirements set forth in this subparagraph (J) are applicable only to index warrants, currency index warrants and currency warrants listed for trading on Nasdaq or a national securities exchange on or after September 28, 1995.

(B) Definitions

The following definitions shall apply to transactions in index warrants, currency index warrants, and currency warrants.

(i) through (ii) No Change.

(iii) The term “current market value” of an index warrant, currency index warrant or currency warrant shall mean

the total cost or net proceeds of the transaction on the day the warrant was purchased or sold and at any other time shall mean the most recent closing price of that issue of warrants on [Nasdaq, in the case of a Nasdaq-listed index warrants, or] the exchange on which it is listed on any day with respect to which a determination of current market value is made.

(iv) through (xiv) No Change.

(C) through (D) No Change.

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**2522. Definitions Related to Options, Currency Warrants, Currency Index Warrants and Stock Index Warrants Transactions**

(a) The following definitions shall apply to the margin requirements for options, currency warrants, currency index warrants and stock index warrants transactions:

(1) through (46) No Change.

(47) Options Trading

The term “options trading” means trading in any option issued by The Options Clearing Corporation, whether or not of a type, class or series [which] *that* has been approved for trading [on Nasdaq or] on a national securities exchange.

(48) through (49) No Change.

(50) Primary Market

The term “primary market” means (A) in respect of an underlying security that is principally traded on a national securities exchange, the principal exchange market in which the underlying security is traded and (B) in respect of an underlying security that is principally traded in the over-the-counter market, the market reflected by any widely recognized quotation dissemination system or service [(Nasdaq in the case of a Nasdaq stock)].

(51) through (77) No Change.

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**2700. SECURITIES DISTRIBUTIONS**

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**2720. Distribution of Securities of Members and Affiliates—Conflicts of Interest**

(a) No Change.

(b) Definitions

For purposes of this Rule, the following words shall have the stated meanings:

(1) through (2) No Change.

(3) Bona fide independent market—a market in a security [which] *that*:

(A) through (D) No Change.

(4) Bona fide independent market maker—a market maker [which] *that*:

(A) is registered *with the NASD* [as a Nasdaq] *or a national securities*

*exchange* as a market maker in the security to be distributed pursuant to this Rule;

(B) through (C) No Change.

(5) through (18) No Change.

(c) through (p) No Change.

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**2800. SPECIAL PRODUCTS**

**2810. Direct Participation Programs**

(a) No Change.

(b) Requirements

(1) No Change.

(2) Suitability

(A) through (C) No Change.

(D) Subparagraphs (A) and (B), and, only in situations where the member is not affiliated with the direct participation program, subparagraph (C) shall not apply to:

(i) A secondary public offering of or a secondary market transaction in a unit, depositary receipt, or other interest in a direct participation program [for which quotations are displayed on Nasdaq or which] *that* is listed on a registered national securities exchange; or

(ii) an initial public offering of a unit, depositary receipt or other interest in a direct participation program for which an application for [inclusion on Nasdaq or] listing on a registered national securities exchange has been approved by [Nasdaq or] such exchange and the applicant makes a good faith representation that it believes such [inclusion on Nasdaq or] listing on an exchange will occur within a reasonable period of time following the formation of the program.

(3) through (5) No Change.

(6) Participation in Rollups

(A) through (B) No Change.

(C) No member or person associated with a member shall participate in any capacity in a limited partnership rollup transaction if the transaction is unfair or unreasonable.

(i) A limited partnership rollup transaction will be presumed not to be unfair or unreasonable if the limited partnership rollup transaction provides for the right of dissenting limited partners:

a. to receive compensation for their limited partnership units based on an appraisal of the limited partnership assets performed by an independent appraiser unaffiliated with the sponsor or general partner of the program [which] *that* values the assets as if sold in an orderly manner in a reasonable period of time, plus or minus other balance sheet items, and less the cost of

sale or refinancing and in a manner consistent with the appropriate industry practice. Compensation to dissenting limited partners of limited partnership rollup transactions may be cash, secured debt instruments, unsecured debt instruments, or freely[-] tradeable securities; provided, however, that:

1. through 3. No Change.

4. freely[-] tradeable securities [utilized] *used* as compensation to dissenting limited partners must be previously listed on a *registered* national securities exchange [or previously traded on Nasdaq] prior to the limited partnership rollup transaction, and the number of securities to be received in return for limited partnership interests must be determined in relation to the average last sale price of the freely[-] tradeable securities in the 20-day period following the date of the meeting at which the vote on the limited partnership rollup transaction occurs. If the issuer of the freely[-] tradeable securities is affiliated with the sponsor or general partner, newly issued securities to be [utilized] *used* as compensation to dissenting limited partners shall not represent more than 20 percent of the issued and outstanding shares of that class of securities after giving effect to the issuance. For purposes of the preceding sentence, a sponsor or general partner is "affiliated" with the issuer of the freely[-] tradeable securities if the sponsor or general partner receives any material compensation from the issuer or its affiliates in conjunction with the limited partnership rollup transaction or the purchase of the general partner's interest; provided, however, that nothing herein shall restrict the ability of a sponsor or general partner to receive any payment for its equity interests and compensation as otherwise provided by this subparagraph.

b. and c. No Change.

(ii) No Change.

(c) No Change.

\* \* \* \* \*

## 2840. Trading in Index Warrants, Currency Index Warrants, and Currency Warrants

### 2841. General

(a) Applicability—This Rule 2840 Series shall be applicable: (1) To the conduct of accounts, the execution of transactions, and the handling of orders in index warrants listed on The Nasdaq Stock Market ("Nasdaq"); and (2) to the extent appropriate unless otherwise stated herein, to the conduct of accounts, the execution of transactions, and the handling of orders in exchange-listed stock index warrants, currency

index warrants, and currency warrants by members who are not members of the exchange on which the warrant is listed or traded.

(b) and (c) No Change.

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### 2850. Position Limits

[(a)] Except with the prior written approval of the Association pursuant to the Rule 9600 Series for good cause shown in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, a purchase or sale transaction in an index warrant listed [on Nasdaq or] on a national securities exchange if the member has reason to believe that as a result of such transaction the member, or partner, officer, director or employee thereof, or customer would, acting alone or in concert with others, directly or indirectly, hold or control an aggregate position in an index warrant issue on the same side of the market, combining such index warrant position with positions in index warrants overlying the same index on the same side of the market, in excess of the position limits established by the Association[, in the case of Nasdaq-listed index warrants,] or the exchange on which the index warrant is listed.

[(b)] In determining compliance with this Rule, the position limits for Nasdaq-listed index warrants are as follows:]

[(1)] Fifteen million warrants with respect to warrants on the same stock index (other than the Standard & Poor's MidCap 400 Index) with an original issue price of ten dollars or less.]

[(2)] Seven million five hundred thousand warrants, with respect to warrants on the Standard & Poor's MidCap 400 Index with an original issue price of ten dollars or less.]

[(3)] For stock index warrants with an original issue price greater than ten dollars, positions in these warrants must be converted to the equivalent-of warrants on the same index priced initially at ten dollars by dividing the original issue price of the index warrants priced above ten dollars by ten and multiplying this number by the size of such index warrant position. After recalculating a warrant position pursuant to this subparagraph, such recalculated warrant position shall be aggregated with other warrant positions on the same underlying index on the same side of the market and subjected to the applicable position limit set forth in subparagraph (1) or (2) above. For example, if an investor held 100,000 Nasdaq 100 Index warrants offered

originally at \$20 per warrant, the size of this position for the purpose of calculating position limits would be 200,000, or 100,000 times 20/10.]

### 2851. Exercise Limits

(a) Except with the prior written approval of the Association pursuant to the Rule 9600 Series for good cause shown, in each instance, no member or person associated with a member shall exercise, for any account in which such member or person associated with such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, a long position in any index warrant if as a result thereof such member or partner, officer, director or employee thereof or customer, acting alone or in concert with others, directly or indirectly,[:]

[(1)] Has or will have exercised within any five (5) consecutive business days a number of index warrants overlying the same index in excess of the limits for index warrant positions contained in Rule 2850; or

[(2)] Has or will have exceeded the applicable exercise limit fixed from time to time by an exchange for an index warrant [not dealt in on Nasdaq].

(b) The Association, pursuant to the Rule 9600 Series for good cause shown, may institute other limitations concerning the exercise of index warrants from time to time by action of the Association. Reasonable notice shall be given of each new limitation fixed by the Association. These exercise limitations are separate and distinct from any other exercise limitations imposed by the issuers of index warrants.

### [2852. Reporting Requirements] Reserved

[(a)] Each member shall file with the Association a report with respect to each account in which the member has an interest, each account of a partner, officer, director or employee of such member, and each customer account of the member, which has established an aggregate position of 100,000 index warrants on the same side of the market in an index warrant issue listed on Nasdaq, combining such index warrant position with positions in index warrants overlying the same index on the same side of the market traded on Nasdaq or a national securities exchange.]

[(b)] Such report shall identify the person or persons having an interest in such account and shall identify separately the total number of each type of index warrant that comprises the reportable position in such account. The

report shall be in such form as may be prescribed by the Association and shall be filed no later than the close of business on the next business day following the day on which the transaction or transactions necessitating the filing of such report occurred. Whenever a report shall be required to be filed with respect to an account pursuant to this Rule, the member filing such report shall file with the Association such additional periodic reports with respect to such account as the Association may from time to time prescribe.]

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### 2854. [Trading Halts or Suspensions] Reserved

[(a) The trading in an index warrant on Nasdaq shall be halted whenever the Senior Vice President for Market Regulation, or its designee, shall conclude that such action is appropriate in the interests of a fair and orderly market and to protect investors. Among the factors that may be considered are the following:]

[(1) Trading has been halted or suspended in underlying stocks whose weighted value represents 20% or more of the index value;]

[(2) the current calculation of the index derived from the current market prices of the stocks is not available;]

[(3) other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.]

[(b) Trading in index warrants that has been the subject of a trading halt or suspension may resume if the Senior Vice President for Market Regulation, or its designee, determines that the conditions which led to the halt or suspension are no longer present or that the interests of a fair and orderly market are served by a resumption of trading. In either event, the reopening may not occur until the Association has determined that trading in underlying stocks whose weighted value represents more than 50% of the index is occurring.]

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### 2860. Options

(a) No Change.

(b) Requirements

(1) General

(A) Applicability—This Rule shall be applicable (i) [to the trading of options contracts issued by The Options Clearing Corporation and displayed on The Nasdaq Stock Market and to the terms and conditions of such contracts; (ii) to the extent appropriate unless

otherwise stated herein, to the conduct of accounts, the execution of transactions, and the handling of orders in exchange-listed options by members [who] that are not members of an exchange on which the option executed is listed; [(iii)] (ii) to the extent appropriate unless otherwise stated herein, to the conduct of accounts, the execution of transactions, and the handling of orders in conventional options; and [(iv)] (iii) other matters related to options trading.

Unless otherwise indicated herein, subparagraphs (3) through (12) shall apply only to [options displayed on Nasdaq and] standardized and conventional options on common stock and subparagraphs (13) through (24) shall apply to transactions in all options as defined in paragraph (a), including common stock. The position and exercise limits for FLEX Equity Options for members [who] that are not also members of the exchange on which FLEX Equity Options trade shall be the same as the position and exercise limits as applicable to members of the exchange on which such FLEX Equity Options are traded.

(B) through (C) No Change.

(2) Definitions

The following terms shall, unless the context otherwise requires, have the stated meanings:

(A) through (F) No Change.

(G) Call—The term “call” means an option contract under which the holder of the option has the right, in accordance with the terms of the option, to purchase the number of units of the underlying security or to receive a dollar equivalent of the underlying index covered by the option contract. In the case of a “call” issued by The Options Clearing Corporation on common stock [or on an option displayed on The Nasdaq Stock Market], it shall mean an option contract under which the holder of the option has the right, in accordance with the terms of the option, to purchase from The Options Clearing Corporation the number of units of the underlying security or receive a dollar equivalent of the underlying index covered by the option contract.

(H) through (DD) No Change. [(EE) Nasdaq Market Index Option—The term “Nasdaq market index option” means an option contract issued by The Options Clearing Corporation and displayed on Nasdaq based upon an underlying index which has been deemed by the Commission to be a market index.]

[(FF) Nasdaq Option Transaction—The term “Nasdaq option transaction”

means a transaction effected by a member of the Association for the purchase or sale of an option contract which is displayed on The Nasdaq Stock Market or for the closing out of a long or short position in such option contract.]

(GG) through (II) are renumbered as (EE) through (GG).

[(JJ)] (HH) Options Contract—The term “options contract” means any option as defined in paragraph (a). For purposes of subparagraphs (3) through (12), an option to purchase or sell common stock shall be deemed to cover 100 shares of such stock at the time the contract granting such option is written. [A Nasdaq index option shall be deemed to cover a dollar equivalent to the numerical value of the underlying index multiplied by the applicable index multiplier.] If a stock option is granted covering some other number of shares, then for purposes of subparagraphs (3) through (12), it shall be deemed to constitute as many option contracts as that other number of shares divided by 100 (e.g., an option to buy or sell five hundred shares of common stock shall be considered as five option contracts). A stock option contract [which] that, when written, grants the right to purchase or sell 100 shares of common stock shall continue to be considered as one contract throughout its life, notwithstanding that, pursuant to its terms, the number of shares [which] that it covers may be adjusted to reflect stock dividends, stock splits, reverse splits, or other similar actions by the issuer of such stock.

(KK) through (NN) are renumbered as (II) through (LL).

[(OO)] (MM) Put—The term “put” means an option contract under which the holder of the option has the right, in accordance with the terms of the option, to sell the number of units of the underlying security or deliver a dollar equivalent of the underlying index covered by the option contract. In the case of a “put” issued by The Options Clearing Corporation on common stock [or on an option displayed on The Nasdaq Stock Market], it shall mean an option contract under which the holder of the option has the right, in accordance with terms of the option, to sell to The Options Clearing Corporation the number of units of the underlying security covered by the option contract or to tender the dollar equivalent of the underlying index.

[(PP) Registered Nasdaq Index Options Market Maker—The term “registered Nasdaq index options market maker” means a member who meets the qualifications for such, as set forth in subparagraph (3), is willing and

able to serve as such in connection with Nasdaq index option contracts and who is authorized by the Association to do so.]

(QQ) through (VV) are renumbered as (NN) through (SS).

[(WW)] (TT) The Options Clearing Corporation—The term “The Options Clearing Corporation” means The Options Clearing Corporation, the issuer of exchange-listed options [and options displayed on The Nasdaq Stock Market].

(XX) through (YY) are renumbered as (UU) through (VV).

[(ZZ) Underlying Index—The term “underlying index” means an index upon which a Nasdaq index option contract is based.]

(AAA) through (BBB) are renumbered as (YY) through (ZZ).

### (3) Position Limits

(A) Stock Options—Except in highly unusual circumstances, and with the prior written approval of the Association pursuant to the Rule 9600 Series for good cause shown in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, non-member broker, or non-member dealer, an opening transaction through [Nasdaq,] the over-the-counter market or on any exchange in a stock option contract of any class of stock options if the member has reason to believe that as a result of such transaction the member or partner, officer, director or employee thereof, or customer, non-member broker, or non-member dealer, would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate equity options position in excess of:

(i) No Change.

(ii) 22,500 options contracts of the put class and the call class on the same side of the market covering the same underlying security, provid[ing]ed that the 22,500 contract position limit shall only be available for option contracts on securities [which] *that* underlie [Nasdaq or] exchange-traded options qualifying under applicable rules for a position limit of 22,500 option contracts; or

(iii) 31,500 option contracts of the put class and the call class on the same side of the market covering the same underlying security provid[ing]ed that the 31,500 contract position limit shall only be available for option contracts on securities [which] *that* underlie [Nasdaq or] exchange-traded options qualifying under applicable rules for a position limit of 31,500 option contracts; or

(iv) 60,000 options contracts of the put and the call class on the same side of the market covering the same underlying security, provid[ing]ed that the 60,000 contract position limit shall only be available for option contracts on securities [which] *that* underlie [Nasdaq or] exchange-traded options qualifying under applicable rules for a position limit of 60,000 option contracts; or

(v) 75,000 options contracts of the put and the call class on the same side of the market covering the same underlying security, provid[ing]ed that the 75,000 contract position limit shall only be available for option contracts on securities [which] *that* underlie [Nasdaq or] exchange-traded options qualifying under applicable rules for a position limit of 75,000 option contracts; or

(vi) through (ix) No Change.

#### (B) Index Options

[(i)] Except in highly unusual circumstances, and with the prior written approval of the Association pursuant to the Rule 9600 Series for good cause shown in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, an opening transaction in an option contract of any class of index options [displayed on Nasdaq or] dealt in on an exchange if the member has reason to believe that as a result of such transaction the member or partner, officer, director or employee thereof, or customer, would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate position in excess of position limits established by [the Association, in the case of Nasdaq index options, or] the exchange on which the option trades.

[(ii)] In determining compliance with this subparagraph (3), option contracts on a market index displayed in Nasdaq shall be subject to a contract limitation fixed by the Association, which shall not be larger than the equivalent of a \$300 million position. For this purpose, a position shall be determined by the product of the closing index value times the index multiplier times the number of contracts on the same side of the market.]

(C) through (D) No Change.

(4) through (6) No Change.

### (7) Limit on Uncovered Short Positions

Whenever the Association shall determine in light of current conditions in the markets for options, or in the markets for underlying securities, that there are outstanding a number of uncovered short positions in option contracts of a given class in excess of

the limits established by the Association for purposes of this subparagraph or that a percentage of outstanding short positions in option contracts of a given class are uncovered, in excess of the limits established by the Association for purposes of this subparagraph, the Association, upon its determination that such action is in the public interest and necessary for the protection of investors and the maintenance of a fair and orderly market in the option contracts or underlying securities, may prohibit any further opening writing transactions in option contracts of that class unless the resulting short position will be covered, and it may prohibit the uncovering of any existing covered short position in option contracts of one or more series of options of that class. [The Association may exempt transactions in Nasdaq options by registered Nasdaq options market makers from restrictions imposed under this subparagraph and it shall rescind such restrictions upon its determination that they are no longer appropriate.]

(8) through (11) No Change.

### (12) Confirmations

Every member shall promptly furnish to each customer a written confirmation of each transaction in option contracts for such customer's account. Each such confirmation shall show the type of option, the underlying security or index, the expiration month, the exercise price, the number of option contracts, the premium, the commission, the trade and settlement dates, whether the transaction was a purchase or a sale (writing) transaction, whether the transaction was an opening or a closing transaction, whether the transaction was effected on a principal or agency basis and, for other than options issued by The Options Clearing Corporation, the date of expiration. The confirmation shall by appropriate symbols distinguish between exchange listed [and Nasdaq option transactions] and other transactions in option contracts.

(13) through (22) No Change.

### (23) Tendering Procedures for Exercise of Options

#### (A) Exercise of Options Contracts

(i) Subject to the restrictions established pursuant to paragraph (b)(4) hereof and such other restrictions [which] *that* may be imposed by the Association, The Options Clearing Corporation or an options exchange pursuant to appropriate rules, an outstanding option contract issued by The Options Clearing Corporation may be exercised during the time period specified in the rules of The Options



Clearing Corporation. An exercise notice may be tendered to The Options Clearing Corporation only by the clearing member in whose account the option contract is carried. Exercise instructions of their customers relating to exchange listed [or Nasdaq] option contracts shall not be accepted by members after 5:30 p.m. (Eastern Time) on the business day immediately prior to the expiration date of any option contract. Exercise instructions in respect of such option contracts carried in any proprietary account of a member shall similarly not be accepted by any other member with [whom] which such member maintains an account after 5:30 p.m. (Eastern Time) on the business day immediately prior to the expiration date of any option contract.

- (ii) through (iii) No Change.
- (B) through (D) No Change.

**[(E) Exercise of Nasdaq Index Option Contracts]**

(i) With respect to Nasdaq index option contracts, clearing members are required to follow the procedures of The Options Clearing Corporation for tendering exercise notices, and member organizations also are required to comply with the following procedures:]

[a. A memorandum to exercise any Nasdaq index option contract issued or to be issued in a customer or market maker account at The Options Clearing Corporation must be received or prepared by the member organization no later than 4:10 p.m. (Eastern Time) and must be time-stamped at the time it is received or prepared. Member organizations must accept exercise instructions until 4:10 p.m. (Eastern Time) each business day.]

[b. A memorandum to exercise any Nasdaq index option contract issued or to be issued in a firm account at The Options Clearing Corporation must be prepared by the member organization no later than 4:10 p.m. (Eastern Time) and must be time-stamped at the time it is prepared.]

[c. Any member or member organization that intends to submit an exercise notice for 25 or more contracts in the same series of Nasdaq index options on the same business day on behalf of an individual customer, registered Nasdaq options market maker or firm account must notify the Association of such exercises in a manner prescribed by the Association no later than 4:10 p.m. (Eastern Time) on that day. For purposes of this subparagraph (E), exercises for all accounts controlled by the same individual must be aggregated.]

- (ii) The provisions of subparagraphs (i) a. and b. above are not applicable in

respect to any series of Nasdaq index options on the last day of trading prior to the expiration date of such series.]

(24) No Change.

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**2870. [Nasdaq Index Options] Reserved**  
**[2871. Definitions]**

[(a) Aggregate Current Index Value—The term “aggregate current index value” means the value required to be delivered to the holder of a call or by the holder of a put (against payment of the aggregate exercise price) upon the valid exercise of an index option. Such value is equal to the index multiplier times the current index value on the trading day on which an exercise notice is properly tendered to The Options Clearing Corporation, or, if the day on which such notice is so tendered is not a trading day, then on the most recent trading day.]

[(b) Aggregate Index Option Exercise Price—The term “aggregate index option exercise price” in respect of an index option means the exercise price of such option times the index multiplier.]

[(c) Best Bid and Asked—The term “best bid” means the best or highest price of all the open, active bids. The term “best asked” means the best or lowest (but greater than zero) price of all the open active offers.]

[(d) Cabinet Transaction—The term “cabinet transaction” means a transaction in a Nasdaq index option executed at a price of \$1.00 per contract for the purpose of opening or closing a position in an index option having a nominal market value.]

[(e) Call—The term “call” means an option contract under which the holder of the options has the right, in accordance with the terms of the option, to buy a number of units of the underlying security or to receive a dollar equivalent of the underlying index covered by the option contract.]

[(f) Class of Options—The term “class of options” means all option contracts of the same type of option covering the same underlying security or index.]

[(g) Clearing Member—The term “clearing member” means a member of the Association which has been admitted to membership in The Options Clearing Corporation pursuant to the provisions of the rules of The Options Clearing Corporation.]

[(h) Closing Purchase Transaction—The term “closing purchase transaction” means an option transaction in which the purchaser’s intention is to reduce or eliminate a short position in the series of options involved in such transaction.]

[(i) Closing Sale Transaction—The term “closing sale transaction” means

an option transaction in which the seller’s intention is to reduce or eliminate a long position in the series of options involved in such transaction.]

[(j) Combination Order—The term “combination order” means an order to buy a number of call option contracts and the same number of put option contracts with respect to the same underlying security or index or put and call option contracts representing the same number of shares or units of trading at option, which contracts do not have both the same exercise price and expiration date; or an order to sell a number of call option contracts and the same number of put option contracts with respect to the same underlying security or index, or put and call option contracts representing the same number of shares, or units of trading at option, which contracts do not have both the same exercise price and expiration date (e.g., an order to buy two XYZ April 50 calls and to buy two XYZ July 40 puts is a combination order). In the case of adjusted option contracts, a combination order need not consist of the same number of put and call contracts if such contracts represent the same number of shares or units of trading at option.]

[(k) Covered—The term “covered” in respect of a short position in a call option contract means that the writer’s obligation is secured by a “specific deposit” or an “escrow deposit,” meeting the conditions of Rules 610(e) or 610(h), respectively, of the rules of The Options Clearing Corporation, or the writer holds in the same account as the short position, on a unit-for-unit basis, a long position either in the underlying security or in an option contract of the same class of options where the exercise price of the option contract in such long position is equal to or less than the exercise price of the option contract in such short position. The term “covered” in respect of a short position in a put option contract means that the writer holds in the same account as the short position, on a unit-for-unit basis, a long position in an option contract of the same class of options having an exercise price equal to or greater than the exercise price of the option contract in such short position.]

[(l) Current Index Value—The term “current index value” means the level of a particular index (derived from the current market prices and capitalization of the underlying securities in the index group) at the close of trading on any trading day, or any multiple or fraction thereof specified by the Association as such value is reported by the reporting authority.]

[(m) Expiration Cycle—The term “expiration cycle” means all option contracts covering the same underlying security or index having the same expiration month, or the time period during which such options are authorized for trading.]

[(n) Expiration Date—The term “expiration date” of a Nasdaq option contract issued by The Options Clearing Corporation means the day and time fixed by the rules of The Options Clearing Corporation for the expiration of all option contracts having the same expiration month as such option contract.]

[(o) Expiration Month—The term “expiration month” in respect of an option contract means the month and year in which such option contract expires.]

[(p) Index Dollar Equivalent—The term “index dollar equivalent” is the dollar amount which results when the index value is multiplied by the appropriate index multiplier.]

[(q) Index Group—The term “index group” means a group of securities, whose inclusion and relative representation in the group is determined by the inclusion and relative representation of their current market values in a widely disseminated securities index specified by the Association.]

[(r) Index Multiplier—The term “index multiplier” as used in reference to an index option contract means the dollar amount (as specified by the Association) by which the current index value is multiplied to arrive at the index dollar equivalent. Such term replaces the term “unit of trading” used in reference to other kinds of options.]

[(s) Index Option Exercise Price—The term “index option exercise price” in respect of an index option means the specified index value which, when multiplied by the index multiplier, will yield the aggregate exercise price at which the aggregate current index value may be purchased (in the case of a call) or sold (in the case of a put) upon the exercise of such option.]

[(t) Index Option Premium—The term “index option premium” means the price of each such option (expressed in points), as agreed upon by the purchaser and seller in such transaction, times the index multiplier and the number of options subject to the transaction.]

[(u) Index Underlying Security—The term index underlying security means any of the securities included in an index group underlying a class of Nasdaq index options.]

[(v) Internalized Trade Transaction—The term “Internalized Trade Transaction” or “ITT” means an OCT

entered into The Nasdaq Stock Market by a participant containing the terms of a transaction executed by the participant as principal where the participant is also the order entry firm.]

[(w) Long Position—The term “long position” means the number of outstanding option contracts of a given series of options held by a person (purchaser).]

[(x) Nasdaq Index Option Contract—The term “Nasdaq index option contract” means an option contract which is authorized for quotation display on The Nasdaq Stock Market.]

[(y) Nasdaq Index Options Order Entry Firm—The term “order entry firm” shall mean a member of the Association who is registered as an order entry firm for purposes of participation in the Nasdaq Index Options Service which permits the firm to enter options orders via Order Confirmation Transactions (OCT) or Internalized Trade Transaction (ITT).]

[(z) Nasdaq Index Options Participant—The term “participant” shall mean either a Nasdaq index options market maker or Nasdaq index options order entry firm registered as such with the Association for participation in the Nasdaq Index Options Service.]

[(aa) Nasdaq Index Options Service—The term “Nasdaq Index Option Service” or “Service” means the Service owned and operated by The Nasdaq Stock Market, Inc. which enables participants to report transaction in Nasdaq index options, to have reports of all Nasdaq index options transactions automatically forwarded to the Options Price Reporting Authority (OPRA) for dissemination to the public and the industry, and to “lock-in” these trades by sending both sides to The Options Clearing Corporation for clearance and settlement; and to provide participants with sufficient monitoring and updating capabilities to participate in such trading environment.]

[(bb) Nasdaq Market Index Option—The term “Nasdaq market index option” means an option contract issued by The Options Clearing Corporation and displayed on The Nasdaq Stock Market based upon an underlying index which has been deemed by the Commission to be a market index.]

[(cc) Opening Purchase Transaction—The term “opening purchase transaction” means an option transaction in which the buyer’s intention is to create or increase a long position in the series of options involved in such transaction.]

[(dd) Opening Writing Transaction—The term “opening writing transaction” means an option transaction in which

the seller’s (writer’s) intention is to create or increase a short position in the series of options involved in such transaction.]

[(ee) Options Clearing Corporation—The term “Options Clearing Corporation” (OCC) means The Options Clearing Corporation, the issuer of options displayed on The Nasdaq Stock Market.]

[(ff) Order Confirmation Transaction—The term “Order Confirmation Transaction” or “OCT” means a message entered into The Nasdaq Stock Market by an order entry firm which is directed to a market maker not simultaneously acting as both a market maker and an order entry firm, which message contains the information specified by the Association as necessary for trade reporting purposes and for submission of trade detail to The Options Clearing Corporation.]

[(gg) Outstanding—The term “outstanding” in respect of an option contract means an option contract which has neither been the subject of a closing sale transaction nor has been exercised nor has reached its expiration date.]

[(hh) Put—The term “put” means an option contract under which the holder of the option has the right, in accordance with the terms of the option, to sell the number of units of the underlying security or deliver a dollar equivalent of the underlying index covered by the option contract.]

[(ii) Registered Nasdaq Index Options Market Maker—The term “registered Nasdaq index options market maker” means a member who meets the qualifications for such as set forth in Rule 2873, is willing and able to serve as such in connection with Nasdaq index option contracts and who is authorized by the Association to do so.]

[(jj) Rules of The Options Clearing Corporation—The term “rules of The Options Clearing Corporation” means the by-laws and the rules of The Option Clearing Corporation, and all written interpretations thereof as may be in effect from time to time.]

[(kk) Series of Options—The term “series of options” means all option contracts of the same class of options having the same exercise price and expiration date and which cover the same number of units of the underlying security or index.]

[(ll) Short Position—The term “short position” means the number of outstanding option contracts of a given series of options with respect to which a person is obligated as a writer (seller).]

[(mm) Spread Order—The term “spread order” means an order to buy a stated number of option contracts and

to sell the same number of option contracts, or contracts representing the same number of shares or units of trading at option in a different series of the same class of options.]

[(nn) Straddle Order—The term “straddle order” means an order to buy a number of call option contracts and the same number of put option contracts with respect to the same underlying security or index, or put and call option contracts representing the same number of shares or units of trading at option, and having the same exercise price and expiration date; or an order to sell a number of call option contracts and the same number of put option contracts with respect to the same underlying security or index, or put and call option contracts representing the same number of shares or units of trading at option and having the same exercise price and expiration date, (e.g., an order to buy two XYZ July 50 calls and to buy two XYZ July 50 puts is a straddle order). In the case of adjusted option contracts, a straddle order need not consist of the same number of put and call contracts if such contracts both represent the same number of shares, or units of trading at option.]

[(oo) Type of Options—The term “type of options” means the classification of an option contract as either a put or a call.]

[(pp) Uncovered—The term “uncovered” in respect of a short position in an option contract means the short position is not covered.]

[(qq) Underlying Index—The term “underlying index” means an index upon which a Nasdaq index option contract is based.]

[(rr) Unit of Trading—The term “unit of trading” means the number of units of the underlying security designated by The Options Clearing Corporation as the subject of a single option contract. In the absence of any other designation, the unit of trading for a common stock is 100 shares.]

#### **[2872. Nasdaq Index Option Services Available]**

[(a) Level 2 Nasdaq Index Options Service]

[(1) Nature of Service

This service will provide the subscriber with access to the quotations of all of the registered Nasdaq index options market makers entering quotes on each of the Nasdaq index options, in addition to the last reported sale for each Nasdaq index option, the most recent index computation for the underlying index, daily high and low, daily volume, time of last sale and inside quotations.]

[(2) Availability

This service is available only to persons approved and authorized by the Association for retrieval of Nasdaq index options quotation and last sale data.]

[(b) Level 3 Nasdaq Index Options Service]

[(1) Nature of Service

This service will enable a registered Nasdaq index options market maker to enter quotations in The Nasdaq Stock Market only on the Nasdaq index options as to which the Association has authorized it to enter quotes pursuant to the procedures set forth in Rule 2873. A subscriber to Level 3 Nasdaq Index Options Service shall also receive Level 2 Nasdaq Index Options Service.]

[(2) Availability

Level 3 Nasdaq Index Options Service is available to any member which, upon application, is approved and authorized by the Association to participate in The Nasdaq Stock Market as a registered Nasdaq index options market maker.]

#### **[2873. Registration, Qualification and Other General Requirements Applicable to All Nasdaq Index Options Market Makers]**

[(a) Registration of Nasdaq Index Options Market Makers—Prior to acting as a market maker in Nasdaq index options, a member must make application to the Association on a form prescribed by the Association and become registered as such with it. In connection with such application, a member must submit to the Association such financial and other information as required by the Association to determine if such member meets the qualifications of a registered Nasdaq index options market maker specified herein. Such other information will include those classes and series of Nasdaq options in which such member desires to be registered as an index options market maker.]

[(b) Participation in the Nasdaq Index Options Service shall be mandatory for all Nasdaq index options market makers. Accordingly, a Nasdaq index options market maker's registration as such shall be conditioned upon the member's initial and continuing compliance with the following requirements:]

[(1) execution of a Nasdaq Index Options Service participant application agreement with the Association;]

[(2) maintenance of the physical security of the equipment located on the premises of the Nasdaq index options market maker to prevent the

unauthorized entry of information into the Nasdaq Index Options Service;]

[(3) acceptance and settlement of each NASD index option trade that the Service identifies as having been effected by such Nasdaq index options market maker, or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified trade by the clearing member on the regularly scheduled settlement date;]

[(4) membership in The Options Clearing Corporation, or a clearing arrangement with such member; and]

[(5) compliance with all applicable rules and operating procedures of the Association and the Commission.]

[(c) Nasdaq index options market makers shall be under a continuing obligation to inform the Association of non-compliance with any of the registration requirements set forth above.]

[(d) Obligation to Honor Trades—If a Nasdaq index options market maker, or clearing member acting on his behalf, is reported by the Service to clearing at the close of any trading day, or shown by the activity reports generated by the Service as constituting a side of a trade, such market maker, or clearing member acting on his behalf, shall honor such trade on the scheduled settlement date.]

[(e) Compliance with Rules and Registration Requirements—Failure by Nasdaq index options market makers to comply with any of the Rules or registration requirements applicable to the Service identified herein shall subject such participants to censure, fine, suspension or revocation of its registration as Nasdaq index options market maker and/or order entry firm or any other fitting penalty under the Rules of the Association.]

[(f) Market Maker Financial Requirements—A registered Nasdaq index options market maker shall continuously maintain net capital of at least \$50,000 computed in accordance with the provisions of SEC Rule 15c3-1(c)(2) under the Act, plus \$5,000 per options series up to a maximum requirement of \$150,000.]

[(g) Normal Business Hours—A registered Nasdaq index options market maker shall keep the Association advised as to the normal business hours during which it shall enter quotations. All firms should be open and active between the hours of 9:30 a.m. and 4:10 p.m. (Eastern Time). Nasdaq shall publish a “close symbol” for a registered Nasdaq index options market maker on Level 2 and Level 3 terminals at the close of such firm's normal business hours.]

[(h) Initiation of Service—Upon initial application, the registration of a Nasdaq index options market maker in a Nasdaq index options series shall be effective at the start of business on the second business day following receipt of his registration application by the Association; provided, however, said registration is accepted by the Association. If said initial registration is received for a Nasdaq index options series which has not previously been authorized by the Association, the registered Nasdaq index options market maker's registration shall be effective at the start of business on the first day that the Nasdaq options series is authorized for quotation by the Association; provided, however, said registration is accepted by the Association. A Nasdaq index options market maker shall commence market making and participation in the Service by initially contacting the Nasdaq Market Operations Center to obtain authorization for the trading of a particular Nasdaq index options series and identifying those terminals on which the Service information is to be displayed and thereafter by an appropriate keyboard entry which obligates him to execute transactions for at least one contract at the market maker's displayed quotations so long as the market maker remains active. All entries shall be made in accordance with the requirements set forth in the User Guide.]

[(i) Withdrawal Procedure for Nasdaq Index Options Market Makers]

[(1) With the approval of the Association, a registered Nasdaq index options market maker may suspend its quotations in a Nasdaq index options series for a specified period of time upon a showing that it is seriously impaired in its ability to enter quotations, or, in the case of a contemplated financing in the underlying security, the presence of statutory prohibitions or restrictions, or such other reason acceptable to the Association.]

[(2) In the event of a malfunction in the Nasdaq index options market maker's equipment rendering on-line communications with the Service inoperable, the Nasdaq index options market maker is obligated to immediately contact the Nasdaq Market Operations Center by telephone to request withdrawal from the Service. Nasdaq operational personnel will in turn enter the withdrawal notification from a supervisory terminal. Such manual intervention, however, will take a certain period of time for completion and any transaction occurring prior to the effectiveness of the withdrawal shall

remain the responsibility of the withdrawing market maker.]

[(3) A registered Nasdaq index options market maker who suspends its quotations in a Nasdaq index options series pursuant to subparagraphs (1) and (2) above may not re-enter quotations in such series during the same trading day without the prior approval of the Association.]

[(j) Voluntary Termination—A registered Nasdaq index options market maker may voluntarily terminate its registration as to any Nasdaq options series by withdrawing its quotations from the Service without prior approval of the Association, subject to the conditions set forth in Rules 2875 and 2876. Such Nasdaq index options market maker may, by making application to the Association under the procedures and requirements set forth in this Rule, re-register as a Nasdaq index options market maker in a Nasdaq options series in which his registration is terminated.]

[(k) A Nasdaq index options market maker withdrawing option quotations from the Nasdaq Index Options Service for any reason has a specific obligation to monitor his status to assure that a withdrawal has in fact occurred. Any transaction occurring prior to the effectiveness of the withdrawal shall remain the responsibility of the withdrawing market maker.]

[(l) Suspension and Termination of a Registered Nasdaq Index Options Market Maker's Authority to Enter Quotations by Action of the Association—The Association may, pursuant to provisions specified in the Code of Procedure as set forth in the Rule 9000 Series, suspend, condition or terminate a registered index options market maker's authority to enter quotations on one or more series of Nasdaq index options for violations of applicable Rules of the Association.]

[(m) Termination of Service on the Failure to Promptly Pay Fines and Assessments]

[(1) The Association, upon notice, may terminate service on any level of Nasdaq Index Options Service for failure of a subscriber to maintain the standards of availability specified in this Rule for such service or to pay the Service operator for services rendered.]

[(2) Any member which is a respondent in a complaint pursuant to any Rule of the Association is required promptly to pay any fine or costs imposed to the Treasurer of the Association. In the event that the respondent fails to do so, the Association may, after ten business days notice in writing to such respondent, suspend his authority to enter options

quotations into or receive options quotations from Level 2 and 3 of the Nasdaq Index Options Services.]

**[2874. Character of Index Options Quotations Entered Into the Nasdaq Index Options Service by All Nasdaq Index Options Market Makers]**

[(a) All bids or offers for Nasdaq index options shall be for at least one option contract or the minimum unit of trading.]

[(b) All bids and offers for Nasdaq index options shall be expressed in terms of the applicable index multiplier (e.g., a bid of five for a Nasdaq index option having an index multiplier of \$100 shall represent a bid to pay a premium of \$500 for an option contract).]

[(c) All bids or offers for a Nasdaq index option contract for which The Options Clearing Corporation has established an adjusted unit of trading in accordance with paragraphs (c) and (d) of Section 11 of Article VI of the OCC's By-Laws shall be expressed in terms of dollars per the appropriate fractional part of the total securities and/or other property constituting such adjusted unit of trading.]

[(d) A registered Nasdaq index options market maker who receives a buy or sell order must execute a trade for at least one contract at his quotation as they appear on the Nasdaq CRT screen at the time of receipt of any such buy or sell order. Each quotation entered by a registered Nasdaq index options market maker must be reasonably related to the prevailing market.]

[(e) A registered Nasdaq index options market maker will be permitted to enter a one-sided quotation (0–1/16) with respect to those options which have no present market value.]

[(f) Crossed Markets—A registered Nasdaq index options market maker shall not be permitted, except under extraordinary circumstances, to enter quotations into the Nasdaq Index Options Service if (1) the bid quotation entered is greater than the ask quotation of another registered market maker in the same options series or (2) the asked quotation is less than the bid quotation of another registered market maker in the same options series.]

[(g) Quote Spread Parameters—A registered Nasdaq index options market maker shall not be permitted, except under extraordinary circumstances, to enter index option quotations into the Nasdaq Index Options Service if the spread between the market maker's bid and ask exceeds the following parameters:]

[(1) ¼ of \$1, if the member's bid price is \$.50 or less;]

[(2) ½ of \$1, if the bid price is more than \$.50 but does not exceed \$10;]

[(3) ¾ of \$1, if the bid price is more than \$10 but does not exceed \$20; or]

[(4) \$1, if the bid price is more than \$20;]

[Providing, however, that the allowable quote spread differentials for the longest term options series open for trading in each option class shall be twice the amounts stated in subparagraphs (1) through (4) above.]

[(h) Except under extraordinary circumstances, a registered Nasdaq index options market maker shall not be permitted to enter on an intra-day basis a bid quotation more than \$1 lower and/or an offering more than \$1 higher than the last reported transaction for the particular index option contract. However, this standard shall not ordinarily apply if the price per share (or other unit of trading of the underlying index value has changed since the last preceding transaction for the particular option contract, in which event a market maker may then bid no lower than or offer no more than \$1 plus the aggregate change in the price per unit of trading) of the underlying index value since the time of the last preceding transaction for the particular index option contract. Nothing in this paragraph shall alter the maximum bid-ask differential established by paragraph (g) above.]

[(i) Whenever, in the judgment of the Association, the interest of maintaining a fair and orderly market so requires, the Association may waive the requirements of paragraph (h) above on a case by case basis.]

[(j) When unusual trading conditions exist, and the interest of maintaining a fair and orderly market, the Association may waive the requirements of paragraph (g) above in those option series 10 or more points in the money to allow market makers to make bid/ask differentials as wide as the quotation in the primary market as determined by the inside quotation displayed on Nasdaq. Such waiver shall not automatically carry over from one day to the next.]

**[2875. Commitment Rules Applicable to Options Market Makers in Nasdaq Index Options]**

[(a) Commitment Rule for Index Options Market Makers. A market maker in a Nasdaq index option, unless excused from entering quotations pursuant to Rule 2873(i) shall, during normal options business hours, continuously quote all options series in such index option through the

expiration of the longest term index options authorized for trading at the time the member commences such market making. Failure to abide by this commitment shall cause the index options market maker to be subject to the sanctions contained in Rule 2876.]

[(b) The following examples illustrate the commitment rule for index option market makers established by this Rule.]

[(1) Member A is authorized as a Nasdaq index options market maker prior to the expiration of January Nasdaq-100 Index® Options. Member A is thus obligated to continuously quote all series of Nasdaq-100 put and call options authorized for trading in the January, February and March expirations through the expiration of the March options.]

[(2) Member B is authorized as a market maker in Nasdaq-100 Index® Options at the time these options are authorized for the Nasdaq Options Program, but prior to the commencement of trading in these index options. The first authorized expiration cycle in Nasdaq-100 Index options will consist of options expiring in April, May and June with trading to commence in March. Member B would be obligated to continuously quote all authorized Nasdaq-100 Index option series from the commencement of trading in such options in March through the expiration of June Nasdaq-100 Index options.]

**[2876. Sanctions Applicable to Nasdaq Index Options Market Makers]**

[(a) A registered Nasdaq market maker in index options whose quotation for any option series in which the member is a market maker is withdrawn without the approval of the Association shall, at or before the daily close of the Nasdaq Index Options Service, have its registration terminated in all Nasdaq index options series covering the same underlying index as that for which option quotations were suspended by the member, subject, however, to the re-registration procedures set forth in paragraph (b) below.]

[(b) A Nasdaq index options market maker in index options whose registration in options classes is terminated pursuant to paragraph (a) above may, by making application to the Association under the procedures and requirements set forth in Rule 2873, re-register as a Nasdaq index options market maker in any Nasdaq index options series in the options classes in which his registration was terminated pursuant to paragraph (a) above providing, however, that the Association shall not grant effectiveness to such registration until the near-term

options and those in the following expiration cycle have expired.]

[(c) The following example illustrates the sanction for index options market makers established by paragraph (a) above.]

[(1) Market Maker A, without approval of the Association, withdraws quotations from the Nasdaq Index Options Service for a series of Nasdaq-100 Index® options causing the member's registration in all Nasdaq-100 Index options series to be terminated pursuant to paragraph (a) above.]

[(2) At the time Market Maker A's registration is terminated, January, February and March Nasdaq-100® Index options are trading. Pursuant to paragraph (b), any application by member A to again register as a market maker in Nasdaq-100 Index options would not be granted effectiveness by the Association until the expiration of the February Nasdaq-100 Index options.]

[(d) A registered market maker in Nasdaq index options who withdraws index options quotations from the Nasdaq Index Options Service in any options series without prior authorization during the 15 business days preceding the expiration of the near-term options on the same underlying index may be deemed to be in violation of Rule 2110.]

**[2877. Requirements Applicable to Nasdaq Index Options Order Entry Firms]**

[(a) Participation in the Nasdaq Index Options Service as an order entry firm requires current registration as such with the Association. Such registration shall be conditioned upon the order entry firm's initial and continuing compliance with the following requirements:]

[(1) Execution of a Nasdaq Index Options Service participant application agreement with the Association;]

[(2) membership in, or a clearing arrangement with, a member of The Options Clearing Corporation;]

[(3) compliance with all applicable rules and operating procedures of the Association and the Commission;]

[(4) maintenance of the physical security of the equipment located on the premises of the Nasdaq index options order entry firm to prevent the unauthorized entry of information into the Nasdaq Index Options Service; and]

[(5) acceptance and settlement of each trade that the Service identifies as having been effected by such Nasdaq index options order entry firm or, if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such

identified trade by the clearing member on the regularly scheduled settlement date.]

[(b) The registration required hereunder will apply solely to the qualification of a participant to participate in the Nasdaq Index Options Service. Such registration shall not be conditioned upon registration in any particular eligible or active Nasdaq index options contracts.]

[(c) Each participant shall be under a continuing obligation to inform the Association of non-compliance with any of the registration requirements set forth above.]

[(d) Upon the effectiveness of registration as a Nasdaq index options order entry firm, the participant may commence activity for entry of orders, as applicable. The operating hours of the Nasdaq Index Options Service are currently 9:30 a.m. to 4:10 p.m. (Eastern Time), but may be modified by the Association. The extent of participation in Nasdaq by a Nasdaq index options order entry firm shall be determined solely by the firm in the exercise of its ability to enter orders into Nasdaq.]

[(e) Market orders shall not be permitted in the Nasdaq Index Options Service. All orders entered into the Service other than accommodation transactions shall be priced and all orders shall be directed to a specified Nasdaq index options market maker. Nasdaq index options order entry firms will be immediately notified on the terminal screen and printer, if requested, of the execution or rejection of an order entered into via OCT.]

[(f) If a Nasdaq index options order entry firm or clearing member acting on his behalf, is reported by the Service to clearing at the close of any trading day, or shown by the activity reports generated by the Service as constituting a side of a Nasdaq index option trade, such order entry firm or clearing member acting on his behalf, shall honor such trade on the scheduled settlement date.]

[(g) Failure by a Nasdaq index options order entry firm to comply with any of the Rules or registration requirements applicable to the Service identified herein shall subject such participant to censure, fine, suspension or revocation of its registration as a Nasdaq index options order entry and/or market maker firm or any other fitting sanction under the Rules of the Association.]

#### **[2878. Transaction Reporting and Other Reporting Requirements]**

[(a) All Nasdaq index options participants, upon becoming so registered and qualified, shall have access to, and be required to utilize, the

Order Confirmation Transaction (OCT) and Internalized Trade Transaction (ITT) trade reporting systems established by the Association for Nasdaq index options transactions. Such trade reporting systems are designed to “lock-in” all Nasdaq index options transactions. Thus these systems serve trade comparison and clearing functions as well as trade reporting functions, and require the participation of both the order entry and the market making firms in the reporting process. Because these procedures, which are detailed in the User Guide, vary from those applying to transaction reporting in other Nasdaq securities, it is imperative that all Nasdaq index options participants become familiar with and comply with the provisions of this Rule. Failure on the part of a Nasdaq index options participant to comply with Nasdaq index options reporting provisions may subject participants to censure, fine, suspension or revocation of registration as a Nasdaq index options market maker and/or order entry firm or any other fitting sanction under the Rules of the Association.]

[(b) Order Confirmation Transaction (OCT)—Nasdaq index options order entry firms shall enter an OCT into the Service promptly upon the execution of their order. Upon the acceptance by a market maker of an OCT, the Service shall automatically forward a trade report to the Options Price Reporting Authority (OPRA). Nasdaq index options market makers shall accept an OCT via terminal entry within two minutes as specified by the Association, or the OCT shall be “timed-out,” in which case the Service will notify the order entry firm of the market maker’s non-acceptance of the order. The order entry firm will also be notified if the market maker affirmatively rejects the order via terminal entry. If the market maker wishes to subsequently confirm an OCT which has been timed-out or rejected, a new OCT must be entered into the Service by the order entry firm with a late trade indicator. Once accepted, an OCT may only be canceled or corrected by mutual consent of the market maker and order entry firm.]

[(c) Unsolicited Orders—Nasdaq index options market makers are not obligated to accept an OCT which is unsolicited but, if they choose to do so, must accept the order within two minutes of its receipt as specified by the Association. Upon the acceptance of an unsolicited OCT order by a Nasdaq index options market maker, the system will automatically forward a trade report to OPRA. Once accepted by the market maker, the OCT may only be

canceled or corrected with the mutual consent of the market maker and the order entry firm.]

[(d) Internalized Trade Transaction (ITT)—Nasdaq Index Options Service participants shall, where appropriate, enter an ITT message into the Service within two minutes of the execution of an internalized trade. Upon the entry of an ITT message, the Service shall automatically forward a trade report to OPRA. An ITT may be subsequently canceled or corrected by the member.]

[(e) A Nasdaq index options order entry firm shall transmit OCT and ITT for transactions in Nasdaq index options other than cabinet transactions at the price recorded on the trade ticket exclusive of commission, taxes or other charges.]

[(f) Nasdaq index options participants may effect cabinet transactions in any class of options contracts authorized for trading via the Service at a price of \$1.00 per contract, providing such price is reasonably related to the prevailing market for the option. In reporting cabinet transactions, participants shall designate these transactions as such with the appropriate indicator on OCT or ITT entered into the Service. Cabinet transactions will not be disseminated to OPRA but will be reported to OCC for clearance.]

[(g) Weekly and/or Monthly Reports—A member shall report weekly and/or monthly to the Association such data on Nasdaq index options quoted in the Service as the Board of Governors shall require. Such report shall be on a form prescribed by the Association.]

[(h) Trade Tickets—All trade tickets on transactions in Nasdaq index options and authorized underlying securities must indicate the time the order was received and the time the order was executed or canceled.]

#### **[2879. Authorization of Nasdaq Index Option Market Making]**

[(a) The Association shall not authorize index option market making in any options series unless, at the time such market making activity is to commence, there are a minimum of five registered Nasdaq index options market makers in the index option.]

[(b) Once market making has commenced in any class of Nasdaq index options, the Association shall withdraw approval of further market making activity with respect to any succeeding options series to be opened in that Nasdaq index option if there are fewer than three registered market makers in the index option.]

[(c) Whenever the Association shall withdraw its approval for index option market making activity in a particular

Nasdaq index options series pursuant to paragraph (b) above, it shall not reinstate such market making until the provisions of paragraph (a) above have been satisfied.]

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**[2880. Nasdaq Index Option Contracts Authorized for Trading]**

[The Association may from time to time approve for display on Nasdaq put option contracts and call option contracts in respect of underlying indexes which have been selected by the Association and approved for trading. All such option contracts shall be designated as to the type of option, the underlying index, the expiration month and the exercise price. Only quotations in respect to option contracts in a class or series of options approved by the Association and currently open for display on the Service may be quoted by a registered Nasdaq index options market maker on the Nasdaq Index Options Service.]

**[2881. Series of Nasdaq Index Options for Trading]**

[(a) Nasdaq Index Options—After a particular class of index options has been approved for display on the Service and quotation thereon by registered Nasdaq index options market makers, the Association shall from time to time open for trading series of options therein. Prior to the opening of trading in any series of options the Association shall fix the expiration month and exercise price of options contracts included in each such series.]

[(1) Expiration Months—At the commencement of trading in a particular class of Nasdaq index options, series of options having three different expiration months will normally be opened. Such expirations shall occur in consecutive months. The first such expiration will occur in the month following the month in which such options are introduced, the second expiration will occur in the month following the first, and the third expiration will occur in the month following the second. Additional series of index options of the same class may be opened for trading at or about the time a prior series expires and the expiration month of each such series will normally be approximately three months following the opening of such series.]

[(2) Exercise Prices—The procedures for fixing the exercise or strike price of each series of index options opened for trading shall be as follows:]

[(A) Strike prices shall be fixed at an index value which is an integer.]

[(B) Regardless of the value of an index, the interval between strike prices will be \$5.00.]

[(C) New series of index option contracts may be added up to the fifth business day prior to expiration.]

[(D) When new series of index option contracts within a new expiration cycle are opened for trading, two strike prices above and two strike prices below the current index value may be added.]

[(E) When the value of the index underlying a class of index options reaches a strike price, the Association may add one or more additional strike prices such that there are at least two strike prices above and two strike prices below the strike price which has been reached.]

[(F) In unusual market conditions, the Association may add additional series of index option contracts up to three strike prices above and three strike prices below the current index price.]

[(b) Specification Adjustments—The unit of trading and the exercise price initially established for index option contracts of a particular series are subject to adjustment in accordance with the rules of The Options Clearing Corporation. When such adjustment(s) have been determined, announcement thereof shall be made by the Association and, effective as of the time specified in such announcement, the adjusted unit of trading and the adjusted exercise price shall be applicable with respect to all subsequent transactions in such series.]

[(c) Contract Adjustments—Index option contracts shall be subject to adjustments in accordance with the rules of The Options Clearing Corporation.]

[(d) Puts and Calls—When calls are first opened for trading on an underlying index stock group, the Association may open a series of puts corresponding to each series of calls open or to be opened for trading on the same underlying index stock group.]

**[2882. Unit of Trading]**

[The unit of trading in each series of options displayed on the Service shall be the unit of trading established by The Options Clearing Corporation pursuant to the rules of The Options Clearing Corporation.]

**[2883. Suspension of Authorization of Nasdaq Index Option Contracts]**

[(a) The Association shall have the authority to suspend trading in Nasdaq index option contracts by either one or more market maker or all market makers where it deems it necessary and appropriate:]

[(1) to prevent fraudulent and manipulative acts and practices;]

[(2) to promote just and equitable principles of trade; or]

[(3) to prevent excessive speculation and promote the likelihood of a competitive and orderly market.]

[(b) The Association shall suspend trading in Nasdaq index options contracts by all market makers:]

[(1) If the underlying index is not being computed or disseminated; or]

[(2) if trading is halted or suspended in underlying stocks that collectively contribute (A) 20 percent of the current index group value (in the case of index stock groups comprised of more than 50 stocks); and (B) 10 percent of the current index group value (in the case of index stock groups comprised of 50 or fewer stocks).]

**[2884. Trade Comparison Procedures for Nasdaq Index Options]**

[(a) Scope and Applicability—All transactions in Nasdaq index options shall be reported to the Association pursuant to reporting procedures established by the Association. The Association shall report all compared transactions to The Options Clearing Corporation for clearance and settlement. All compared transactions in Nasdaq options which are cleared and settled through the facilities of The Options Clearing Corporation shall be subject to the rules of The Options Clearing Corporation.]

[(b) Responsibility of Clearing Members—Every member which is a member of The Options Clearing Corporation (a “clearing member”) shall be responsible for the clearance and settlement of every Nasdaq index option transaction to which it is a party and for each Nasdaq index option transaction of a member for which it acts as correspondent and/or clearing agent pursuant to agreement. Unless specifically authorized by The Options Clearing Corporation, no member shall be permitted to have more than one such agreement with a clearing member in effect at any time.]

[(c) Reporting of Clearing Information]

[(1) Filing of Trade Information—Each Nasdaq index option participant shall individually report each transaction in a Nasdaq index option, for which it has a responsibility to report, each business day to the Association via OCT or ITT in the manner specified by the Association.]

[(2) (A) The Association will provide each Nasdaq index options participant with the opportunity to review on trade date OCT and ITT transactions to which the participant is a party.]

[(B) All OCT orders which are accepted by the contra party and all ITT which have not been canceled shall be considered to be compared trades, i.e., trades where the trade information agrees as to the identity of the other party to the transaction, the type of option contract, the underlying index, the exercise price, the expiration month, the number of options contracts, the amount of the premium, the designation of the parties as purchaser and writer, respectively, and the trade date, if other than the date of submission.]

[(3) Verification of Nasdaq Index Options Transactions—Each participant shall promptly review each OCT or ITT execution report received and report corrected trade information to the Association as soon as possible, but in any event, not later than the hour which shall be from time to time prescribed by the Association. It shall be the sole responsibility of participants to review the accuracy of all reports promptly upon receipt, and the Association shall not assume any responsibility for reviewing such reports for accuracy or for making any corrections not reported by a participant.]

[(4) Reporting of Compared Trades to The Options Clearing Corporation—On each business day, at or prior to such time as may be prescribed by The Options Clearing Corporation, the Association shall furnish The Options Clearing Corporation a report of each clearing member's compared trades as reported to the Association on that day. Only those trades which have been confirmed by both parties shall be furnished by the Association to The Options Clearing Corporation, and the Association shall assume no responsibility with respect to any unaccepted order nor for any delays or errors in the reporting of trades.]

#### **[2885. Clearance and Settlement Procedures for Nasdaq Index Options]**

[(a) Failure to Pay Premium]

[(1) Whenever The Options Clearing Corporation shall reject a Nasdaq index option transaction because of the failure of a clearing member acting on behalf of the purchaser to pay the premium due thereon as required by the rules of The Options Clearing Corporation, the member acting as or on behalf of the seller (writer) shall have the right either to cancel the transaction by giving notices thereof to the defaulting clearing member or to enter into either a new opening writing transaction or closing sale transaction, as the case may be, in respect of the same Nasdaq index option contract that was the subject of the rejected Nasdaq index option transaction, charging any loss resulting

therefrom (including any commissions paid or payable in connection with such new transaction) to the defaulting clearing member. Such action shall be taken on the day the Nasdaq index option transaction was rejected by The Options Clearing Corporation, unless the Association shall extend such time.]

[(2) In the event the rejected transaction involves a Nasdaq index option contract of a series in which trading has been terminated or suspended before a new Nasdaq index option transaction can be effected to establish the amount of loss, the member acting as or on behalf of the seller shall have a claim against the defaulting clearing member for the amount of the premium due thereon.]

[(b) Index Option Contracts of Suspended Members—When announcement is made of the suspension from membership in the Association of a member, other than a clearing member of The Options Clearing Corporation (a "non-clearing member"), pursuant to the By-Laws of the Association, all open short positions in option contracts of such member and all open positions that are secured in full by a specific deposit or evidenced by an escrow receipt in accordance with the rules of The Options Clearing Corporation, shall be closed out without unnecessary delay by all members carrying such positions for the account of the suspended non-clearing member; provided, however, that upon any such suspension, the Association may, in its discretion and where it determines that such is necessary for the protection of investors, suspend the mandatory close-out provisions hereof and may, in its discretion and where it determines that such is necessary for the protection of investors, reinstate such provisions at such time as it may determine. No temporary suspension of the mandatory close-out provisions hereof shall relieve any suspended non-clearing member of its obligations or of any damages incurred by members carrying positions for the account of such suspended non-clearing member. Should an open short position or an open position resulting from an exercise of an option contract not be closed when required by this Rule, the price for the purpose of determining claims shall be fixed by the price current at the time when such position should have been closed under this Rule. When a member of The Options Clearing Corporation is suspended pursuant to the provisions of the By-Laws, the positions of such clearing member shall be closed out in

accordance with the rules of The Options Clearing Corporation.]

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#### **3100. BOOKS AND RECORDS, AND FINANCIAL CONDITION**

##### **3110. Books and Records**

(a) No Change.

(b) Marking of Customer Order Tickets

(1) No Change.

(2) A person associated with a member shall indicate on the memorandum for each transaction in a [non-Nasdaq] *non-exchange-listed* security, as that term is defined in the Rule [6700] 6600 Series, the name of each dealer contacted and the quotations received to determine the best inter-dealer market; however, the requirements of this subparagraph shall not apply if two or more priced quotations for the security are displayed in an inter-dealer quotation system, as defined in Rule 2320(g), that permits quotation updates on a real-time basis for which NASD Regulation has access to historical quotation information.

(c) No Change.

\* \* \* \* \*

##### **IM-3110. Customer Account Information**

(a) Members should be aware that, effective January 1, 1990, any transaction [which] *that* involves a [non-Nasdaq.] non-exchange-listed equity security trading for less than five dollars per share may be subject to the provisions of SEC Rules 15g-1 through 15g-9, and those rules should be reviewed to determine if an executed customer suitability agreement is required.

(b) through (h) No Change.

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##### **[3350] 5100. Short Sale Rule**

(a) No member shall effect a short sale *in a Nasdaq National Market Security (as that term is defined in Rule 4200) otherwise than on an exchange* for the account of a customer or for its own account in a Nasdaq National Market security at or below the current national best (inside) bid when the current national best (inside) bid [as displayed by The Nasdaq Stock Market] is below the preceding national best (inside) bid in the security.

(b) No change.

(c) The provisions of paragraph (a) shall not apply to:

(1) Sales by a [qualified] registered market maker registered in the security *with* NASD [on Nasdaq] in connection with bona fide market making activity. For purposes of this paragraph,



transactions unrelated to normal market making activity, such as index arbitrage and risk arbitrage that are independent from a member's market making functions, will not be considered bona fide market-making activity.

(2) through (8) No Change.

(d) through (e) No Change.

(f) A member that is not currently registered as NASD [Nasdaq] market maker in a security and that has acquired a security while acting in the capacity of a block positioner shall be deemed to own such security for the purposes of this Rule notwithstanding that such member may not have a net long position in such security if and to the extent that such member's short position in such security is the subject of one or more offsetting positions created in the course of bona fide arbitrage, risk arbitrage, or bona fide hedge activities.

(g) through (h) No Change

(i) (1) A member shall be permitted, consistent with its quotation obligations, to execute a short sale for the account of a warrant market maker that would otherwise be in contravention of this Rule, if:

(A) The warrant market maker is a registered [Nasdaq] NASD market maker for the warrant; and

(B) No Change.

(j) No Change.

(k) Definitions

(1) through (2) No Change.

[(3)(A) Until February 1, 1996, the term "qualified market maker" shall mean a registered Nasdaq market maker that has maintained, without interruption, quotations in the subject security for the preceding 20 business days. Notwithstanding the 20-day period specified in this subparagraph, after an offering in a stock has been publicly announced, a registration statement has been filed, or a merger or acquisition involving two issues has been announced, no market maker may register in the stock as a qualified market maker unless it meets the requirements set forth below:]

[(i) For secondary offerings, the offering has become effective and the market maker has been registered in and maintained quotations without interruption in the subject security for 40 calendar days;]

[(ii) For initial public offerings, the market maker may register in the offering and immediately become a qualified market maker; provided however, that if the market maker withdraws on an unexcused basis from the security within the first 20 days of the offering, it shall not be designated as a qualified market maker on any

subsequent initial public offerings for the next 10 business days;]

[(iii) After a merger or acquisition involving an exchange of stock has been publicly announced and not yet consummated or terminated, a market maker may immediately register in either or both of the two affected securities as a qualified market maker pursuant to the same-day registration procedures in Rule 4611; provided, however, that if the market maker withdraws on an unexcused basis from any stock in which it has registered pursuant to this paragraph within 20 days of so registering, it shall not be designated as a qualified market maker pursuant to this subparagraph (3) for any subsequent merger or acquisition announced within three months subsequent to such unexcused withdrawal.]

[(B) For purposes of this subparagraph (3), a market maker will be deemed to have maintained quotations without interruption if the market maker is registered in the security and has continued publication of quotations in the security through Nasdaq on a continuous basis; provided however, that if a market maker is granted an excused withdrawal pursuant to the requirements of Rule 4619, the 20 business day standard will be considered uninterrupted and will be calculated without regard to the period of the excused withdrawal. Beginning February 1, 1996, the term "qualified market maker" shall mean a registered Nasdaq market maker that meets the criteria for a Primary Nasdaq Market Maker as set forth in Rule 4612.]

[(I) This Rule shall be in effect until March 1, 2002.]

\* \* \* \* \*

#### **IM-[3350]5100. Short Sale Rule**

(a) (1) In developing a Short Sale Rule for Nasdaq National Market securities *effected otherwise than on an exchange*, the Association *has* adopted an exemption to the Rule for certain market making activity. This exemption [was deemed] *is* an essential component of the Rule because bona fide market making activity is necessary and appropriate to maintain continuous, liquid markets in Nasdaq National Market securities. Rule 3350(c)(1) states that short selling prohibitions shall not apply to sales by [qualified] *registered* [Nasdaq] *NASD* market makers in connection with bona fide market making activity and specifies that transactions unrelated to normal market making activity, such as index arbitrage and risk arbitrage that are independent from a member's market making functions, will not be considered as

bona fide market making. Thus two standards are to be applied: one must be a [ "qualified" Nasdaq] *registered NASD* market maker and one must engage in "bona fide" market making activity to take advantage of this exemption. With this interpretation, the Association wishes to clarify for members some of the factors that will be taken into consideration when reviewing market making activity that may not be deemed to be bona fide market making activity and therefore would not be exempted from the Rule's application.

(2) through (3) No change.

(b) (1) Rule [3350] *5100* requires that no member shall effect a short sale *otherwise than on an exchange* for the account of a customer or for its own account in a Nasdaq National Market security at or below the current *national best* (inside) bid when the current *national best* (inside) bid [as displayed by The Nasdaq Stock Market] is below the preceding best (inside) bid in the security. The Association has determined that in order to effect a "legal" short sale when the current best bid is lower than the preceding best bid the short sale must be executed at a price of at least  $\frac{1}{16}$ th point above the current *national* inside bid when the current inside spread is  $\frac{1}{16}$ th point or greater. The last sale report for such a trade would, therefore, be above the *national* inside bid by at least  $\frac{1}{16}$ th of a point. If the current spread is less than  $\frac{1}{16}$ th of a point, however, the short sale must be executed at a price equal to or greater than the current inside offer price.

(2) Moreover, the Association believes that requiring short sales to be a minimum increment of  $\frac{1}{16}$ th point above the *national best* bid when the current spread is  $\frac{1}{16}$ th or greater and equal to or greater than the offer when the current spread is less than  $\frac{1}{16}$ th ensures that transactions are not effected at prices inconsistent with the underlying purpose of the Rule. It would be inconsistent with Rule [3350] *5100* for a member or customer to cause the inside spread for an issue to narrow when the current best bid is lower than the preceding best bid (e.g., lowering its offer to create an inside spread less than  $\frac{1}{16}$ th) for the purpose of facilitating the execution of a short sale at a price less than  $\frac{1}{16}$ th above the inside bid.

(3) *For Nasdaq National Market securities trading in decimals pursuant to the Decimals Implementation Plan for Equity and Options Markets, the Association has determined that in order to effect a "legal" short sale in such securities when the current bid is lower than the preceding bid the short sale must be executed at least \$0.01*

above the current inside bid. The last sale report for such a trade would, therefore, be above the inside bid by at least \$0.01.

(c) (1) No Change.

(2) For example, in instances where the current best bid is below the preceding best bid, if a market maker alone at the inside best bid were to lower its bid and then raise it to create an "up bid" for the purpose of facilitating a short sale, the Association would consider such activity to be a manipulative act and a violation of the Association's Short Sale Rule. The Association also would consider it a manipulative act and a violation of the Rule if a market maker with a long stock position were to raise its bid above the inside bid and then lower it to create a "down bid" for the purpose of precluding market participants from selling short. In addition, if a market maker agrees to an arrangement proposed by a member or a customer whereby the market maker raises its bid [in The Nasdaq Stock Market] in order to effect a short sale for the other party and is protected against any loss on the trade or on any other executions effected at its new bid price, the market maker would be deemed to be in violation of Rule [3350] 5100. Similarly, a market maker would be deemed in violation of the Rule if it entered into an arrangement with a member or a customer whereby it used its exemption from the rule to sell short at the bid at successively lower prices, accumulating a short position, and subsequently offsetting those sales through a transaction at a prearranged price, for the purpose of avoiding compliance with the Rule, and with the understanding that the market maker would be guaranteed by the member or customer against losses on the trades.

(3) No Change.

\* \* \* \* \*

The 4000 Series is replaced in its entirety by the following proposed rule language.

#### **4000. NASD Alternative Display Facility**

##### **4100. General**

The NASD Alternative Display Facility is the facility to be operated by the NASD for members that effect trades in Nasdaq and CQS/CTA ("ADF-eligible") securities otherwise than on an exchange. The NASD Alternative Display Facility will collect and disseminate quotations, compare trades, and collect and disseminate trade reports.

##### **4110. Use of NASD Alternative Display Facility Data Systems**

NASD may at any time authorize the use of NASD's Alternative Display Facility data systems on a test basis for whatever studies it considers necessary and appropriate.

##### **4200. DEFINITIONS**

(a) Unless the context requires otherwise, the terms used in the Rule 4000 through 6000 Series shall have the meanings below. Terms not specifically defined below shall have the meaning in NASD's By-Laws and Rules and SEC Rule 11Aa3-1.

(1) "Act" means the Securities Exchange Act of 1934.

(2) "ADF-eligible security" means a Nasdaq or CQS/CTA security.

(3) "CQS/CTA security" means a security that is eligible for inclusion in the CQ/CTA Plan as from time to time amended in accordance with the provisions of the Plan and with the approval of the SEC.

(4) "Nasdaq" means the registered national securities exchange and its facilities operated by The Nasdaq Stock Market, Inc.

(5) "Nasdaq market maker" shall have the meaning as defined in the Nasdaq rules.

(6) "Nasdaq National Market" or "NNM" is a distinct tier of the Nasdaq Stock Market comprised of securities that meet the requirements of and are authorized as a Nasdaq National Market Security.

(7) "Nasdaq National Market security" or "NNM security" shall have the meaning as defined in the Nasdaq rules.

(8) "Nasdaq security" means a security that is listed on the Nasdaq Stock Exchange.

(9) "Nasdaq SmallCap Market" or "SCM" is a distinct tier of The Nasdaq Stock Market comprised of securities that meet the requirements of and are authorized as a Nasdaq SmallCap Security.

(10) "Nasdaq SmallCap Market security" shall have the meaning as defined in the Nasdaq rules.

(11) "Non-Registered Member" means a member of NASD that is not a Registered Market Maker or a Registered ECN.

(12) "Normal unit of trading" means 100 shares of a security unless, with respect to a particular security, the market where the security is listed determines that a normal unit of trading shall constitute other than 100 shares. If a normal unit of trading is other than 100 shares, a special identifier shall be appended to the issuer's symbol.

(13) "Otherwise than on an exchange" means a trade effected by an NASD member otherwise than on or through a national securities exchange. The determination of what constitutes a trade "on or through" a particular national securities exchange shall be determined by that exchange in accordance with all applicable statutes, rules and regulations, and with any necessary SEC approval.

(14) "Registered ECN" means a member of NASD that is an electronic communications network ("ECN") that elects to display orders in the NASD Alternative Display Facility. A member is a Registered ECN in only those designated securities for which it is registered with NASD. A member shall cease being a Registered ECN in a designated security when it has withdrawn or voluntarily terminated its quotations in that security or when its quotations have been suspended or terminated by action of NASD.

(15) "Registered Market Maker" means a member of NASD that is registered as an NASD market maker in a particular designated security and, with respect to that security, holds itself out (by entering quotations in the NASD Alternative Display Facility) as being willing to buy and sell such security for its own account on a regular and continuous basis. A member is a Registered Market Maker in only those designated securities for which it is registered as an NASD market maker. A member shall cease being a Registered Market Maker in a designated security when it has withdrawn or voluntarily terminated its quotations in that security or when its quotations have been suspended or terminated by action of NASD.

(16) "SEC Rule 100," "SEC Rule 101," "SEC Rule 103," and "SEC Rule 104" mean the rules adopted by the Commission under Regulation M, and any amendments thereto.

(17) "Stabilizing bid" means the terms "stabilizing" or to "stabilize" as defined in SEC Rule 100.

(18) "Underwriting Activity Report" is a report provided by the Corporate Financing Department of NASD Regulation, Inc. in connection with a distribution of securities subject to SEC Rule 101 pursuant to NASD Rule 2710(b)(11) and includes forms that are submitted by members to comply with their notification obligations under Rules 4614, 4619, and 4623.

(b) For purposes of Rules 4619, and 4623, the following terms shall have the meanings as defined in SEC Rule 100: "affiliated purchaser," "distribution," "distribution participant," "independent bid," "net purchases,"

“passive market maker,” “penalty bid,” “reference security,” “restricted period,” “subject security,” and “syndicate covering transaction.”

Selected NASD Notices to Members: 94-70, 95-64, 95-82.

### 4300. Quote and Order Access Requirements

(a) To ensure that NASD Market Participants comply with their quote and order access obligations as defined below, for each security in which they elect to display a bid and offer (for Registered Market Makers), or a bid or offer (for Registered ECNs), in the Alternative Display Facility, NASD Market Participants must:

(1) Provide other NASD Market Participants direct electronic access, as defined below; and

(2) Provide NASD member broker-dealers that are not NASD Market Participants direct electronic access or allow for indirect electronic access, as defined below. Indirect electronic access must be readily available to broker-dealers seeking access, otherwise the NASD Market Participant must provide direct electronic access. In any event, an NASD Market Participant is prohibited from (A) in any way directly or indirectly influencing or prescribing the prices that their customer broker-dealer may choose to impose for providing indirect access; and (B) precluding or discouraging indirect electronic access, including through the imposition of discriminatory pricing or quality of service with regard to a broker-dealer that is providing indirect electronic access.

(b) Subject to the terms and conditions contained herein, all NASD Market Participants that display quotations in the NASD Alternative Display Facility must record each item of information described in paragraphs (b)(1) and (2) of this Rule for all orders they receive via direct or indirect electronic access, and report this information to the NASD as specified below.

(1) NASD Market Participants must record the following information for every order they receive via direct or indirect electronic access during the trading day:

- (A) Unique Order Identifier
- (B) Order Entry Firm (OEID)
- (C) Order Side (Buy/Sell)
- (D) Order Quantity
- (E) Issue Identifier
- (F) Order Price
- (G) Order Price Modifier (i.e. .N)
- (H) Time In Force (i.e. 3 minutes, day, etc.)
- (I) Order Date
- (J) Order Time (including seconds)

(K) Minimal Acceptable Quantity (i.e. C1, M1, AON, etc.)

(L) Market Making Firm (MMID)  
The information described in paragraphs (A) through (L) must be reported to the NASD within 10 seconds of receipt of the order.

(2) In addition to the information previously provided pursuant to paragraph (b)(1), NASD Market Participants must record the following information, as applicable, for every order that has been acted upon or responded to:

- (A) Unique Order Identifier (as provided in paragraph (b)(1)(A))
- (B) Order Response (i.e. E=Execute, D=Decline, X=Cancel, T=timed out, P=partial, etc.)
- (C) Order Response Time (including seconds)
- (D) Partial Quantity
- (E) Counter Price
- (F) Total Execution Quantity
- (G) Execution Price

The information described in paragraphs (A) through (G) must be reported to the NASD within 10 seconds of any response to or action taken regarding an order.

#### (3) Maintaining and Preserving Records

(A) In addition to submitting the information described herein to the NASD, each member shall maintain and preserve records of the information required to be recorded under this Rule for the period of time and accessibility specified in SEC Rule 17a-4(b).

(B) The records required to be maintained and preserved under this Rule may be immediately produced or reproduced on “micrographic media” as defined in SEC Rule 17a-4(f)(1)(i) or by means of “electronic storage media” as defined in SEC Rule 17a-4(f)(1)(ii) that meet the conditions set forth in SEC Rule 17a-4(f) and may be maintained and preserved for the required time in that form.

#### (4) Orders Not Required To Be Recorded

The recording and reporting requirements contained in paragraphs (a) and (b) of this Rule shall not apply to orders received via ITS or any system operated by a national securities exchange or national securities association.

#### (5) Method of Transmitting Data

Members shall transmit this information in such form as prescribed by the Association.

#### (6) Reporting Agent Agreements

(A) “Reporting Agent” shall mean a third party that enters into any agreement with a member pursuant to

which such third party agrees to fulfill such member’s obligations under this Rule.

(B) Any member may enter into an agreement with a Reporting Agent pursuant to which the Reporting Agent agrees to fulfill the obligations of such member under this Rule. Any such agreement shall be evidenced in writing, which shall specify the respective functions and responsibilities of each party to the agreement that are required to effect full compliance with the requirements of this Rule.

(C) All written documents evidencing an agreement described in paragraph (6)(B) shall be maintained by each party to the agreement.

(D) Each member remains responsible for compliance with the requirements of this Rule, notwithstanding the existence of an agreement described in this paragraph.

#### (7) Withdrawal of Quotations

If an NASD Market Participant knows or has reason to believe that it or its Reporting Agent is not complying with the requirements of this Rule, the member must withdraw its quotations from the NASD Alternative Display Facility until such time that the member is satisfied that its order information is being properly recorded and reported.

(c) NASD Market Participants are required to specify as part of their NASD Alternative Display Facility Workstation Subscriber Agreement the method and terms by which they will comply with the requirements of this Rule. NASD Regulation staff will not approve a Market Participant’s Subscriber Agreement unless the method and terms provided by the Market Participant are in compliance with this Rule.

#### (d) Definitions

(1) Customer broker-dealer is any broker-dealer that has, or seeks to have, an ongoing relationship with a Market Participant, including an ECN subscriber, for the purposes of executing securities transactions.

(2) Direct electronic access means the ability to deliver an order for execution directly against an individual NASD Market Participant’s best bid and offer subject to quote and order access obligations, as defined herein, without the need for voice communication, with the equivalent speed, reliability, availability, and cost, as are made available to the NASD Market Participant’s own customer broker-dealers or other active customers or subscribers.

(3) Indirect electronic access means the ability to route an order through

customer broker-dealers of an NASD Market Participant that are not affiliates of the NASD Market Participant, for execution against the NASD Market Participant's best bid and offer subject to quote and order access obligations, without the need for voice communication, with equivalent speed, reliability, availability, and cost, as are made available to the Market Participant's customer broker-dealer providing the indirect access or other active customers or subscribers. The NASD Market Participant's customer broker-dealers providing indirect electronic access shall remain responsible for all orders routed through them as though the orders were the firms' own orders.

(4) NASD Market Participant means (a) an NASD Registered Market Maker, (b) an ATS, (c) or an NASD Registered ECN.

(5) Best bid and offer for purposes of this Rule includes the best-priced buy and sell orders of an NASD Registered ECN.

(6) Quote and Order Access Obligations include the requirements under this Rule and the firm quote obligations under Rule 11Ac1-1 under the Act, the standards under Rule 11Ac1-1(c)(5)(ii)(A)(2) under the Act, Sections 301(b)(3) through (5) of Regulation ATS and other order access-related regulatory requirements for ATSs, ECNs and market makers. Obligations under this Rule include providing the ability to send or receive Trade-or-Move messages, identifiable as such, as required by Rule 4613(d) and providing access to any reserved size orders as required by Rule 4623(c).

\* \* \* \* \*

## **4600. TRADING IN NASDAQ SECURITIES**

### **4610. Registration and Other Requirements**

#### **4611. Registration as a Market Maker**

(a) Quotations and quotation sizes in Nasdaq securities may be entered into the NASD Alternative Display Facility only by a Registered Market Maker or other entity approved by NASD to function in a market-making capacity.

(b) An NASD member seeking registration as a market maker shall file an application with NASD. The application shall certify the member's good standing with NASD and shall demonstrate compliance with the net capital and other financial responsibility provisions of the Act. It shall be sufficient to obtain registration as a market maker for a member to demonstrate proof that it is a registered

Nasdaq market maker in good standing. A member's registration as a market maker shall become effective upon receipt by the member of notice of approval of registration from NASD.

(c) A market maker may become registered in an issue by entering a registration request via an NASD terminal or other NASD approved electronic interface with NASD's systems or by contacting NASD Alternative Display Facility Operations. If the requirements of paragraph (b) above are satisfied, registration shall become effective on the day the registration request is entered. It shall be sufficient to obtain registration in an issue for a member to demonstrate proof that it is currently registered in that issue as a Nasdaq market maker and is in good standing.

(d) A market maker's registration in an issue shall be terminated if the market maker fails to enter quotations in the issue within five (5) business days after the market maker's registration in the issue becomes effective.

Selected NASD Notices to Members: 93-24, 94-68, 94-83.

4612. Reserved

### **4613. Character of Quotations**

#### **(a) Two-Sided Quotations**

(1) For each Nasdaq security for which a member is a Registered Market Maker, the member shall be willing to buy and sell such security for its own account on a continuous basis and shall enter and maintain two-sided quotations through the NASD Alternative Display Facility, subject to the procedures for excused withdrawal set forth in Rule 4619.

(A) A Registered Market Maker in a security listed on Nasdaq must display a quotation size for at least one normal unit of trading (or a larger multiple thereof) when it is not displaying a limit order in compliance with SEC Rule 11Ac1-4, provided, however, that a Registered Market Maker may augment its displayed quotation size to display limit orders priced at the market maker's quotation.

#### **(B) Minimum Price Variation for Decimal-based Quotations**

The minimum quotation increment for securities authorized for decimal pricing as part of the SEC-approved Decimals Implementation Plan for the Equities and Options Markets shall be \$0.01. Quotations failing to meet this standard shall be rejected.

#### **(b) Firm Quotations**

(1) A Registered Market Maker that receives an offer to buy or sell from another NASD member shall execute a

transaction for at least a normal unit of trading at its displayed quotations as disseminated through the NASD Alternative Display Facility at the time of receipt of any such offer. If a Registered Market Maker displays a quotation for a size greater than a normal unit of trading, it shall, upon receipt of an offer to buy or sell from another NASD member, execute a transaction at least at the size displayed.

(2) If a Registered Market Maker, upon receipt of an offer to buy or sell from another NASD member in any amount that is at least one normal unit of trading greater than its published quotation size as disseminated through the NASD Alternative Display Facility at the time of receipt of any such offer, executes a transaction in an amount of shares less than the size of the offer, then such Registered Market Maker shall, immediately after such execution, display a revised quotation at a price that is inferior to its previous published quotation. The failure of a Registered Market Maker to execute the offer in an amount greater than its published quotation size shall not constitute a violation of subparagraph (b)(1) of this rule.

#### **(c) Quotations Reasonably Related to the Market**

A Registered Market Maker shall enter and maintain quotations that are reasonably related to the prevailing market. In the event it appears that a Registered Market Maker's quotations are no longer reasonably related to the prevailing market, NASD may require the market maker to re-enter its quotations. If a Registered Market Maker whose quotations are no longer reasonably related to the prevailing market fails to re-enter its quotations, NASD may suspend the market maker's quotations in one or all securities.

(1) In the event that a Registered Market Maker's ability to enter or update quotations is impaired, the Registered Market Maker shall immediately contact NASD Alternative Display Facility Operations to request the withdrawal of its quotations.

(2) In the event that a Registered Market Maker's ability to enter or update quotations is impaired and the Registered Market Maker elects to continue to participate through the NASD Alternative Display Facility, the Registered Market Maker shall execute an offer to buy or sell received from another NASD member at its quotations as disseminated through the NASD Alternative Display Facility.

*(d) Locked and Crossed Markets*

(1) A Registered Market Maker shall not, except under extraordinary circumstances, enter or maintain quotations through the NASD Alternative Display Facility during normal business hours if:

(A) the bid quotation entered is equal to ("lock") or greater than ("cross") the asked quotation of another market maker entering quotations in the same security; or

(B) the asked quotation is equal to ("lock") or less than ("cross") the bid quotation of another market maker entering quotations in the same security.

*(2) Obligations Regarding Locked/Crossed Market Conditions Prior to Market Opening*

(A) *Locked/Crossed Market Prior to 9:20 a.m.*—For locks/crosses that occur prior to 9:20 a.m. Eastern Time, a Registered Market Maker that is a party to a lock/cross because the Registered Market Maker either has entered a bid (ask) quotation that locks/crosses another market maker's quotation(s) or has had its quotation(s) locked/crossed by another market maker ("party to a lock/cross") may, beginning at 9:20 a.m. Eastern Time, send a message, making use of direct electronic access in accordance with Rule 4300, of any size, that is at the receiving market maker's quoted price ("Trade-or-Move Message"). Any Registered Market Maker that receives a Trade-or-Move Message at or after 9:20 a.m. Eastern Time, and that is a party to a lock/cross, must within 30 seconds of receiving such message either: fill the incoming Trade-or-Move Message for the full size of the message; or move its bid down (offer up) by a quotation increment that unlocks/uncrosses the market.

(B) *Locked/Crossed Market Between 9:20 and 9:29:59 a.m.*—If a Registered Market Maker locks or crosses the market between 9:20 and 9:29:59 a.m. Eastern Time, the Registered Market Maker must immediately send, making use of direct electronic access in accordance with Rule 4300, to the market maker whose quotes it is locking or crossing a Trade-or-Move message that is at the receiving market maker's quoted price and that is for at least 5,000 shares (in instances where there are multiple market makers to a lock/cross, the locking/crossing market maker must send a message to each party to the lock/cross and the aggregate size of all such messages must be at least 5,000 shares); provided, however, that if a market participant is representing an agency order, the market participant shall be required to send a Trade-or-Move Message(s) in an

amount equal to the agency order, even if that order is less than 5,000 shares. A Registered Market Maker that receives a Trade-or-Move Message during this period and that is a party to a lock/cross, must within 30 seconds of receiving such message either: fill the incoming Trade-or-Move Message for the full size of the message; or move its bid down (offer up) by a quotation increment that unlocks/uncrosses the market.

(C) A Registered Market Maker that sends a Trade-or-Move Message pursuant to of this rule must append to the message a symbol indicating that it is a Trade-or-Move Message.

(D) For the purposes of this rule "agency order" shall mean an order(s) that is for the benefit of the account of a natural person executing securities transactions with or through or receiving investment banking services from a broker/dealer, or for the benefit of an "institutional account" as defined in NASD Rule 3110. An agency order shall not include an order(s) that is for the benefit of a market maker in the security at issue, but shall include an order(s) that is for the benefit of a broker/dealer that is not a market maker in the security at issue.

(3) A Registered Market Maker, prior to entering a quotation that locks or crosses another quotation, must make reasonable efforts to avoid such locked or crossed market by executing transactions with all market makers whose quotations would be locked or crossed. Reasonable efforts shall include making use of direct electronic access in accordance with Rule 4300. Pursuant to the provisions of paragraph (b) of this Rule, a Registered Market Maker whose quotations are causing a locked or crossed market is required to execute transactions at its quotations as displayed through the NASD Alternative Display Facility at the time of receipt of any order.

(4) For purposes of this Rule 4613(d), the term "Registered Market Maker" shall include:

(A) any NASD member that enters into an ECN, as that term is defined in SEC Rule 11Ac1-1(a)(8), a order that is displayed through the NASD Alternative Display Facility;

(B) any NASD member that operates the ECN when the order being displayed has been entered by a person or entity that is not an NASD member;

(C) any NASD member that enters into an ATS, as that term is defined in SEC Regulation ATS, a priced order that is displayed through the NASD Alternative Display Facility; and

(D) any NASD member that operates the ATS when the priced order being

displayed has been entered by a person or entity that is not an NASD member.

*(e) Other Quotation Obligations*

(1) Members that display priced quotations on a real-time basis for Nasdaq securities in two or more market centers that permit quotation updates on a real-time basis must display the same priced quotations for the security in each market center.

(2) A member that is registered as a market maker in a Nasdaq security shall be obligated to have available in close proximity to the NASD Alternative Display Facility terminal at which it makes a market in a Nasdaq security a quotation service that disseminates the bid price and offer price then being furnished by or on behalf of national securities exchanges and other market makers trading and quoting that Nasdaq security.

Selected NASD Notices to Members: 91-37, 93-2, 93-43, 99-61.

**IM-4613. Autoquote Policy**

(a) *General Prohibition*—NASD bans the automated update of quotations by market makers through the NASD Alternative Display Facility. Except as provided below, this policy prohibits systems known as "autoquote" systems from effecting automated quote updates or tracking of inside quotations through the NASD Alternative Display Facility. This ban is necessary to offset the negative impact on the capacity and operation of the NASD Alternative Display Facility caused by certain autoquote techniques that track changes to the inside quotation and automatically react by generating another quote to keep the market maker's quote away from the best market.

(b) *Exceptions to the General Prohibition*—Automated updating of quotations is permitted when: (1) the update is in response to an execution in the security by that firm (such as execution of an order that partially fills a market maker's quotation size), and is in compliance with Rule 4613(b)(2); (2) it requires a physical entry (such as a manual entry to the market maker's internal system which then automatically forwards the update to Nasdaq); or (3) the update is to reflect the receipt, execution, or cancellation of a customer limit order. elected NASD Notices to Members: 99-61.

4614. Reserved

4615. Reserved

4616. Reserved

**4617. Normal Business Hours**

A Registered Market Maker shall be open for business as of 9:30 a.m.

Eastern Time and shall close no earlier than 4:00 p.m. Eastern Time. An NASD Registered Market Maker may remain open for business on a voluntary basis for any period of time between 4:00 p.m. Eastern time and 6:30 p.m. Eastern Time. Registered Market Makers whose quotes are open after 4:00 p.m. Eastern Time shall be obligated to comply, while their quotes are open, with all NASD Rules that are not by their express terms, or by an official interpretation of NASD, inapplicable to any part of the 4:00 p.m. to 6:30 p.m. Eastern Time period.

4618. Reserved

#### **4619. Withdrawal of Quotations and Passive Market Making**

(a) A Registered Market Maker that wishes to withdraw quotations in a security or have its quotations identified as the quotations of a passive market maker shall contact NASD Alternative Display Facility Operations to obtain excused withdrawal status prior to withdrawing its quotations or identification as a passive market maker. Withdrawals of quotations or identifications of quotations as those of a passive market maker shall be granted by NASD Alternative Display Facility Operations only upon satisfying one of the conditions specified in this Rule.

(b) Excused withdrawal status based on circumstances beyond the market maker's control may be granted for up to five (5) business days, unless extended by NASD Alternative Display Facility Operations. Excused withdrawal status based on demonstrated legal or regulatory requirements, supported by appropriate documentation and accompanied by a representation that the condition necessitating the withdrawal of quotations is not permanent in nature, may, upon notification, be granted for not more than sixty (60) days (unless such request is required to be made pursuant to paragraph (d) below). Excused withdrawal status based on religious holidays may be granted only if notice is received by NASD one business day in advance and is approved by NASD. Excused withdrawal status based on vacation may be granted only if:

(1) The request for withdrawal is received by NASD one business day in advance, and is approved by NASD;

(2) the request includes a list of the securities for which withdrawal is requested; and

(c) Excused withdrawal status may be granted to a Registered Market Maker that has withdrawn from an issue prior to the public announcement of a merger or acquisition and wishes to re-register in the issue pursuant to the same-day

registration procedures contained in Rule 4611, above, provided the Registered Market Maker has remained registered in one of the affected issues. The withdrawal of quotations because of pending news, a sudden influx of orders or price changes, or to effect transactions with competitors shall not constitute acceptable reasons for granting excused withdrawal status; or

(d) Excused withdrawal status may be granted to a member that experiences a documented problem or failure impacting the operation or utilization of any automated system operated by or on behalf of the firm (chronic system failures within the control of the member will not constitute a problem or failure impacting a firm's automated system).

(e) Excused withdrawal status may be granted to a Registered Market Maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency, thereby terminating its registration as a Registered Market Maker; provided however, that if NASD finds that the Registered Market Maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused pursuant to Rule 4620.

(f) Excused withdrawal status or passive market maker status may be granted to a Registered Market Maker that is a distribution participant (or, in the case of excused withdrawal status, an affiliated purchaser) in order to comply with SEC Rules 101, 103, or 104 under the Act on the following conditions:

(1) A member acting as a manager (or in a similar capacity) of a distribution of a security that is a subject security or reference security under Rule 101 and any member that is a distribution participant or an affiliated purchaser in such a distribution that does not have a manager shall provide written notice to NASD Alternative Display Facility Operations and the Market Regulation Department of NASD Regulation, Inc. no later than the business day prior to the first entire trading session of the one-day or five-day restricted period under SEC Rule 101, unless later notification is necessary under the specific circumstances.

(A) The notice required by subparagraph (f)(1) of this Rule shall be provided by submitting a completed Underwriting Activity Report that includes a request on behalf of each market maker that is a distribution participant or an affiliated purchaser to withdraw the market maker's quotations, or that includes a request on

behalf of each market maker that is a distribution participant (or an affiliated purchaser of a distribution participant) that its quotations be identified as those of a passive market maker and includes the contemplated date and time of the commencement of the restricted period.

(B) The managing underwriter shall advise each Registered Market Maker that it has been identified as a distribution participant or an affiliated purchaser to NASD Alternative Display Facility Operations and that its quotations will be automatically withdrawn or identified as passive market maker quotations, unless a market maker that is a distribution participant (or an affiliated purchaser of a distribution participant) notifies NASD Alternative Display Facility Operations as required by subparagraph (f)(2), below.

(2) A Registered Market Maker that has been identified to NASD Alternative Display Facility Operations as a distribution participant (or an affiliated purchaser of a distribution participant) shall promptly notify NASD Alternative Display Facility Operations and the manager of its intention not to participate in the prospective distribution or not to act as a passive market maker in order to avoid having its quotations withdrawn or identified as the quotations of a passive market maker.

(3) If a Registered Market Maker that is a distribution participant withdraws its quotations in a Nasdaq security in order to comply with the net purchases limitation of SEC Rule 103 or with any other provision of SEC Rules 101, 103, or 104 and promptly notifies NASD Alternative Display Facility Operations of its action, the withdrawal shall be deemed an excused withdrawal. Nothing in this subparagraph shall prohibit NASD from taking such action as is necessary under the circumstances against a member and its associated persons for failure to contact NASD Alternative Display Facility Operations to obtain an excused withdrawal as required by subparagraphs (a) of this Rule.

(4) The quotations of a passive market maker shall be identified on NASD Alternative Display Facility Data Systems as those of a passive market maker.

(5) A member acting as a manager (or in a similar capacity) of a distribution subject to subparagraph (f)(1) of this Rule shall submit a request to NASD Alternative Display Facility Operations and the Market Regulation Department of NASD Regulation, Inc. to rescind the excused withdrawal status or passive market making status of distribution

participants and affiliated purchasers, which request shall include the date and time of the pricing of the offering, the offering price, and the time the offering terminated, and, if not in writing, shall be confirmed in writing no later than the close of business the day the offering terminates. The request referenced in this subparagraph may be submitted on the Underwriting Activity Report.

(g) The NASD Alternative Display Facility Operations Review Committee shall have jurisdiction over proceedings brought by market makers seeking review of a denial of an excused withdrawal pursuant to this Rule, or the conditions imposed on their reentry. Selected NASD Notices to Members: 88-69, 89-15, 93-29, 93-41.

#### **4620. Voluntary Termination of Registration**

A Registered Market Maker may voluntarily terminate its registration in a security by (1) withdrawing its quotations from the NASD Alternative Display Facility and not re-entering its quotations for five (5) minutes or (2) failing to re-enter quotations within thirty (30) minutes of the end of a trading halt. A Registered Market Maker that voluntarily terminates its registration in a security may not re-register as a market maker in that security for twenty (20) business days, absent an excused withdrawal specified in Rule 4619. Withdrawal from participation as a Registered Market Maker in the NASD Alternative Display Facility shall constitute termination of registration as a market maker in that security for purposes of this Rule; provided, however, that a Registered Market Maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency and thereby terminates its registration as a market maker in Nasdaq securities may register as a market maker at any time after a clearing arrangement has been reestablished.

#### **4621. Suspension and Termination of Quotations by NASD Action**

NASD may, pursuant to the procedures set forth in the Rule 9000 Series, suspend, condition, limit, prohibit or terminate a Registered Market Maker's authority to enter quotations in one or more authorized securities for violations of applicable requirements or prohibitions.

#### **4622. Termination of NASD Alternative Display Facility Data System Service**

NASD may, upon notice, terminate NASD Alternative Display Facility Data System service in the event that a Registered Market Maker fails to qualify under specified standards of eligibility or fails to pay promptly for services rendered by NASD. Selected NASD Notices to Members: 88-43.

#### **4623. Alternative Trading Systems**

(a) NASD may provide a means to permit alternative trading systems ("ATSs"), as such term is defined in Regulation ATS, and electronic communications networks ("ECNs"), as such term is defined in SEC Rule 11Ac1-1(a)(8), to comply with the display requirements of SEC Rule 301(b)(3) and the terms of the ECN display alternative provided for in SEC Rule 11Ac1-1(c)(5)(ii)(A) and (B) ("ECN display alternatives"). NASD will not facilitate compliance with access requirements, which are the responsibility of Market Participants under Rule 4300.

(b) An ATS or ECN that seeks to use the NASD-provided means to comply with SEC Rule 301(b)(3), the ECN display alternatives shall:

(1) Demonstrate to NASD that it is in compliance with Regulation ATS or that it qualifies as an ECN meeting the definition in the SEC Rule;

(2) be registered as a NASD member;

(3) enter into and comply with the terms of a NASD Alternative Display Facility Workstation Subscriber Agreement, as amended for ATSs and ECNs;

(4) agree to provide for NASD's dissemination in the quotation data made available to quotation vendors the prices and sizes of NASD Registered Market Maker orders (and orders from other subscribers of the ATS or ECN, if the ATS or ECN so chooses or is required by SEC Rule 301(b)(3) to display a subscriber's order in the NASD Alternative Display Facility), at the highest buy price and the lowest sell price for each Nasdaq security entered in and widely disseminated by the ATS or ECN; and prior to entering such prices and sizes, register with NASD Alternative Display Facility Operations as an ATS or ECN; and

(5) comply with Rule 4300.

(c) When a NASD member attempts to access electronically an ATS or ECN-displayed order by sending an order that is larger than the ATS's or ECN's Nasdaq-displayed size and the ATS or ECN is displaying the order on a reserved size basis, the NASD member

that operates the ATS or ECN shall execute such delivered order:

(1) Up to the size of the delivered order, if the ATS or ECN order (including the reserved size and displayed portions) is the same size or larger than the NASD-delivered order; or

(2) up to the size of the ATS or ECN order (including the reserved size and displayed portions), if the delivered order is the same size or larger than the ATS or ECN order (including the reserved size and displayed portions).

No ATS or ECN operating through the NASD Alternative Display Facility pursuant to this Rule is permitted to provide a reserved-size function unless the size of the order displayed through the NASD Alternative Display Facility is 100 shares or greater. For purposes of this Rule, the term "reserved size" shall mean that a customer entering an order into an ATS or ECN has authorized the ATS or ECN to display publicly part of the full size of the customer's order with the remainder held in reserve on an undisplayed basis to be displayed in whole or in part as the displayed part is executed.

4624. Reserved

#### **4625. Regulatory Cooperation**

(a) The NASD may enter into agreements with other self-regulatory organizations, markets, associations and other entities that provide for the exchange of information and other forms of mutual assistance for regulatory purposes.

(b) No member or associated person shall refuse a request to appear and testify before, or provide documents or other information to, another self-regulatory organization, market, association or other entity with which NASD has entered into an agreement pursuant to paragraph (a) of this Rule, provided that the request is made in connection with an investigation or proceeding covered by the agreement with NASD. The requirements of this paragraph (b) shall apply irrespective of whether the NASD has initiated its own investigation or proceeding.

(c) Whenever a member or associated person responds to a request pursuant to this Rule, the member or associated person shall have all the same rights and obligations that would be accorded if the request had been made pursuant to Rule 8210.

**4630. Reporting Transactions in Securities Listed on Nasdaq**

4631. Reserved

4632. Reserved

**4633. Transactions Reported by Members****(a) General**

(1) This Rule governs the reporting of trades through the NASD's Trade Reporting and Comparison Service ("TRACS") in Nasdaq securities effected otherwise than on an exchange.

(2) All times referenced in this Rule are Eastern time.

(3) For Purposes of this Rule, the term "Reporting NASD Member" or "Reporting Member" shall mean an NASD member with the trade reporting obligation as set forth in Rule 4633(d).

(4) For purposes of this Rule, the term "Non-Reporting NASD Member" or "Non-Reporting Member" shall mean the contra side of a trade reported by a Reporting Member.

(5) For purposes of this Rule, the term "normal market hours" means from 9:30 a.m. to 4:00 p.m.

(6) Times in trade reports shall be expressed in hours, minutes, and seconds according to the 24 hour clock (e.g., a trade executed at 1:30:45 p.m. Eastern Time shall be reported as executed at 13:30:45). All times referenced in this Rule are Eastern Time.

(7) Participation in the trade reporting function of TRACS is mandatory for all members that have trade reporting obligations under this Rule. Participation in the trade reporting function of TRACS is conditioned upon (a) execution of, and continuing compliance with, a TRACS trade reporting Participant Application Agreement and (b) maintenance of the physical security of the equipment on the premises of the member to prevent unauthorized entry of information into the trade reporting function of TRACS.

**(b) Normal Market Hours**

Reporting NASD Members shall transmit last sale reports in Nasdaq securities effected otherwise than on an exchange to TRACS within 90 seconds after execution. Transactions not reported within 90 seconds after execution shall be designated as late and such trade reports must include the time of execution.

**(c) Outside Normal Market Hours**

Transactions in Nasdaq securities effected otherwise than on an exchange outside normal market hours shall be reported by members to TRACS as set out below.

(1) For transactions effected otherwise than on an exchange between the hours of 8:00 a.m. and 9:30 a.m. and 4:00 p.m. and 6:30 p.m.,

(A) A Reporting NASD Member shall transmit last sale reports to TRACS within 90 seconds after execution. Such last sale reports shall be designated as ".T" trades to denote their execution outside normal market hours.

Transactions not reported within 90 seconds must include the time of execution on the trade report.

(2) For transactions effected otherwise than on an exchange between the hours of midnight and 8:00 a.m.,

(A) A Reporting NASD Member shall transmit last sale reports to TRACS between 8:00 a.m. and 9:30 a.m. on trade date. Such last sale reports shall be designated as ".T" trades, to denote their execution outside normal market hours, and must include the time of execution.

(3) For securities transactions effected otherwise than on an exchange between the hours of 6:30 p.m. and 12:00 p.m.

(A) A Reporting NASD Member shall transmit last sale reports to TRACS on the next business day (T+1) between 8:00 a.m. and 6:30 p.m. Such last sale reports shall be designated "as/of" trades, to denote their execution on a prior day, and must include the time of execution.

**(d) Determining Which Party Reports a Transaction**

(1) For transactions between two Registered Market Makers or Registered ECNs, the Registered Market Maker or ECN representing the sell side shall report the transaction.

(2) For transactions between a Registered Market Maker or Registered ECN and a Non-Registered Member, the Registered Market Maker or ECN shall report the transaction.

(3) For transactions between two Non-Registered Members, the Non-Registered Member representing the sell side shall report the transaction.

(4) For transactions between a member and a customer, the member shall report the transaction.

(5) For transactions between a member and a broker-dealer that is not a member of NASD, the member shall report the transaction.

(6) For all transactions between an NASD member and an NASD member that is also a member of Nasdaq or another national securities exchange, where the reporting party has a choice of reporting venues and chooses not to report to Nasdaq or another national securities exchange, the reporting party described in (1) through (5) above shall report the transaction to the NASD.

**(e) Information To Be Reported—Two Party Trade Reports**

(1) A two party trade report is a last sale report that denotes a trade between one Reporting NASD member and one Non-Reporting Member. The Reporting NASD Member is denoted as the ("MMID") side of the trade report and the Non-Reporting Member is denoted as the ("OEID") side of the report.

(2) Each Two Party Last Sale Report Submitted by a Reporting NASD Member Should Contain:

(A) Security identification symbol (SECID);

(B) Number of shares or bonds;

(C) Price of the transaction as required by paragraph (h) below;

(D) A designated symbol denoting whether the transaction, from the Reporting NASD Member's perspective, is a buy, sell, sell short, sell short exempt, or cross;

(E) If known, a designated symbol denoting whether the transaction, from the perspective of the Non-Reporting Member, is a buy, sell, sell short, or sell short exempt;

(F) A designated symbol denoting whether the transaction, from the perspective of the Reporting Member, is a principal, riskless principal, or agent;

(G) If known, a designated symbol denoting whether the transaction, from the perspective of the Non-Reporting Member, is a principal, riskless principal, or agent;

(H) For any transaction in an order for which a member has recording and reporting obligations under NASD Rules 6954 and 6955, the trade report must include:

(i) An order identifier, meeting such parameters as may be prescribed by the NASD, assigned to the order that uniquely identifies the order for the date it was received (see Rule 6954(b)(1));

(ii) The time of execution. This information must be reported regardless of the period of time between execution of the trade and the NASD report.

(I) Execution time for any transaction not reported within 90 seconds of execution;

(J) The market participant identifier of the Reporting Member and the Non-Reporting Member;

(K) Reporting Member clearing broker;

(L) Reporting Member Executing Broker in case of a "give up;"

(M) Non-Reporting Member Executing Broker;

(N) Non-Reporting Member introducing broker in case of a "give up;"

(O) Non-Reporting Member clearing broker;



(P) A designated symbol denoting whether the trade report should be published;

(Q) A designated symbol denoting whether the trade report should be compared in TRACS;

(R) If the contra side to the trade report is a customer of the Reporting Member, the Reporting Member shall denote that the trade is an internalized trade with the designated symbol;

(S) If the contra side to the trade report is a Non-NASD member, the Reporting Member shall indicate with the designated symbol that the contra side is a non-member.

(T) For two party trade reports submitted pursuant to an Automated Give Up ("AGU") arrangement or a Qualified Service Representative ("QSR") Agreement, disclosure of the information set forth in subparagraphs (e) (2) (E) and (G) is mandatory.

**(f) Information To Be Reported—Three Party Trade Reports**

(1) A three party trade report is a single last sale trade report that denotes one Reporting Member and two contra parties. The Reporting Member is denoted as the MMID side of the trade report and the two non-reporting sides are denoted as the OEID side of the trade report. In a three party report, the Reporting Member is the buyer to one OEID and the seller to the other OEID. Registered ECNs shall only submit three party trade reports. Riskless principal trades may be submitted by reporting members as three party trade reports.

(2) Each Three Party Trade Report Submitted by a Reporting Member shall contain the following information:

**Transaction Information**

(A) Security Identification Symbol (SECID);

(B) Number of shares or bonds;

(C) Price of the transaction as required by paragraph (h) below;

(D) Execution time for any transaction not reported within 90 seconds of execution;

(E) The market participant identifier of the Reporting Member and the two Non-Reporting Members;

(F) A designated symbol denoting whether the trade should be published;

(G) For any transaction in an order for which a member has recording and reporting obligations under NASD Rules 6954 and 6955, the trade report must include:

(i) An order identifier, meeting such parameters as may be prescribed by the NASD, assigned to the order that uniquely identifies the order for the date it was received (see Rule 6954(b)(1)). This order number must associate both

the buy side and sell side OATS Execution Reports to the TRACS report;

(ii) The time of execution. This information must be reported regardless of the period of time between execution of the trade and the NASD report.

**MMID Side**

(H) All three party trade reports from ECNs must be marked as agency cross transactions;

(I) All three party trade reports from Non-ECNs must be denoted as riskless principal trade reports and shall include a designated symbol denoting whether the trade between the non-ECN and the buy-side OEID is a sell, sell short, or sell short exempt transaction;

(J) Reporting Member clearing broker;

(K) Reporting Member Executing Broker in the case of a "give up";

**Buy Side OEID**

(L) Buy Side OEID executing broker;

(M) Buy Side OEID introducing broker in case of a "give up";

(N) Buy Side OEID clearing broker;

(O) If known, a designated symbol denoting whether the trade, from the Buy Side OEID's perspective, is as principal, riskless principal, or agent;

(P) If the Buy Side OEID is a customer of the Reporting Member, the Reporting Member shall denote that the trade is an internalized trade with the designated symbol;

(Q) If the Buy Side OEID is a non-NASD member, the Reporting Member shall indicate with the designated symbol that the buy side OEID is a non-member;

(R) A designated symbol denoting whether the trade between the MMID and the Buy Side OEID shall be compared in TRACS;

**Sell Side OEID**

(S) Sell Side OEID executing broker;

(T) Sell Side OEID introducing broker in case of a "give up";

(U) Sell Side OEID clearing broker;

(V) If known, a designated symbol denoting whether the trade, from the Sell Side OEID's perspective, is as principal, riskless principal, or agent;

(W) If known, a symbol denoting whether the trade, from the Sell Side OEID's perspective, is a sell, sell short, or sell short exempt transaction;

(X) If the Sell Side OEID is a customer of the Reporting Member, the Reporting Member shall denote that the trade is an internalized trade with the designated symbol;

(Y) If the Sell Side OEID is a non-NASD Member, the Reporting Member shall indicate with the designated symbol that the buy side OEID is a non-member;

(Z) A designated symbol denoting whether the trade between the MMID and the Sell Side OEID shall be compared in TRACS;

(AA) If the transactions between the Buy Side OEID and the Reporting Member is reported pursuant to an AGU arrangement or a QSR agreement, disclosure of the information set forth in subparagraph (f) (2) (O) is mandatory; and

(BB) If the transaction between the Sell Side OEID and the Reporting Member is reported pursuant to an AGU arrangement or a QSR agreement, disclosure of the information set forth in subparagraphs (f) (2) (V) and (W) is mandatory.

**(g) Trade Report Modifiers**

(1) Reporting Members shall append the following trade report modifiers to a last sale report if applicable:

(A) .SLD, if the trade is executed during normal market hours and it is reported later than 90 seconds after execution;

(B) .PRP, if the trade reflects a price different from the current market when the execution is based on a prior reference point in time during normal market hours, which time shall be denoted in the trade report;

(C) .B, if the trade is executed during market hours and is an aggregation of transaction reports meeting the conditions set forth in paragraph (h) below;

(D) .SB, if the trade is executed during market hours and is a .B trade that is reported later than 90 seconds after execution;

(E) .SNN, if the trade is a Seller's Option Trade. .NN denotes the number of days for delivery;

(F) .C, if the trade is a Cash Trade;

(G) .ND, if the trade is a Next Day Trade;

(H) .W, if the trade occurs at a price based on an average weighting or another special pricing formula;

(I) .T, if the trade is executed outside of normal market hours;

(J) .O, if the trade is priced beyond certain price validation parameters as established by the NASD; and

(K) Any other trade report modifier approved for use by the Securities and Exchange Commission.

(2) It will be a violation of this Rule for a Reporting Member to fail to append a required trade modifier or to append a modifier that is not required.

(3) A Reporting Member shall not append a .O modifier to a trade report unless the trade price is beyond certain price validation parameters as established by the NASD.

(4) The Association seeks to emphasize the obligations of members

to report securities transactions within 90 seconds after execution. All reportable transactions not reported within 90 seconds after execution shall be reported as late, and the Association routinely monitors members' compliance with the 90 second requirement. If the Association finds a pattern or practice of unexcused late reporting, that is, repeated reports of executions after 90 seconds without reasonable justification or exceptional circumstances, the member may be found to be in violation of Rule 2110. Exceptional circumstances will be determined on a case by case basis and may include instances of system failure by a member or service bureau, or unusual market conditions, such as extreme volatility in a security, or in the market as a whole. Timely reporting of all transactions is necessary and appropriate for the fair and orderly operation of the Association's marketplace, and the Association will view noncompliance as a rule violation.

(h) Procedures for Reporting Price and Volume

(1) Members that are required to report transactions pursuant to paragraph (d) above shall transmit last sale reports in the following manner:

(A) For agency transactions, report the number of shares (or bonds) and the price excluding the commission charged.

Example:

SELL as agent 100 shares at 40 less a commission of \$12.50;

REPORT 100 shares at 40.

(B) For dual agency transactions, report the number of shares (or bonds) only once, and report the price excluding the commission charged.

Example:

SELL as agent 100 shares at 40 less a commission of \$12.50;

BUY as agent 100 shares at 40 plus a commission of \$12.50;

REPORT 100 shares at 40.

(C) (i) For principal transactions, except as provided below, report each purchase and sale transaction separately and report the number of shares (or bonds) and the price. For principal transactions that are executed at a price that includes a mark-up, mark-down or service charge, the price reported shall exclude the mark-up, mark-down or service charge. Such reported price shall be reasonably related to the prevailing market, taking into consideration all relevant circumstances including, but not limited to, market conditions with respect to the security, the number of shares (or bonds) involved in the transaction, the published bids and offers with size at

the time of the execution (including the reporting firm's own quotation), the cost of execution and the expenses involved in clearing the transaction.

Example:

BUY as principal 100 shares from another member at 40 (no mark-down included);

REPORT 100 shares at 40.

Example:

BUY as principal 100 shares from a customer at 39.85 which includes a .15 mark-down from prevailing market at 40;

REPORT 100 shares at 40.

Example:

SELL as principal 100 shares to a customer at 40.15, which includes a .15 mark-up from the prevailing market of 40;

REPORT 100 shares at 40.

Example:

BUY as principal 10,000 shares from a customer at 39.75, which includes a .25 mark-down or service charge from the prevailing market of 40;

REPORT 10,000 shares at 40.

(ii) Exception: A "riskless" principal transaction in which a member after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported as one three party transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless principal transaction by submitting the following report(s) to the NASD:

a. The member with the obligation to report the transaction pursuant to paragraph (d) above must submit a last sale report for the initial leg of the transaction.

b. Regardless of whether a member has a reporting obligation pursuant to paragraph (d) above, the firm must submit, for the offsetting, "riskless" portion of the transaction, either:

1. a clearing-only report with a capacity indicator of "riskless principal," if a clearing report is necessary to clear the transaction; or
2. a non-tape, non-clearing report with a capacity indicator of "riskless principal," if a clearing report is not necessary to clear the transaction.

Example:

SELL as a principal 100 shares to another member at 40 to fill an existing order;

BUY as principal 100 shares from a customer at 40 minus a mark-down of \$12.50;

REPORT 100 shares at 40 by submitting to the NASD either a single

trade report marked with a "riskless principal" capacity indicator or by submitting the following reports:

3. where required by this Rule, a tape report marked with a "principal" capacity indicator; and

4. either a non-tape, non-clearing report or a clearing-only report marked with a "riskless principal" capacity indicator.

(D) For transactions that are executed at a price different from the current market when the execution is based on a prior reference point in time, members shall append to the transaction report a trade report modifier designated by NASD and shall include in the transaction report the prior reference time.

Example:

At 9:45 a.m., a member discovers that a customer's order to BUY 100 shares at the opening price has not been executed. The member executes the customer's order at 9:45 a.m. at the opening price (40). Current market is 41.

REPORT 100 shares at 40 and append the .PRP modifier with the time 9:30.

(i) Aggregation of Transaction Reports

(1) Under the following conditions, individual executions of orders in a security at the same price may be aggregated, for transaction reporting purposes, into a single transaction report. Individual transactions in convertible debt securities cannot be aggregated pursuant to this paragraph.

(A) Orders received prior to the opening of the reporting member's market in the security and simultaneously executed at the opening. Also, orders received during a trading or quotation halt in the security and executed simultaneously when trading or quotations resume. In no event shall a member delay its opening or resumption of quotations for the purpose of aggregating transactions.

Example:

A firm receives, prior to its market opening, several market orders to sell which total 10,000 shares. All such orders are simultaneously executed at the opening at a reported price of 40.

REPORT 10,000 shares at 40.

(B) Simultaneous executions by the member of customer transactions at the same price, e.g., a number of limit orders being executed at the same time when a limit price has been reached.

Example:

A firm has several customer limit orders to sell which total 10,000 shares at a limit price of 40. That price is reached and all such orders are executed simultaneously.

REPORT 10,000 shares at 40.

(C) Orders relayed to the trading department of the reporting member for

simultaneous execution at the same price.

Example:

A firm purchases a block of 50,000 shares from an institution at a reported price of 40.

REPORT 50,000 at 40.

Subsequently, one of the firm's branch offices transmits to the firm's trading department for execution customer buy orders in the security totaling 12,500 shares at a reported price of 40.

REPORT 12,500 at 40.

Subsequently, another branch office transmits to the firm's trading department for execution customer buy orders totaling 15,000 shares in the security at a reported price of 40.

REPORT 15,000 at 40.

Example:

Due to a major change in market conditions, a firm's trading department receives from a branch office for execution customer market orders to sell totaling 10,000 shares. All are executed at a reported price of 40.

REPORT 10,000 at 40.

(D) Orders received or initiated by the reporting member that are impractical to report individually and are executed at the same price within 60 seconds of execution of the initial transaction; provided however, that no individual order of 10,000 shares or more may be aggregated in a transaction report and that the aggregated transaction report shall be made within 90 seconds of the initial execution reported therein. Furthermore, it is not permissible for a member to withhold reporting a trade in anticipation of aggregating the transaction with other transactions. The limitation on aggregating individual orders of 10,000 shares or more for a particular security shall not apply on the first day of secondary market trading of an IPO for that security.

Examples:

A reporting member receives and executes the following orders at the following times and desires to aggregate reports to the maximum extent permitted under this Rule.

First Example

11:01:00 500 shares at 40

11:01:05 500 shares at 40

11:01:10 9,000 shares at 40

11:01:15 500 shares at 40

REPORT 10,500 shares at 40 within ninety seconds of 11:01.

Second Example

11:01:00 100 shares at 40

11:01:10 11,000 shares at 40

11:01:30 300 shares at 40

REPORT 400 shares within ninety seconds of 11:01 and 11,000 shares

within ninety seconds of 11:01:10 (individual transactions of 10,000 shares or more must be reported separately).

Third Example

11:01:00 100 shares at 40

11:01:15 500 shares at 40

11:01:30 200 shares at 40

11:02:30 400 shares at 40

REPORT 800 shares at 40 within ninety seconds of 11:01 and 400 shares at 40 within ninety seconds of 11:02:30 (the last trade is not within sixty seconds of the first and must, therefore, be reported separately).

(2) The reporting member shall identify aggregated transaction reports and order tickets of aggregated trades in a manner directed by Nasdaq.

(j) Reporting Transactions on Form T

All Reporting NASD Members required (or that elect) to report transactions to the NASD shall report, as soon as practicable to NASD Regulation's Market Regulation Department on Form T, last sale reports of transactions in designated securities for which electronic submission into the NASD is not possible (e.g., the ticker symbol for the security is no longer available, a market participant identifier is no longer active, or the NASD will not accept the date of execution because the NASD Alternative Display Facility was closed on that date). Transactions that can be reported into the NASD, whether on trade date or on a subsequent date on an "as of" basis (T+N), shall not be reported on Form T.

(k) Trade Tickets

All trade tickets for transactions in Nasdaq securities shall be time-stamped at the time of execution.

(l) Special Trade Indicator

A Reporting Member shall append the designated symbol for special trades, step out trades, reversals, and as-of trades.

(m) Clearing Indicators

A Reporting Member shall use a designated symbol to denote whether the trade is to be: (i) compared in TRACS; (ii) not compared in TRACS; (iii) compared in TRACS pursuant to an Automatic Give Up Agreement ("AGU"); or (iv) not compared in TRACS, but locked in pursuant to a Qualified Service Representation Agreement ("QSR").

(n) Transactions Not To Be Reported To NASD

The following types of transactions effected by NASD members otherwise

than on an exchange shall not be reported to TRACS for publication:

(1) Odd-lot transactions;

(2) transactions that are part of a primary distribution by an issuer or of a registered secondary distribution (other than "shelf distributions") or of an unregistered secondary distribution;

(3) transactions made in reliance on Section 4(2) of the Securities Act of 1933;

(4) transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security (e.g., to enable the seller to make a gift);

(5) purchases or sales of securities effected upon the exercise of an option pursuant to the terms thereof or the exercise of any other right to acquire securities at a pre-established consideration unrelated to the current market.

(o) Dissemination of Transaction Reports in Convertible Debt Securities

For surveillance purposes, NASD will collect and process trade reports for all transactions in convertible debt securities listed on Nasdaq and effected through the NASD Alternative Display Facility. On a real-time basis, NASD will disseminate to members and the public through NASD, and through securities information processors, transactions in convertible debt securities reported to it equaling 99 bonds or less. Selected NASD Notices to Members: 83-1, 87-85, 93-9, 93-25, 93-83, 94-71, 98-82, 99-65, 99-66.

\* \* \* \* \*

## 5000. [OTHER NASDAQ AND NASD MARKETS] TRADING OTHERWISE THAN ON AN EXCHANGE

### [5100. NASDAQ INTERNATIONAL SERVICE RULES]

#### [5101. Applicability]

[(a) These Rules shall be known as the "International Rules" and govern operation of the Nasdaq International Service ("Nasdaq International" or "Service"), as well as the obligations, access to and use of the Service by the following parties: broker/dealers admitted to membership in the Association (collectively, "Association members"); associated persons of such Association members; and any non-member broker/dealer having the status of an approved affiliate. Unless otherwise indicated, the requirements of the International Rules are in addition to those contained in the By-Laws and other Rules of the Association.]

[(b) Rules 5106, 5108, 5109, and 5112 of the International Rules establish requirements that apply exclusively to

participation in the Service during the European Session. As such, these provisions of the International Rules supersede the Rule 2870, 4640, 6300 and 6600 Series; and Rules 6410, 6420 and 6450. Non-compliance with any applicable requirement will subject the Association member and/or its associated person(s) to regulatory action under the Association's Code of Procedure, the Rule 9000 Series.]

[(c) Unless otherwise indicated within a particular provision of the International Rules, all procedures, requirements, and prohibitions shall apply with equal force to Association members, their associated persons, and approved affiliates that participate in the Service.]

#### **[5102. Definitions]**

[Unless the context otherwise requires, or unless defined in the International Rules, the terms used herein shall retain their present meanings as defined in the By-Laws and other Rules of the Association.]

[(a) "Approved affiliate" means a broker/dealer that meets all of the following requirements:]

[(1) it is not admitted to membership in the Association or any registered national securities exchange;]

[(2) it is authorized to conduct securities business in the United Kingdom in accord with all applicable provisions of the Financial Services Act of 1986;]

[(3) it controls, is controlled by, or is under common control with an Association member (hereinafter referred to as a "control relationship"); and]

[(4) it has been approved by the Association to participate as a Service market maker, in an agency capacity, on behalf of the Association member with whom it has a control relationship.]

[(b) "Domestic Session" refers to the market session operated by the Association between the hours of 9:30 a.m. and 4:00 p.m. Eastern Time on each U.S. business day.]

[(c) "European-only market maker" means a broker/dealer that is registered with the Association to make markets in one or more qualified securities in the SERVICE, but is not registered in the same security(ies) for purposes of making a market during the Domestic Session.]

[(d) European Session refers to the market session supported by the Service during the hours specified in Rule 5103.]

[(e) "International market maker" means a broker/dealer that is registered with the Association to make markets in one or more qualified securities in the

SERVICE and is also registered with the Association to make markets in the same security(ies) during the Domestic Session.]

[(f) The terms "Nasdaq International" and "Service refer to an extension of the basic automation capabilities that support Association members' market making in the Nasdaq National Market (NNM), and exchange-listed securities to the business hours fixed by Rule 5103.]

[(g) "Non-NNM security" means every qualified security in the subset defined by Rule 5104(b).]

[(h) "Qualified security" means any security that satisfies the requirements contained in Rule 5104.]

[(i) "Service market maker" includes any Association member that is registered as a European-only or International market maker in one or more qualified securities, and any approved affiliate registered as a European-only market maker in one or more qualified securities.]

#### **[5103. Normal Business Hours]**

[The Nasdaq International market session (hereinafter referred to as the "European Session") will run from 3:30 a.m. to 9:00 a.m. Eastern Time on each business day in the U.S.; pre-opening procedures will commence at 2:30 a.m. Eastern Time. Appropriate adjustments will be made in the event that the U.S. and the U.K. move to (or from) daylight-saving time on different dates. All times referenced in the International Rules relate to the Eastern Time zone of the U.S.]

#### **[5104. Qualified Securities]**

[The Association deems the following classes of securities qualified for inclusion in Nasdaq International:]

[(a) any Nasdaq security that is designated an NNM security;]

[(b) any non-Canadian, foreign security or ADR that is included in Nasdaq but not designated an NNM security; and]

[(c) any equity security that is listed on a registered national securities exchange.]

[Inclusion of a qualified security in Nasdaq International requires a market making commitment by one or more broker/dealers that participate as Service market makers.]

#### **[5105. Access]**

[(a) Access to the market making capabilities provided by Nasdaq International is restricted to broker/dealers that are either Association members or approved affiliates and that have all equipment and communication lines specified by the Association for

receipt of Nasdaq Workstation Service. Additionally, Association members that participate as Service market makers, either directly or through the agency of an approved affiliate, must satisfy the same financial and operational requirements applicable to market makers in Nasdaq securities and/or exchange-listed securities traded off-board during the Domestic Session.]

[(b) Association members that utilize Nasdaq Workstation units to receive Level 2 Nasdaq Service during the Domestic Session can also receive real-time quotation information entered by Service market makers. Similar access terms will be provided to non-member, Level 2 subscribers utilizing Nasdaq Workstation units.]

#### **[5106. Requirements Applicable to Market Makers]**

##### **[(a) Service Market Maker]**

[Association members and approved affiliates can function as Service market makers by registering with the Association in one or more qualified securities. Two classifications of market makers are authorized: (1) European-only and (2) International. Association members can register in either capacity in any qualified security; approved affiliates are limited to European-only registration. At the time of registration, a Service market maker must select one of the following time periods to define its daily market making commitment, on a security-by-security basis: 3:30 a.m. to 9:00 a.m.; 5:30 a.m. to 9:00 a.m., and 7:30 a.m. to 9:00 a.m. Every Service market maker must fulfill the market making obligations specified below in each of its registered securities while participating in the European Session. Based on experience gained with Service market makers' use of the multiple openings, the Association may determine to alter the specified times by up to one hour or to eliminate an opening altogether.]

##### **[(b) Market Maker Obligations]**

[The following requirements and procedures govern a broker/dealer's participation in Nasdaq International as a Service market maker.]

##### **[(1) Registration]**

[(A) Quotations and quotation size may be entered into the Service only by a Service market maker.]

[(B) To function as a Service market maker, an Association member must initially obtain registration as a European-only or International market maker by filing an application with the Association. The application shall certify the Association member's good standing with the Association,

demonstrate compliance with the net capital and other financial responsibility provisions of the Act and the rules thereunder, and specify the qualified security(ies) in which the member is seeking to register as a European-only or International market maker. Initial registration as a Service market maker shall become effective upon the member's receipt of the Association's notice approving such registration.]

[(C) For an approved affiliate to function as a Service market maker, it must initially obtain registration as a European-only market maker by filing an application with the Association. Such application must be co-signed by a registered principal of the Association member for whom the approved affiliate will act as agent. The application shall certify the following: the Association member's good standing with the Association; the approved affiliate's authorization to conduct securities business in the United Kingdom in accord with all applicable provisions of the Financial Services Act of 1986; and the Association member's ability to comply and its assumption of compliance with the net capital and other financial responsibility requirements of the Act and the rules thereunder in respect of the approved affiliate's market making in the Service as agent for the Association member. The application shall also specify the qualified security(ies) in which the approved affiliate is seeking to register as a European-only market maker. Initial registration as a Service market maker shall become effective upon the approved affiliate's receipt of the Association's notice approving such registration.]

[(D) A Service market maker may become registered in a newly qualified security by telephoning Market Operations. If registration is requested within five (5) business days after the issue becomes qualified, registration shall take effect at the time the request is entered.]

[(E) A Service market maker may register in additional qualified securities by entering a registration request via its Nasdaq Workstation unit authorized for receipt of the Service. If registration is requested respecting a security that has been a qualified security for more than five (5) days, and the requirements of either subparagraph (B) or (C) above are satisfied, registration shall take effect on the day after the registration request is entered.]

[(F) Registration in a qualified security shall be terminated by the Association if the Service market maker fails to enter quotations in that security

within five (5) business days after its registration in that security first became effective.]

[(2) Normal Business Hours]

[Service market makers must be open for business, on each U.S. business day, during the time periods established by their registration in one or more qualified securities. By virtue of the multiple openings feature, a Service market maker would have the flexibility, for example, to register and quote markets in some securities during the 5:30 a.m. to 9:00 a.m. segment and others during the 7:30 a.m. to 9:00 a.m. segment. This flexibility is equally available to Association members and approved affiliates that participate as Service market makers. Appropriate adjustments will be made in the event that the U.S. and U.K. move to (or from) daylight savings time on different dates.]

[(3) Character of Quotations]

[(A) For each security in which an Association member has registered as a Service market maker, it shall be willing to buy and sell such security for its own account on a continuous basis and shall enter and maintain two-sided quotations in the Service during the hours specified above in subparagraph (2), above, subject to the procedures for excused withdrawal set forth in subparagraph (4) below. An approved affiliate registered as a Service market maker shall assume identical obligations in each of its registered securities. Purchases and sales effected to fulfill those obligations shall be deemed to be made for the account of the Association member on whose behalf the approved affiliate acts as agent.]

[(B) A Service market maker that receives an offer to buy or sell from another Association member or approved affiliate shall execute a transaction for at least a normal unit of trading at its displayed quotations as disseminated through the Service at the time of receipt of any such offer. If a Service market maker displays a quotation for a size greater than a normal unit of trading, it shall, upon receipt of an offer to buy or sell from another Association member or approved affiliate, execute a transaction at least at the size displayed.]

[(C) A Service market maker shall enter and maintain quotations that are reasonably related to the prevailing market. If it appears that such market maker's quotations are no longer reasonably related to the prevailing market, the Association may require the firm to re-enter its quotations. However, if that Service market maker fails to re-

enter its quotations, the Association may suspend the market maker's quotations in one or all of the qualified securities in which it is registered.]

[(D) If a Service market maker's ability to enter or update quotations is impaired, the market maker shall immediately contact Market Operations to request the withdrawal of its quotations.] [(E) If a Service market maker's ability to enter or update quotations is impaired and it elects to remain in the Service, the market maker shall execute an offer to buy or sell received from another Association member or approved affiliate at its quotations as disseminated through the Service.]

[(F) A Service market maker should refrain from entering quotations into the Service that exceed the guidelines for maximum allowable spreads set forth below:]

SPREAD GUIDELINES

Average spread	Maximum allowable spread
1/8 or less	1/4
1/4	1/2
3/8	3/4
1/2	1
5/8	1
3/4	1 1/2
7/8	1 1/2
1	1 1/2
1 1/8	1 5/8
1 1/4	1 3/4
1 3/8	1 7/8
1 1/2	2
1 5/8	2
1 3/4	3
1 7/8	3
2	3
2 1/8	3
2 1/4	3
2 3/8	3
2 1/2	3
2 5/8	4
2 3/4	4
2 7/8	4

[For an average spread of 3 or more, the maximum allowable spread is 125 percent of the average spread rounded to the next highest whole number.]

[The Association regards these spread parameters as guidelines rather than absolute requirements. Nonetheless, the Association will continuously monitor the quotation spreads of every Service market maker and consider taking regulatory action upon finding a pattern of excessive spreads disseminated during European Sessions. A pattern of excessive spreads will be deemed to exist where a Service market maker exceeds the applicable guideline on five

or more occasions in the same qualified security during a calendar month or exceeds the applicable guideline respecting at least 10% of its quotation updates entered into the Service during a calendar month.]

[(G) A Service market maker shall not, except under extraordinary circumstances, enter or maintain quotations in the Service during the European Session if: the bid quotation entered is equal to or greater than the asked quotation of another Service market maker displaying quotations in the same qualified security; or the asked quotation is equal to or less than the bid quotation of another Service market maker displaying quotations in the same qualified security.]

[(H) A Service market maker shall, prior to entering a quotation that locks or crosses another quotation, make reasonable efforts to avoid such locked or crossed market by executing transactions with all Service market makers whose quotations would be locked or crossed. A Service market maker whose quotations are causing a locked or crossed market is required to execute transactions at its quotations as displayed through the Service at the time of receipt of any order.]

#### [(4) Withdrawal of Quotations]

[(A) A Service market maker that wishes to withdraw its quotations in a qualified security shall contact Market Operations to obtain excused withdrawal status prior to effecting withdrawal. Excused withdrawals shall be granted by Market Operations only upon the demonstration of the existence of one of the circumstances set forth in subparagraphs (B) and (C) below.]

[(B) Excused withdrawal status based on physical circumstances beyond the Service market maker's control may be granted for up to five (5) business days, unless extended by Market Operations. Excused withdrawal status based on demonstrated legal or regulatory requirements, supported by appropriate documentation and accompanied by a representation that the condition necessitating the withdrawal of quotations is not permanent in nature, may, upon written request, be granted for not more than sixty (60) days. Excused withdrawal status based on religious holidays or national holidays in the U.K. may be granted only if the request is received by the Association five (5) business days in advance and is approved by the Association. Excused withdrawal status based on vacation may be granted only if: the request for withdrawal is received by the Association twenty (20) business days in advance, and is approved by the

Association; the request includes a list of the securities for which withdrawal is requested; and the request is made by a Service market maker with three (3) or fewer Nasdaq Workstation units authorized for market making in the Service. The following shall not constitute acceptable reasons for granting excused withdrawal status: pending news, a sudden influx of orders or price changes, or the desire to effect transactions with competitors.]

[(C) Excused withdrawal status may be granted to a Service market maker that fails to maintain a clearing arrangement with a registered clearing agency or with another party that is a member of such an agency and is therefore withdrawn from participation in the Association's Automated Confirmation Transaction Service. However, if the Association finds that the Service market maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be deemed a voluntary termination pursuant to subparagraph (5) below.]

#### [(5) Voluntary Termination of Registration]

[A Service market maker may voluntarily terminate its registration in a qualified security by withdrawing its quotations in that security from the Service. A market maker that voluntarily terminates its registration in a qualified security may re-register to quote that security in the Service in accord with procedures contained in paragraph (b)(1)(E) above. Nonetheless, if an International market maker voluntarily terminates both the domestic and European components of its registration in a qualified security that is included in Nasdaq (qualified Nasdaq security), this Association member cannot re-register to quote that qualified Nasdaq security during the Domestic Session until twenty (20) business days have elapsed. This waiting period would not apply where an International market maker in a qualified Nasdaq security had terminated the European component of its registration but maintained the domestic component.]

#### [(6) Stabilizing Bids]

[(A) A Service market maker may enter a stabilizing bid in the Service for a qualified Nasdaq security, which bid will be identified with the appropriate identifier on the quotation display. Only one market maker in an issue may enter a stabilizing bid. A stabilizing bid will not be displayed unless one market maker in addition to the market maker entering the stabilizing bid is registered

in the issue and enters quotations during the European Session.]

[(B) A stabilizing bid, a pre-effective stabilizing bid, or a penalty bid may be entered into the Service. A stabilizing bid must be available for all freely tradeable outstanding securities of the same class being offered.]

#### [(C) Notice to the Association]

[(i) A Service market maker that wishes to enter a stabilizing bid shall notify Market Operations in writing prior to the first day on which the stabilizing bid is to appear in the Service. The notice shall include: the name of the qualified Nasdaq security and its Nasdaq symbol; the date on which the security's registration will become effective, if it is already quoted in the Service; whether the stabilizing bid will be a penalty bid or a penalty-free bid; and a copy of the preliminary prospectus or shelf registration statement, unless the Association determines otherwise.]

[(ii) In the case of a pre-effective stabilizing bid, the notice shall include: the name of the qualified Nasdaq security and its Nasdaq symbol; the contemplated effective date of the offering; whether it is contemplated that the pre-effective stabilizing bid will be converted to a stabilizing bid and, if so, whether the stabilizing bid will be a penalty bid or a penalty-free bid; and a copy of the preliminary prospectus, unless the Association determines otherwise.]

[(iii) A service market maker that has provided the written notice prescribed above shall also contact Market Operations for authorization on the day the market maker wishes to enter the stabilizing bid into the Service.]

[(D) A Service market maker shall not enter a stabilizing bid at the same time that it is quoting any other bid or offer in the qualified Nasdaq security.]

[(E) A Service market maker entering a stabilizing bid shall report all purchases made on the stabilizing bid and enter "zero volume" for sales during the period in which the stabilizing bid is in effect.]

#### [5107. Automated Submission of Trading Data]

[Reserved for Future Use. Redesignated as 8212 by SR-NASD-97-81 eff. Jan. 16, 1998.]

#### [5108. Reports]

[Every Association member and approved affiliate that functions as a Service market maker shall submit the following reports to the Association at the frequency specified:]

[(a) A Service market maker shall report each business day any data relating to qualified securities quoted in the Service as the Association shall require.]

[(b) A Service market maker shall report monthly such data on qualified securities that are quoted in the Service as the Association shall require.]

[(c) A Service market maker shall make such other reports as the Association may prescribe from time to time.]

#### **[5109. Clearance and Settlement of International Transactions]**

[(a) Association members and approved affiliates that effect international transactions must clear and settle all such transactions through a clearing agency registered with the Commission that uses a continuous net settlement system. This requirement may be satisfied through direct participation in a suitable clearing agency or through a clearing arrangement with another party.]

[(b) For purposes of this Rule, the term "international transaction" means every transaction having the following three characteristics: (1) the transaction involves a qualified security quoted in the Service by at least one registered market maker; (2) the transaction is consummated during the hours of the European Session between two Association members, two approved affiliates, or an Association member and an approved affiliate; and (3) the transaction involves at least one Association member (acting in a principal or agency capacity) that is registered as a European-only or International market maker in any qualified security, or alternatively, at least one approved affiliate (acting in a principal or agency capacity) that is registered as a European-only market maker in any qualified security.]

[(c) Participation in the Automated Confirmation Transaction Service is mandatory for self-clearing Association members participating in the Service directly or through an approved affiliate.]

#### **[5110. Suspension and Termination of Quotations by Association Action]**

[The Association may, pursuant to the procedures set forth in the Association Code of Procedure, the Rule 9000 Series, suspend, condition, limit, prohibit or terminate a Service market maker's authority to enter quotations in one or more qualified securities for violations of the applicable requirements or prohibitions contained in the By-Laws or Rules of the Association.]

#### **[5111. Termination of Access]**

[The Association may, upon notice, terminate access to Nasdaq International in the event that a Service market maker fails to qualify under specified standards of eligibility for Association membership or participation in the Service, or fails to pay promptly for services rendered by the Association or its subsidiaries.]

#### **[5112. Transaction Reporting Requirements]**

[During the European Session, broker/dealers registered as International or European-only market makers shall observe the following requirements for reporting transaction information to the Association on qualified securities quoted in Nasdaq International:]

##### **[(a) Definitions]**

[(1) "International Participant" includes any Association member registered as an International or European-only market maker in at least one qualified security, and any approved affiliate registered as a European-only market maker in at least one qualified security.]

[(2) "Reportable transaction" means any round-lot or mixed-lot transaction in a Service security effected during the European Session with an International Participant being on one or both sides. The following are not deemed to be reportable transactions:]

[(A) transactions which are part of a primary distribution by an issuer or of a registered secondary distribution (other than shelf registrations) or of an unregistered secondary distribution; ]

[(B) transactions executed on and reported to a securities exchange domiciled outside the U.S.; ]

[(C) transactions made in reliance on Section 4(2) of the Securities Act of 1933; ]

[(D) transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for a Service security, e.g., to enable the seller to make a gift; and ]

[(E) purchases or sales of Service securities effected upon the exercise of an option pursuant to the terms thereof or the exercise of any other right to acquire securities at a preestablished consideration unrelated to the current market.]

[(3) "Service security" means any qualified security that is quoted in Nasdaq International by at least one registered market maker.]

[(4) "Trade report" refers to the entry of the following elements of information for each reportable trans security symbol, price (exclusive of commission,

mark-up, or mark-down), volume, and a symbol indicating whether the transaction is a buy, sell or cross.]

##### **[(b) Timely Trade Reports]**

[International Participants shall enter trade reports on all reportable transactions within three minutes of execution via a Nasdaq Workstation unit authorized for receipt of Nasdaq International or through a CTCL. Trade reports not submitted within three minutes of execution shall be designated as late by addition of the "SLD" indicator. A pattern or practice of late reporting without exceptional circumstances may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Rule 2110 of the Association's Rules.]

##### **[(c) Obligation To Submit Trade Reports on Reportable Transactions]**

[(1) In transactions between two International Participants that are both Service market makers in the affected Service security, only the party representing the sell side shall report.]

[(2) In transactions between two International Participants where only one is a Service market maker in the affected Service security, the latter party shall report.]

[(3) In transactions between two International Participants where neither is a Service market maker in the affected Service security, only the party representing the sell side shall report.]

[(4) In transactions between an International Participant and a non-member (other than an approved affiliate), the International Participant shall report. Where an International Participant acts as a dual agent in a reportable transaction, it shall be reported only once by the International Participant.]

[(5) In transactions between an International Participant and another Association member that is not an International Participant, only the International Participant shall report.]

##### **[(d) Aggregation of Trade Reports]**

[(1) The following procedures and requirements apply exclusively to an International Participant registered as a Service market maker in a particular Service security.]

[(2) Under the following conditions, individual trade reports in a Service security at the same price may be aggregated into a single trade report by a Service market maker in that security:]

[(A) orders received prior to opening of the European Session and

simultaneously executed at the opening;]

[(B) orders received during a trading halt and executed simultaneously when trading resumes;]

[(C) orders relayed to the trading department of the Service market maker for simultaneous execution at the same price;]

[(D) simultaneous executions by the Service market maker of customer transactions at the same price, e.g., multiple limit orders being executed at the same time when a limit price has been reached; or]

[(E) orders received or initiated by the Service market maker that are impractical to report individually and are executed at the same price within two minutes of execution of the initial transaction; provided, however, that no individual order of 10,000 shares or more may be aggregated in a trade report and that the aggregated trade report shall be made within three minutes of the initial execution reported therein.]

[(3) In no instance shall a Service market maker delay entry of its opening quotations or resumption of trading in a Service security for the purpose of aggregating trade reports. Further, a Service market maker is prohibited from withholding a trade report in anticipation of aggregating the transaction with others.]

[(4) A Service market maker shall identify aggregated trade reports and the underlying order tickets in a manner prescribed by the Association.]

#### [(e) Time Stamping of Transactions]

[All trade tickets for reportable transactions shall be time-stamped at the time of execution. Association members and approved affiliates that utilize screen-based systems for executing transactions shall satisfy this requirement by ensuring that such a system assigns an appropriate execution time to each reportable transaction.]

#### [(f) Weekly Reports]

[International Participants shall submit trade reports weekly respecting Service securities in the following circumstances:]

[(1) European-only market makers. Transactions in Service securities executed outside hours of the European Session;]

[(2) International market makers. Transactions in Service securities executed outside the hours of both the European Session and the Domestic Session;]

[(3) European-only and International Market Makers. Transactions in Service securities that were effected during the European Session and were omitted

inadvertently from reported volume during the preceding week's European Sessions.]

#### [5113. Audit Trail Requirements]

[All existing requirements for submitting audit trail information to the Association, either directly or through a registered clearing agency, shall extend to Association members'/approved affiliates' participation in Nasdaq International. The applicable requirements were published in NASD Notices to Members 84-55 (October 15, 1984), 85-24 (April 12, 1985), and 85-72 (October 30, 1985), which notices are hereby incorporated by reference.]

\* \* \* \* \*

#### 5200. Trading Halts

##### (a) Authority To Initiate Halts in Trading Otherwise Than on an Exchange

*NASD, pursuant to the procedures set forth in paragraph(b):*

*(1) shall halt trading otherwise than on an exchange an ADF-eligible security whenever any market eligible to trade that security imposes a trading halt, or suspends the listing, in order to:*

*(A) Permit dissemination of material news;*

*(B) obtain information from the issuer relating to material news;*

*(C) obtain information relating to the issuer's ability to meet listing qualification requirements; or*

*(D) obtain any other information that is necessary to protect investors and the public interest.*

*(2) shall halt trading otherwise than on an exchange in an American Depository Receipt ("ADR") listed on a national securities exchange, when the security underlying the ADR is listed on or registered with a national or foreign securities exchange or market, and the national or foreign securities exchange or market, or regulatory authority overseeing such exchange or market, halts trading in such security for regulatory reasons.*

*(3) shall halt all trading through the NASD Alternative Display Facility (a) whenever the NASD Alternative Display Facility is unable to transmit real-time quotation or trade reporting information to the applicable Securities Information Processor, or (b) whenever a market-wide trading halt is in effect under circuit breaker rules of a primary exchange.*

*(4) may, in its discretion, halt all trading otherwise than on an exchange in a security listed on a national securities exchange when (i) a national securities exchange imposes a trading halt in that security because of an order*

*imbalance or influx ("operational trading halt"), or (ii) when the security is a derivative or component of a security listed on a national securities exchange and a national securities exchange imposes an operational trading halt in that security. In the event that the NASD, in its discretion, chooses not to halt trading otherwise than on an exchange in a security when the conditions of this paragraph exist, NASD members may continue to conduct trading in such security during the period of any such halt and shall continue to report all last sale prices reflecting transactions in such security.*

*Members shall promptly notify NASD whenever they have knowledge of any matter related to a security or the issuer thereof that has not been adequately disclosed to the public or where they have knowledge of a regulatory problem relating to such security.*

##### (b) Commencement and Termination of a Trading Halt

*(1) In the event NASD determines that a basis exists under Rule 5200(a) to initiate a trading halt, the commencement of the trading halt will be effective simultaneously with appropriate notice via an administrative message.*

*(2) Trading in a halted security shall resume upon notice via an administrative message that a trading halt is no longer in effect.*

##### (c) Authority To Initiate Trading and Quotation Halts in Non-Exchange-Listed Foreign Securities

*In circumstances in which it is necessary to protect investors and the public interest, NASD Regulation may direct members, pursuant to the procedures set forth in paragraph (d), to halt trading and quotations in a quotation medium other than an exchange or the NASD Alternative Display Facility of an American Depository Receipt ("OTC ADR") or a security ("OTC Security") that is traded in the OTC market and that is not otherwise listed on a national securities exchange or included in the OTC Bulletin Board Service ("OTCBB") when the OTC Security or the security underlying the OTC ADR is listed on or registered with a foreign securities exchange or market, and the foreign securities exchange, market, or regulatory authority overseeing such issuer, exchange or market halts trading in such security for regulatory reasons ("Foreign Regulatory Halt"); provided, however, that NASD Regulation will not impose a trading and quotation halt if the Foreign Regulatory Halt was imposed solely for the dissemination of*



material news, a regulatory filing deficiency, or operational reasons.

*(d) Procedure for Initiating a Trading and Quotation Halt*

(1) For a halt initiated under subparagraph (c) of this rule, NASD Regulation will promptly evaluate information received from a foreign securities exchange or market on which the OTC Security or the security underlying the OTC ADR is listed or registered or from a foreign regulatory authority overseeing such issuer, exchange, or market about a Foreign Regulatory Halt and determine whether a trading and quotation halt in the OTC Security is appropriate.

(2) Should NASD Regulation determine that a basis exists under this Rule for initiating a trading and quotation halt, NASD Regulation shall disseminate appropriate public notice that a trading and quotation halt is in effect and the commencement of the trading halt will be effective simultaneously with appropriate public notice.

(3) Trading and quotations in the OTC market may resume when NASD Regulation determines that the basis for the halt no longer exists or when five business days have elapsed from the date NASD Regulation initiated the trading and quotation halt in the security, whichever occurs first. NASD Regulation shall disseminate appropriate public notice that a trading and quotation halt is no longer in effect.

Selected NASD Notices to Members: 88-46, 94-98.

**5300. Transactions Related to Initial Public Offerings**

No member or person associated with a member shall execute or cause to be executed, directly or indirectly, an over-the-counter transaction in a security subject to an initial public offering until such security has first opened for trading on the national securities exchange listing the security, as indicated by the dissemination of an opening transaction in the security by the listing exchange via the Consolidated Tape or, for Nasdaq, the Nasdaq Tape.

**[5200] 6500. INTERMARKET TRADING SYSTEM[COMPUTER ASSISTED EXECUTION SYSTEM]**

**[5210] 6510. Definitions**

(a) The term "ITS Participant Exchange" shall mean a participant in the ITS Plan that is a national securities exchange.

(b) The term "ITS Plan" shall mean the plan agreed upon by the ITS participants, as from time to time

amended in accordance with the provisions therein, and approved by the Commission pursuant to Section 11A(a)(3)(B) of the Act and SEC Rule 11Aa3-2 thereunder.

(c) The term "ITS Security" shall mean any security [which] *that* may be traded through the System by an ITS/ADF[CAES] Market Maker.

(d) The term "ITS System" shall mean the communications network and related equipment that links electronically the ITS Participant Exchanges and ITS/ADF[CAES] Market Makers as described in the Plan.

(e) The term "ITS/ADF[CAES] Market" Maker shall mean a member of the Association that is registered as a market maker with the Association for the purposes of participation in ITS [through CAES] with respect to one or more specified ITS securities in which [he] it is then actively registered. Registration as an ITS/ADF[CAES] Market Maker is [mandatory] *optional* for all registered CQS market makers in securities eligible for inclusion in the ITS/ADF[CAES] linkage.

(f) The term "Participant Market" shall mean the securities trading floor of each participating ITS Exchange and the markets of ITS/ADF[CAES] Market Makers in ITS securities.

(g) The term "Pre-Opening Application" shall mean the application of the System which permits a specialist or ITS/ADF[CAES] Market Maker who wishes to open [his] *its* market in an ITS Security to obtain pre-opening interests from other specialists and ITS/ADF[CAES] Market Makers.

(h) The term "Previous Day's Consolidated Closing Price" shall mean the last price at which a transaction in a security was reported by the consolidated last sale reporting system on the last previous day on which transactions were reported by such system; provided, however, that the "previous day's consolidated closing price" for all Network A or Network B eligible [S] securities shall be the last price at which a transaction in the stock was reported by the New York Stock Exchange, Inc. (NYSE) or the American Stock Exchange, Inc. (Amex), if, because of unusual market conditions, the NYSE or the Amex price is designated as such pursuant to the ITS plan.

(i) A "Third Participating Market Center Trade-Through," as that term is used in this Rule, occurs whenever an ITS/ADF[CAES] Market Maker initiates the purchase of an ITS Security by sending a commitment to trade through the System and such commitment results in an execution at a price [which] *that* is higher than the price at which the security is being offered (or

initiates the sale of such a security by sending a commitment to trade through the System and such commitment results in an execution at a price which is lower than the price at which the security is being bid for) at the time of the purchase (or sale) in another ITS participating market center as reflected by the offer (bid) then being displayed by [ITS/ CAES] Market Makers from such other market center. The member described in the foregoing sentence is referred to in this Rule as the "member who initiated a third participating market center trade-through."

[Amended eff. Nov. 24, 1989; Aug. 5, 1991; amended by SR-NASD-93-10 eff. Oct. 31, 1994; amended by SR-NASD-97-09 eff. May 30, 1997.] Selected Notices to Members: 94-81.

**[5220] 6520. ITS/ADF[CAES] Registration**

In order to participate in ITS, a market maker must be registered with the Association as an ITS/ADF[CAES] Market Maker in each security in which a market will be made in ITS. Such registration shall be conditioned upon the ITS/ADF[CAES] Market Maker's continuing compliance with the following requirements:

(a) Registration as a CQS market maker pursuant to Rule 6320 and compliance with the Rule 6300 Series;

(b) execution of an ITS/ADF[CAES] Market Maker application agreement with the Association at least two days prior to the requested date of registration;

(c) compliance with SEC Rule 15c3-1;

(d) compliance with the ITS Plan, SEC Rule 11Ac1-1 and all applicable Rules of the Association;

(e) the maintenance of continuous two-sided quotations in the absence of the grant of an excused withdrawal or a functional excused withdrawal by the Association. *Any registered ITS Market Maker (excluding ECNs) that participates in a pre-opening application process and does not enter and maintain continuous two-sided quotations in the security on that same trading day may not re-register to participate in ITS in such security for twenty (20) business days unless NASD Alternative Display Facility Operations grants an excused withdraw;*

(f) maintenance of the physical security of the equipment used to interface with the ITS System located on the premises of the ITS/ADF[CAES] Market Makers to prevent the unauthorized entry of communications into the ITS System; and

(g) acceptance and settlement of each ITS System trade that the ITS System

identifies as effected by such ITS/ADF[CAES] Market Maker, or if settlement is to be made through another clearing member, guarantee of the acceptance of settlement of such identified ITS System trade by the clearing member on the regularly scheduled settlement date.

**[5221] 6521. Suspension or Revocation of ITS/ADF[CAES] Registration**

Failure by an ITS/ADF[CAES] Market Maker to comply with the ITS Plan or any of the rules identified herein shall subject such ITS/ADF[CAES] Market Maker to censure, fine, suspension or revocation of its registration as an ITS/ADF[CAES] Market Maker, or any other fitting penalty.

**[5230] 6530. ITS Operations**

(a) All transactions effected through ITS shall be on a "regular way" basis. Each transaction effected through ITS shall be cleared and settled through a clearing agency registered with the Commission [which] *that* maintains facilities through which ITS transactions may be compared and settled.

(b) Any "commitment to trade," which is transmitted by an ITS/ADF[CAES] Market Maker to another ITS participating market center through ITS, shall be firm and irrevocable for the period of *thirty (30) seconds*, [either] one minute or two minutes (specified in accordance with subparagraph (7) below) following transmission by the sender. All such commitments to trade shall, at a minimum:

(1) Include the number or symbol which identifies the ITS/ADF[CAES] Market Maker;

(2) direct the commitment to a particular participant market;

(3) specify the security which is the subject of the commitment;

(4) designate the commitment as either a commitment to buy or a commitment to sell;

(5) specify the amount of the security to be bought or sold, which amount shall be for one unit of trading or any multiple thereof;

(6) specify:

(A) A price equal to the offer or bid price then being furnished by the destination Participant Market, which price shall represent the price at or below which the security is to be bought or the price at or above which the security is to be sold, respectively;

(B) a price at the execution price in the case of a commitment to trade sent in compliance with the block trade rule; or

(C) that the commitment is a commitment to trade "at the market;"

(7) specify [either] *thirty (30) seconds*, one minute or two minutes as the time period during which the commitment shall be irrevocable, but if the time period is not specified in the commitment, a two minute period shall be assumed. It should be noted that the period of time represented by these designations may be changed in the future by action of the ITS Operating Committee, whose decision as to the applicable period shall be binding upon ITS/ADF[CAES] Market Makers;

(8) designate the commitment "short" or "short exempt" whenever it is a commitment to sell which, if it should result in an execution in the receiving market, would result in a short sale to which the provisions of SEC Rule 10a-1(a) under the Act would apply.

(c) If a commitment to trade is directed to an ITS/ADF[CAES] Market Maker, and the execution of such commitment exhausts the size of the quotation being displayed by the ITS/ADF[CAES] Market Maker, then such ITS/ADF[CAES] Market Maker shall be placed in a functional excused withdrawal state pending the input of a new two-sided quotation with size into the Association's [Consolidated Quotation Service] ADF. The new two-sided quotation required of the ITS/

ADF[CAES] Market Maker will be entered as promptly as possible into the Association's [Consolidated Quotation Service] ADF.

(d) Transactions in ITS securities executed [in CAES] by ITS/ADF[CAES] Market Makers or received through the ITS System and executed by an ITS/ADF[CAES] Market Maker are reported to the CTA Plan Processor [by the CAES System] at the price specified in the commitment or if executed at a better price, the execution price.

**[5240] 6540. Pre-Opening Application—Opening by ITS/ADF[CAES] Market Maker**

The pre-opening application enables an ITS/ADF[CAES] Market Maker or ITS Participant Exchange in any participant market who wishes to open [his] *its* market in an ITS Security to obtain through the ITS System [or CAES], any pre-opening interest of an ITS Participant Exchange or other ITS/ADF[CAES] Market Makers registered in that security and/or market makers in other participant markets.

**(a) Notification Requirement—Applicable Price Change, Initial Notification**

(1) Whenever an ITS/ADF[CAES] Market Maker, in an opening transaction in any ITS/ADF[CAES] Security, anticipates that the opening transaction will be at a price that represents a change from the security's previous day's consolidated closing price of more than the "applicable price change" (as defined below), [he] *its* shall notify the other Participant markets of the situation by sending a "pre-opening notification" through the System. Thereafter, the ITS/ADF[CAES] Market Maker shall not open the security in [his] *its* market until not less than three minutes after [his] *its* transmission of the pre-opening notification. The "applicable price changes" are:

Security	Consolidated closing price	Applicable price change (more than)
Network A .....	Under \$15 .....	1/8 point.
	\$15 or over .....	1/4 point. <sup>1</sup>
Network B .....	Under \$5 .....	1/8 point.
	\$5 or over .....	1/4 point. <sup>2</sup>
For transactions involving securities trading in decimal-based increments, the "applicable price changes" are:		
Network A .....	Under \$15 .....	\$0.10
	\$15 or over .....	\$0.25 <sup>3</sup>
Network B .....	Under \$5 .....	\$0.10
	\$5 or over .....	\$0.25 <sup>4</sup>

(2) a pre-opening notification shall:

(A) be designated as a pre-opening notification (POA);

(B) identify the ITS/ADF[CAES] Market Maker and the security involved; and  
 (C) indicate the “applicable price range” by being formatted as a standardized pre-opening administrative message as follows:  
 POA MMID/XYZ

(3) The price range shall not exceed the “applicable price range” shown below:

Security	Consolidated closing price	Applicable price change (more than)
Network A .....	Under \$50 .....	1/2 point.
	\$50 or over .....	1 point. <sup>5</sup>
Network B .....	Under \$10 .....	1/2 point.
	\$10 or over .....	1 point. <sup>6</sup>

For transactions involving securities trading in decimal-based increments, the price range shall not exceed the “applicable price range” shown below:

Security	Consolidated price	Price range
Network A .....	Under \$50 .....	\$0.50
	\$50 or over .....	\$1.00 <sup>7</sup>
Network B .....	Under \$20 .....	\$0.50
	\$10 or over .....	\$1.00 <sup>8</sup>

<sup>1</sup> If the previous day’s consolidated closing price of a Network A Eligible Security exceeded \$100 dollars and the security does not underlie an individual stock option contract listed and currently trading on a national securities exchange the “applicable price change” is one dollar.

<sup>2</sup> If the previous day’s consolidated closing price of a Network B Eligible Security exceeded \$75 and the security is not a Portfolio Deposit Receipt, Index Funds Share, or Trust Issued Receipt, or does not underlie an individual stock option contract listed and currently trading on a national securities exchange the “applicable price change” is one dollar.

<sup>3</sup> If the previous day’s consolidated closing price of a Network A Eligible Security exceeded \$100 dollars and the security does not underlie an individual stock option contract listed and currently trading on a national securities exchange the “applicable price change” is one dollar.

<sup>4</sup> If the previous day’s consolidated closing price of a Network B Eligible Security exceeded \$75 and the security is not a Portfolio Deposit Receipt, Index Funds Share, or Trust Issued Receipt, or does not underlie an individual stock option contract listed and currently trading on a national securities exchange the “applicable price change” is one dollar.

<sup>5</sup> If the previous day’s consolidated closing price of an ITS security exceeded \$100 dollars and the Security does not underlie an individual stock option contract listed and currently trading on a national securities exchange the “applicable price change” is two dollars.

<sup>6</sup> If the previous day’s consolidated closing price of a Network B Eligible Security exceeded \$75 and the security is not a Portfolio Deposit Receipt, Index Fund[s] Share, or Trust Issued Receipt, or does not underlie an individual stock option contract listed and currently trading on a national securities exchange the “applicable price change” is two dollars.

<sup>7</sup> If the previous day’s consolidated closing price of an ITS security exceeded \$100 dollars and the Security does not underlie an individual stock option contract listed and currently trading on a national securities exchange the “applicable price change” is two dollars.

<sup>8</sup> If the previous day’s consolidated closing price of a Network B Eligible Security exceeded \$75 and the security is not a Portfolio Deposit Receipt, Index Fund[s] Share, or Trust Issued Receipt, or does not underlie an individual stock option contract listed and currently trading on a national securities exchange the “applicable price change” is two dollars.

The price range also shall not straddle the previous day’s consolidated closing price, although it may include it as an endpoint (e.g., a 1/8–5/8 price range would be permissible if the previous day’s consolidated closing price were 1/8 or 5/8, but not if the closing price were 1/4, 3/8 or 1/8).

For transactions involving securities trading in decimal-based increments, the price range also shall not straddle the previous day’s consolidated closing price, although it may include it as an endpoint (e.g., a 40.15–40.65 price range would be permissible if the previous day’s consolidated closing price were 40.15–40.65, but not if the closing price were within the price range 40.16–40.64).

**(b) Subsequent Notifications**

If, after sending a pre-opening notification, the situation in an ITS/ADF[CAES] Market Maker’s market changes [he] it may have to issue a subsequent pre-opening notification.

The three situations requiring subsequent notifications are described below. Subsequent pre-opening notifications shall be standardized pre-opening administrative messages. After sending a subsequent notification, the ITS/ADF[CAES] Market Maker shall wait either (1) one minute or (2) until the balance of the original three-minute waiting period expires, whichever is longer, before opening [his] its market (i.e., if more than one minute of the initial waiting period has not yet expired at the time the subsequent notification is sent, the ITS/ADF[CAES] Market Maker must wait for the rest of the period to pass before opening [his] its market).

**(1) Increase or Decrease in Applicable Price Range**

Where, prior to the ITS/ADF[CAES] Market Maker’s opening of [his] its market in the security, [his] its anticipated opening price shifts so that it (A) is outside of the price range

specified in [his] its pre-opening notification but (B) still represents a change from the previous day’s consolidated closing price of more than the applicable price change, [he] it shall issue a replacement pre-opening notification (an “additional” notification) through the system before opening [his] its market in the security. An additional notification contains the same kind of information as is required in an original pre-opening notification.

**(2) Shift to Within Applicable Price Change Parameter**

(A) The ITS/ADF[CAES] Market Maker shall, by issuing a “cancellation” notification through the system, notify the Participant market(s) of the receiving market maker(s) prior to opening the security if the price at which [he] it anticipates opening [his] its market shifts so that it (i) is outside of the price range specified in [his] its pre-opening notification but (ii) does not represent a change from the

previous day's consolidated closing price of more than the applicable price change.

(B) Notwithstanding the preceding sentence, in situations where the price range in an initial or additional notification includes price variations equal to or less than the applicable price change parameters, the "cancellation" notification signifies that the anticipated opening price (i) may or may not be outside of the price range specified in the pre-opening notification and (ii) does not represent a change from the previous day's consolidated closing price of more than the applicable price change.

Example: CTA close at 30. Pre-Opening Notification sent with any one of the following price ranges: 30–30½; 30⅙–30⅘; or 30¼–30¾. It is then determined that the stock will open at 29¾ or 29⅞. Under paragraph (b)(2)(A), the specialist "shall" send cancellation notification. If it is subsequently determined that stock will open at 30, 30⅙, or 30¼, the specialist need not reindicate stock pursuant to paragraph (b)(2)(B).

Example for Decimal-Based Securities: CTA close at 30. Pre-Opening Notification sent with a price range at or within the following range: 30.10–30.60. It is then determined that the stock will open at a price within the range of 29.75 to 29.99. Under paragraph (b)(2)(A), the specialist "shall" send cancellation notification. If it is subsequently determined that stock will open at a price within the range of 30–30.25, the specialist need not reindicate stock pursuant to paragraph (b)(2)(B).

### (3) Participation as Principal Precluded ("Second Look")

If a responding market maker who has shown in [his] *its* pre-opening response interest as a principal at a price better than the anticipated opening price would be precluded from participation as principal in the opening transaction (e.g., [his] *its* responding principal interest is to sell at a price ⅙ or more below the opening price established by paired agency orders), the ITS/ADF[CAES] Market Maker[s] shall send a "second look" notification through the System, notifying such responding market maker of the price and size at which [he] *it* could participate as principal (i.e., in the parenthetical example above, the total amount of the security that [he] *it* would have to sell at the ⅙-better price to permit the opening transaction to occur at that price).

For securities trading in decimal-based increments, if a responding market maker who has shown in [his] *its*

pre-opening response interest as a principal at a price better than the anticipated opening price would be precluded from participation as principal in the opening transaction (e.g., [his] *its* responding principal interest is to sell at a price .01 or more below the opening price established by paired agency orders), the ITS/ADF[CAES] Market Maker[s] shall send a "second look" notification through the System, notifying such responding market maker of the .01 price and size at which [he] *it* could participate as principal (i.e., in the parenthetical example above, the total amount of the security that [he] *it* would have to sell at the .01 better price to permit the opening transaction to occur at that price).

### (c) Tape Indications

If the CTA Plan or the Association's rules require[s] or permits that an "indication of interest" (i.e., an anticipated opening price range) in a security be furnished to the consolidated last sale reporting system prior to the opening of trading or the reopening of trading following a halt or suspension in trading in one or more ITS Securities, then the furnishing of an indication of interest in such situations shall, without any other additional action required of the ITS/ADF[CAES] Market Maker, (1) initiate the pre-opening process, and (2) if applicable, substitute for and satisfy the requirements of paragraphs (a), (b)(1), and (b)(2) (while the furnishing of an indication of interest to the consolidated last sale reporting system satisfies the notification requirements of this rule, an ITS/ADF[CAES] Market Maker should also transmit the indication through the System in the format of a standardized pre-opening administrative message). In any such situation, the ITS/ADF[CAES] Market Maker shall not open or reopen the security until not less than three minutes after [his] *its* transmission of the opening or reopening indication of interest. For the purpose of paragraphs (b)(3), (d), (f), and (g) through (i), "pre-opening notification" includes an indication of interest furnished to the consolidated last sale reporting system.

### (d) Pre-Opening Responses—Decision on Opening Transaction

Subject to paragraph (e), [i]f an ITS/ADF[CAES] Market Maker [who] *that* has issued a pre-opening notification receives "pre-opening responses" through the system containing "obligations to trade" from market makers in other Participant markets ("responding market makers"), [he] *it* shall combine those obligations with

orders [he] *it* already holds in the security and, on the basis of this aggregated information, decide upon the opening transaction in the security. If the ITS/ADF[CAES] Market Maker has received more than one pre-opening response from a Participant market, [he] *it* shall include in such combination only those obligations to trade from such Participant market as are specified in the most recent response, whether or not the most recent response expressly cancels the preceding response(s). An original or revised response received after the ITS/ADF[CAES] Market Maker has effected [his] *its* opening transaction shall be to no effect.

### (e) Pre-Opening Responses From Open Markets

(1) An ITS/ADF[CAES] Market Maker must accept only those pre-opening responses sent to the Association by market makers in other [p]Participant markets prior to the opening of their markets for trading in the security. Following a halt or suspension in trading declared by the Association in an ITS Security, an ITS/ADF[CAES] Market Maker must accept only those pre-opening responses sent by market makers to the Association from other [p]Participant markets that halted trading in the security contemporaneously with the Association and that had not resumed trading in the security at the time the pre-opening response was sent.

(2) In the event that one or more market makers from [p]Participant markets that have already opened trading in a security or, with respect to a halt or suspension in trading, either did not halt trading in the security contemporaneously with the Association, or has already resumed trading in the security, respond to a pre-opening notification in that security, the ITS/ADF[CAES] Market Maker need not, but may in [his] *its* discretion, accept such responses for the purpose of inclusion in the opening or reopening transaction. In the event that a Participant market opens or, with respect to a halt or suspension in trading, resumes trading in a security subsequent to a market maker in the Participant market sending a pre-opening response but prior to the opening or reopening transaction in ITS/ADF[CAES], the market maker who sent the pre-opening response to the Association must confirm the pre-opening response by sending an administrative message through the [s]System stating that the response remains valid. If the market maker fails to so confirm the pre-opening response, the ITS/ADF[CAES] Market Maker need

not, but may in [his] *its* discretion, accept the original response for the purpose of inclusion in the opening or reopening transaction.

#### (f) Allocation of Imbalances

Whenever pre-opening responses from one or more responding market makers include obligations to take or supply as principal more than 50 percent of the opening imbalance, the ITS/ADF[CAES] Market Maker may take or supply as principal 50 percent of the imbalance at the opening price, rounded up or down as may be necessary to avoid the allocation of odd lots. In any such case, where the pre-opening response is from more than one responding market maker, the ITS/ADF[CAES] Market Maker shall allocate the remaining imbalance (which may be greater than 50 percent if the ITS/ADF[CAES] Market Maker elects to take or supply less than 50 percent of the imbalance) among them in proportion to the amount each obligated [himself] *itself* to take or supply as principal at the opening price in [his] *its* pre-opening response, rounded up or down as may be necessary to avoid the allocation of odd lots. For the purpose of this paragraph, multiple responding market makers in the same ITS Security in the same Participant market shall be deemed to be a single responding market maker.

#### (g) Treatment of Obligations To Trade

In receiving a pre-opening response, an ITS/ADF[CAES] Market Maker shall accord to any obligation to trade as agent included in the response the same treatment as [he] *it* would to an order entrusted to [him]*it* as agent at the same time such obligation was received.

#### (h) Responses Increasing the Imbalances

An ITS/ADF[CAES] Market Maker shall not reject a pre-opening response that has the effect of further increasing the existing imbalance for that reason alone.

#### (i) Reports of Participation

Promptly following the opening in any security as to which an ITS/ADF[CAES] Market Maker issued a pre-opening notification, the ITS/ADF[CAES] Market Maker shall report to each Participant responsible for a market in which one or more responding market makers are located (1) the amount of the security purchased and/or sold, if any, by the responding market maker(s) in the opening transaction and the price thereof, or (2) if the responding market maker(s)'s response included agency or principal

interest at the opening price that did not participate in the opening transaction, the fact that such interest did not so participate.

[Amended eff. Aug. 5, 1991; Mar. 31, 1993; amended by SR-NASD-97-09 eff. May 30, 1997; amended by SR-NASD-00-46 eff. Aug. 28, 2000.]

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### [5250] 6550. Pre-Opening Application—Openings on Other Participant Markets

#### (a) Pre-Opening Responses

Whenever an ITS/ADF[CAES] Market Maker [who] *that* has received a pre-opening notification from another ITS/ADF[CAES] Market Maker or ITS Participant Exchange as provided in the ITS Plan in any ITS Security as to which [he] *it* is registered as an ITS/ADF[CAES] Market Maker wishes to participate in the opening of that security in the Participant market from which the pre-opening notification was issued, [he] *it* may do so by sending obligations to trade through the System to such Participant market in a pre-opening response. A pre-opening response shall be designated as a pre-opening response (POR), identify the security, and show the ITS/ADF[CAES] Market Maker's buy and/or sell[,] interest, (if any), both as principal for [his] *its* own account ("P") and as agent for orders left with [him]*it* ("A"), at each price level within the price-range indicated in the pre-opening notification (e.g., 40%), reflected on a netted share basis.

For securities trading in decimal-based increments, whenever an ITS/ADF[CAES] Market Maker [who] *that* has received a pre-opening notification from another ITS/ADF[CAES] Market Maker or ITS Participant Exchange as provided in the ITS Plan in any ITS Security as to which [he] *it* is registered as an ITS/ADF[CAES] Market Maker wishes to participate in the opening of that security in the Participant market from which the pre-opening notification was issued, [he] *it* may do so by sending obligations to trade through the System to such Participant market in a pre-opening response. A pre-opening response shall be designated as a pre-opening response (POR), identify the security, and show the ITS/ADF[CAES] Market Maker's buy and/or sell[,] interest, (if any), both as principal for [his] *its* own account ("P") and as agent for orders left with [him] *it* ("A"), at each price level within the price-range indicated in the pre-opening notification (e.g., 40.40), reflected on a netted share basis.

The pre-opening response shall be formatted as follows:

POR (MMID) BUY [SELL] A-P 40<sup>3</sup>/<sub>8</sub>

For securities trading in decimal-based increments the pre-opening response shall be:

POR (MMID) BUY (SELL) A-P 40.40

The response may also show market orders separately.

#### (b) Revised Responses

An ITS/ADF[CAES] Market Maker may cancel or modify [his] *its* pre-opening response by sending through the System a revised response that cancels the obligations to trade contained in [his] *its* original response and, if a modification is desired, that substitutes new obligations to trade stating the ITS/ADF[CAES] Market Maker's aggregate interest (i.e., [his] *its* interest reflected in the original response plus any additional interest and/or minus any withdrawn interest) at each price level. Each succeeding response, even if it fails to expressly cancel its predecessor response, shall supersede the predecessor response in its entirety. Any revised response shall be to no effect if received in the Participant market from which the pre-opening notification was issued after the security has opened in such Participant market.

#### (c) Pre-Opening Notification From Other Markets

No ITS/ADF[CAES] Market Maker, whether acting as principal or agent, shall send an obligation to trade, commitment to trade or order in any security through the System to any other [p]Participant market[,] prior to the opening of trading in such security on such other market (or prior to the resumption of trading in such security on such other market following the initiation of a halt or suspension in trading in the security) until a pre-opening notification as to such security has been issued from such other market or a quotation has been disseminated from such other market pursuant to SEC Rule 11Ac1-1. No ITS/ADF[CAES] Market Maker that has opened for trading or, with respect to a halt or suspension of trading initiated by another Participant [M]market, did not halt trading in the security reasonably contemporaneously with the Participant [M]market or resumed trading during such trading halt or suspension, shall respond to a pre-opening notification.

#### (d) Sole Means of Pre-Opening Routing

Once a pre-opening notification as to any security is received by the ITS/ADF[CAES] Market Maker through the

System, the ITS/ADF[CAES] Market Maker[s] in such security shall submit obligations to trade that security as principal for [his] *its* own account to the market from which the pre-opening notification was issued only through the Pre-Opening Application and shall not send orders to trade that security for [his] *its* own account to such market for participation at the opening in that market by any other means. However, this restriction shall not apply to any order sent to such market by the ITS/ADF[CAES] Market Maker prior to the issuance of the pre-opening notification.

**(e) Duration of Obligations To Trade**

Responses to pre-opening notifications shall be voluntary, but each obligation to trade that an ITS/ADF[CAES] Market Maker includes in any pre-opening response, or in any modification of a pre-opening response, shall remain binding on [him] *it*, until the security has opened in the market from which the pre-opening notification was issued or until a cancellation or modification of such obligation has been received in such market, and until a subsequent cancellation or modification thereof has been received in such market.

**(f) Request for Participation Report**

The ITS Plan anticipates that an ITS/ADF[CAES] Market Maker [who] *that* has sent one or more obligations to trade in response to a pre-opening notification will request a report through the System as to [his] *its* participation if [he] *it* does not receive a report as required promptly following the opening. If, on or following trade date, [he] *it* does request a report through the System as to [his] *its* participation before 4:00 p.m. Eastern Time, and [he] *it* does not receive a response by 9:30 a.m. Eastern Time on the next trading day, [he] *it* need not accept a later report. If [he] *it* fails to so request a report, [he] *it* must accept a report until 4:00 p.m. Eastern Time on the third trading day following the trade date (i.e., on T+3). The Association does not intend this paragraph to relieve [him] *U the ITS/ASD Market Maker* of the obligation, when [he] *it* does not receive a report, to request a report as soon as [he] *it* reasonably should expect to have received it.

[Amended eff. Nov. 24, 1989; May 15, 1991; Aug. 5, 1991; amended by SR-NASD-97-09 eff. May 30, 1997; amended by SR-NASD-00-46 eff. Aug. 28, 2000.]

**[5260]6560. System Trade and Quotations**

**[5261]6561. [Obligation To Honor System Trades] Obligation Before Issuing External ITS Commitments**

[If an ITS/CAES Market Maker or clearing member acting on his behalf is reported on the clearing tape (as adjusted) at the close of any trading day, or shown by the activity reports developed by CAES as constituting a side of a System trade, such ITS/CAES Market Maker or clearing member shall honor such trade on the scheduled settlement date.]

*Before formatting any order, bid or offer into an ITS commitment to trade and issuing such a commitment to another ITS participant market, a member registered as an ITS Market Maker in an ITS Security shall first exhaust all interest at or better than such order, bid or offer which is resident in the ADF, and then expose for thirty seconds any remaining balance to all ADF Participants, whether or not registered in the ITS Security involved.*

**[5262]6562. Trade-Throughs**

(a) A member registered as an ITS/ADF[CAES] Market Maker in an ITS/ADF[CAES] [s]Security, shall avoid purchasing or selling such security, whether as principal or agent, at a price [which] *that* is lower than the bid or higher than the offer displayed from an ITS Participant Exchange or ITS/ADF[CAES] Market Maker (“trade-through”), unless the following conditions apply:

(1) The size of the bid or offer that is traded-through is for 100 shares;

(2) the ITS/ADF[CAES] Market Maker is unable to avoid the trade-through because of [the] *a* systems/equipment failure or malfunction;

(3) the transaction which constituted the trade-through is not a “regular way” contract;

(4) the bid or offer that is traded[-] through is being displayed from a [M]market [C]center whose members are relieved of their obligations under SEC Rule 11Ac1-1([C]c)(2) with respect to such bid or offer;

(5) the bid or offer that is traded[-] through has caused a locked or crossed market in the ITS Security;

(6) the commitment received by an ITS/ADF[CAES] Market Maker which caused the trade-through was originated by an ITS Participant Exchange;

(7) The transaction involves (A) purchases and sales effected by ITS/ADF[CAES] Market Makers participating in an opening (or reopening) transaction or (B) any “Block Transaction” as defined in the ITS/ADF[CAES] Rules; or

(8) In the case of a third participating market center trade-through, either:

(A) the ITS/ADF[CAES] Market Maker who initiated the trade-through (i) had sent a commitment to trade promptly following the trade-through that satisfies the bid or offer traded[-] through, and (ii) preceded the commitment with an administrative message stating that the commitment was in satisfaction of a third participating market center trade-through; or

(B) a complaint with respect to the trade-through was not received by the Association through the System from the aggrieved party promptly following the trade-through, and, in any event, within ten (10) minutes from the time the aggrieved party sent a complaint through the System to the ITS [p]Participating [m]Market [c]Center that received the commitment to trade that caused the trade-through, which first complaint must have been received within five (5) minutes from the time the report of the transaction that constituted the trade-through was disseminated over the high speed line of the consolidated last sale reporting system.

(b) (1) If a trade-through occurs and a complaint is promptly received by the Association either through the ITS System from the appropriate ITS Participant Exchange whose member is the aggrieved party or from an ITS/ADF[CAES] Market Maker, then:

(A) If ITS/ADF[CAES] Market Makers are on both sides of a principal trade, the price of the transaction which constituted the trade-through shall be corrected, by agreement of the parties, to a price at which a trade-through would not have occurred and the price correction shall be reported through the consolidated last sale reporting system; otherwise (i) the initiating ITS/ADF[CAES] Market Maker shall satisfy, or cause to be satisfied, the bid or offer traded-through in its entirety at the price of such bid or offer or at the price that caused the trade-through (as determined in accordance with subparagraph (E) below, or, if the initiating ITS/ADF[CAES] Market Maker elects not to do so, (ii) the transaction shall be voided.

(B) If an ITS/ADF[CAES] Market Maker executed the transaction and the contra-side was not an ITS/ADF[CAES] Market Maker (i) the ITS/ADF[CAES] Market Maker registered in the security shall satisfy, or cause to be satisfied, the bid or offer traded-through in its entirety at the price of such bid or offer, or, if the ITS/ADF[CAES] Market Maker elects not to do so, (ii) the price of the transaction [which] *that* constituted the trade-through shall be corrected by the

ITS/ADF[CAES] Market Maker to a price at which a trade-through would not have occurred and the price correction shall be reported through the consolidated last sale reporting system.

(C) If ITS/ADF[CAES] Market Makers are on both sides of a trade and one or both are acting as agent, the price of the transaction which constituted the trade-through shall be corrected, by agreement of the parties, to a price at which a trade-through would not have occurred and the price correction shall be reported through the consolidated last sale reporting system; otherwise, the ITS/ADF[CAES] Market Maker that initiated the transaction shall satisfy, or cause to be satisfied, the bid or offer traded-through in its entirety at the price of such bid or offer.

(D) Whenever the provisions of subparagraphs (B) and (C) above apply, the customer's order or a portion thereof [which] *that* was executed in the transaction [which] *that* constituted the trade-through (whether such order or a portion thereof was executed by the member who initiated the trade-through or by the member on the contra-side of the transaction, or both) shall receive the price [which] *that* caused the trade-through, or the price at which the bid or offer traded-through was satisfied, if it was satisfied pursuant to subparagraph (B) above, or the adjusted price, if there was an adjustment pursuant to subparagraph (B) above, whichever price is most beneficial to the order or a portion thereof. Money differences resulting from the application of this paragraph shall be the liability of the member who initiated the trade-through.

(E) The price at which the bid or offer traded-through shall be satisfied shall be the price of such bid or offer except if (i) the transaction that constituted the trade-through was of "block size" but did not constitute a "block trade" (as those terms are defined in the Block Trade Rule) and (ii) the ITS/ADF[CAES] Market Maker who initiated the trade-through did not make every reasonable effort to satisfy, or cause to be satisfied, through the System the bid or offer traded-through at its price and in its entirety within two (2) minutes from the time the report of the transaction that constituted the trade-through was disseminated over the high speed line of the consolidated last sale reporting system. In the case of such exception, the price at which the bid or offer traded-through shall be satisfied shall be the price that caused the trade-through.

(2) Such complaint shall be considered promptly received when no more than five minutes expire from the time the report of the transaction was

disseminated over the high speed line of the consolidated last sale reporting system, unless the transaction is between an ITS/ADF[CAES] Market Maker and another ITS/ADF[CAES] Market Maker or ITS Participant Exchange. In the latter case, the complaint must be received within ten minutes from the time the aggrieved party sent a complaint through the System to the ITS/ADF[CAES] Market Maker or ITS Participant Exchange that received the commitment to trade that caused the trade-through, which first complaint must have been received within five minutes from the time the report of the transaction was disseminated over the high speed line of the consolidated last sale reporting system.

(c) (1) The Association shall notify the ITS/ADF[CAES] Market Maker of any trade-through complaint received from an ITS Participant Exchange or ITS/ADF[CAES] Market Maker. Upon receipt of such notification, the ITS/ADF[CAES] Market Maker shall promptly respond to the complaining ITS Participant Exchange or ITS/ADF[CAES] Market Maker. Such response shall set forth either: (A) the conditions specified in paragraph (a) above, or (B) the corrective action to be taken under paragraph (b) above. If there is more than one ITS/ADF[CAES] Market Maker that is registered in the ITS Security and participating in the transaction, then the ITS/ADF[CAES] Market Maker that initiated the transaction will receive notification of the trade-through complaint.

(2) If it is ultimately determined that an ITS/ADF[CAES] Market Maker has engaged in a trade-through but has not taken corrective action required by paragraph (b) above, then the ITS/ADF[CAES] Market Maker shall be liable for the lesser of (A) the actual loss proximately caused by the trade-through and suffered by the aggrieved party, or (B) the loss proximately caused by the trade-through which would have been suffered by the aggrieved party had [he] *it* purchased or sold the security subject to the trade-through in order to mitigate [his] *its* loss and had such purchase or sale been effected at the "loss basis price." For purposes of this subparagraph the "loss basis price" shall be the price of the next transaction, as reported by the high speed line of the consolidated last sale reporting system in the security in question, after one hour has elapsed from the time the complaint is received (or, if the complaint is so received within the last hour in which transactions are reported on the high speed line of the consolidated last sale

reporting system on any day, then the price of the opening transaction in such security reported on such high speed line on the next day on which the security is traded).

(3) Any ITS/ADF[CAES] Market Maker that becomes the subject of a trade-through by another ITS Participant Exchange or ITS/ADF[CAES] Market Maker may take whatever steps [are] necessary to mitigate any potential loss resulting from the trade-through of his bid or offer. Such action shall be promptly communicated to the offending ITS Participant market.

(4) The provisions of this trade-through rule shall not apply in respect to any Participant Exchange [which] *that* does not have in effect a similar rule imposing similar obligations and responsibilities.

(5) If a complaint of a purported trade-through is received by the Association and the complained-of transaction resulted from an ITS/ADF[CAES] Market Maker's execution of a commitment to trade received from another ITS/ADF[CAES] Market Maker or ITS Participant Exchange, the ITS/ADF[CAES] Market Maker should, if circumstances permit, make reasonable efforts to notify the complaining party, as promptly as practicable following receipt of the complaint, (A) that the transaction was not initiated by the ITS/ADF[CAES] Market Maker and (B) [of] the identity of the ITS/ADF[CAES] Market Maker or ITS Participant Exchange that originated the commitment. Neither compliance nor non-compliance with the preceding sentence shall be the basis for any liability of the ITS/ADF[CAES] Market Maker for any loss associated with the complained-of transaction.

#### [5263]6563. Locked or Crossed Markets

(a) A member registered as an ITS/ADF[CAES] Market Maker in an ITS/ADF[CAES] Security that makes a bid (offer) for such security at a price [which] *that* equals the offering (bid) price at that time from an ITS Participant Exchange or ITS/ADF[CAES] Market Maker has created what is referred to in this [r]Rule as a "locked market."

(b) A member registered as an ITS/ADF[CAES] Market Maker in an ITS/ADF[CAES] Security that makes a bid (offer) for such security at a price [which] *that* exceeds (is less than) the offering (bid) price at that time from an ITS Participant Exchange or ITS/ADF[CAES] Market Maker has created what is referred to in this [r]Rule as a "crossed market."

(c) An ITS/ADF[CAES] Market Maker [who] *that* makes a bid or offer and in

so doing creates a locked or crossed market with another ITS Participant or ITS/ADF[CAES] Market Maker shall promptly send to such other ITS Participant Exchange or ITS/ADF[CAES] Market Maker a commitment to trade seeking either the bid or offer [which] *that* was locked or crossed, unless excused by operation of paragraph (d) below. Such commitment shall be for either the number of shares [he] *it* has bid for (offered) or the number of shares offered (bid for) on the ITS Participant Exchange or by the ITS/ADF[CAES] Market Maker, whichever is less.

(d) The provisions of paragraph (c) above shall not apply when:

(1) The bid or offer in the ITS Participating [m]Market [c]Center is for 100 shares;

(2) the issuance of the commitment to trade referred to above would be prohibited by SEC Rule 10a-1 under the Act;

(3) the ITS/ADF[CAES] Market Maker [who] *that* causes a locked or crossed market is unable to comply with the provisions of paragraph (c) above because of a systems/equipment failure or malfunction;

(4) the bid or offer that causes the locked or crossed market is not for a "regular way" contract;

(5) the locked or crossed market occurs at a time when, with respect to the ITS Security [which] *that* is the subject of the locked or crossed market, members of the ITS [p]Participating [m]Market [c]Center to which the commitment to trade would be sent pursuant to paragraph (c) above are relieved of their obligations under SEC Rule 11Ac1-1(c)(2);

(6) the transaction involves (A) purchases and sales effected by ITS/[CAES]ADF Market Maker[']s participating in an opening or (reopening) transaction or (B) any "Block Transaction" as defined in the ITS/[CAES] Rules.

#### [5264] 6564. Block Transactions

(a) An ITS/ADF[CAES] Market Maker [who] *that* executes a "block transaction" in an ITS/[CAES] [s]Security in which [he] *it* is registered as an ITS/ADF[CAES] Market Maker at an execution price outside the best quotation for the security displayed by any ITS [p]Participant market or other ITS/ADF[CAES] Market Maker, shall, upon executing the block trade, send to each other [p]Participant market and each ITS/ADF[CAES] Market Maker displaying a bid or offer (as the case may be) superior to the execution price, a commitment to trade, at the execution price, to satisfy the number of shares

displayed in that [p]Participant market's bid or offer.

(b) For purposes of this Rule, a block transaction shall be a trade that:

(1) Involves 10,000 or more shares of a common stock traded through ITS (an "ITS Security") or a quantity of any such security having a market value of \$200,000 or more ("block size");

(2) is effected at a price outside the bid or offer displayed from another ITS [p]Participating [m]Market [c]Center; and

(3) involves either:

(A) a cross of block size (where the member represents all of one side of the transaction and all or a portion of the other side); or

(B) any other transaction of block size (i.e., in which the ITS/ADF[CAES] Market Maker represents an order of block size on one side of the transaction only) that is not the result of an execution at the current bid or offer of the ITS/ADF[CAES] Market Maker.

Contemporaneous transactions at the same price filling an order or orders then or theretofore represented by the ITS/ADF[CAES] Market Maker (including transactions resulting from commitments to trade sent by the ITS/ADF[CAES] Market Maker pursuant to paragraph (a) above) shall be deemed to constitute a single transaction for the purpose of this definition.

(c) A "current bid or offer" of the ITS/ADF[CAES] Market Maker, as that term is used in paragraph (b)(3)(B) above, means the price of the current quotation displayed by the ITS/ADF[CAES] Market Maker established independently of the order to buy or sell.

(d) A "bid or offer" displayed from another ITS [p]Participating [m]Market [c]Center (or any derivative phrase), as that term is used in this Rule, means the current quotations from another ITS [p]Participating [m]Market [c]Center displayed to the ITS/ADF[CAES] Market Maker as required by the ITS Plan, and does not include "away-from-the-market" limit orders or other interests that may be represented in such other ITS [p]Participating [m]Market [c]Center.

(e) Inapplicability. Paragraph (a) above shall not apply under the following conditions:

(1) The size of the better priced bid or offer displayed by another ITS [p]Participating [m]Market [c]Center was for 100 shares;

(2) the ITS/ADF[CAES] Market Maker representing the block-size order(s) made every reasonable effort to satisfy through ITS a better-priced bid or offer displayed by another ITS [p]Participating [m]Market [c]Center but

was unable to because of a systems/equipment failure or malfunction;

(3) the block trade was not a "regular way" contract;

(4) the bid or offer that is traded through is being displayed from a [m]Market [c]Center whose members are relieved of their obligations under SEC Rule 11Ac1-1(c)(2) with respect to such bid or offer;

(5) the bid or offer that is traded through has caused a locked or crossed market in the ITS Security;

(6) the better priced bid or offer was being displayed from an ITS [p]Participating [m]Market [c]Center whose members were relieved of their obligations with respect to such bid or offer under SEC Rule 11Ac 1-1(c)(2) pursuant to the "unusual market" exception to SEC Rule 11Ac1-1(b)(3); or

(7) the better priced bid or offer had caused a "locked or crossed market[.]" in the ITS Security that was the subject of the block trade.

#### [5265. Authority To Cancel or Adjust Transactions]

[(a) In circumstances in which the Association deems it necessary to maintain a fair and orderly market and to protect investors and the public interest, the Association may, pursuant to the procedures set forth in Rule 11890 of the Uniform Practice Code, declare any transaction arising out of the use or operation of the ITS/[CAES] System, null and void on the grounds that one or more of the terms of the transaction are clearly erroneous; and the Association may reallocate stock between ITS/[CAES] Market Makers to correct an erroneous transaction.]

[(b) For purposes of this Rule, the terms of the transaction are clearly erroneous when there is an obvious error in any term, such as price, number of shares or other unit of trading, identification of the security, or if a specific commitment to trade has been executed with the wrong ITS/CAES Market Maker.]

#### [5300]6700. THE PORTAL® MARKET

##### [5310]6710. Definitions

For purposes of the PORTAL® Market Rules, unless the context requires otherwise:

(a) "Association" means the National Association of Securities Dealers, Inc. (Association) or its wholly owned subsidiary, *NASD Regulation, Inc.* [The Nasdaq Stock Market, Inc.,] as determined by the Association.

(a) through (aa) No Change.



**[5320]6720. Requirements Applicable to PORTAL Securities****[5321]6721. Application for Designation**

(a) Application for designation as a PORTAL security shall be in the form required by the Association and shall be filed by a PORTAL participant. Applications may be made with or without the concurrence of the issuer. The application shall demonstrate to the satisfaction of the Association that the security meets or exceeds the qualification requirements set forth in Rule 5322.

(b) Designation of a security as a PORTAL security shall be declared effective within a reasonable time after determination of qualification. The effective date of designation as a PORTAL security shall be determined by the Association giving due regard to the requirements of the PORTAL Market.

**[5322]6722. Qualification Requirements for PORTAL Securities**

(a) To qualify for initial designation and continued designation in the PORTAL Market, a security shall:

(1) be:

(A) a restricted security, as defined in SEC Rule 144(a)(3) under the Securities Act; or

(B) a security that upon issuance and continually thereafter only can be sold pursuant to Regulation S under the Securities Act, SEC Rule 144A, or SEC Rule 144 under the Securities Act, or in a transaction exempt from the registration requirements of the Securities Act pursuant to Section 4 thereof and not involving any public offering;

provided, however, that if the security is a depositary receipt, the underlying security shall also be a security that meets the criteria set forth in subparagraphs (A) or (B) hereof;

(2) be eligible to be sold pursuant to SEC Rule 144A under the Securities Act;

(3) be in negotiable form and not subject to any restriction, condition or requirement that would impose an unreasonable burden on any PORTAL participant;

(4) be assigned a CUSIP or CINS security identification number that is different from any identification number assigned to any unrestricted securities of the same class [which] *that* do not satisfy paragraph (a)(1)(B); or, if issued in physical certificate form to investors, have a legend placed on each certificate stating that the securities have not been registered under the Securities Act and cannot be resold without registration

under the Securities Act or an exemption therefrom; and

(5) satisfy such additional criteria or requirements as the Association may prescribe.

(b) Notwithstanding the provisions of paragraph (a)(1)(B) of this Rule, if a PORTAL security is sold pursuant to the provisions of Rule 144, including Rule 144(k), it will thereby cease being a PORTAL security and it must be assigned a CUSIP or CINS security identification number that is different from the identification number assigned to a PORTAL security of the same class.

**[5323]6723. Suspension or Termination of a PORTAL Security Designation**

(a) The Association may, in its discretion, suspend or terminate designation as a PORTAL security if it determines that:

(1) The security is not in compliance with the requirements of the PORTAL Rules;

(2) a holder or prospective purchaser that requested issuer information pursuant to SEC Rule 144A(d)(4) did not receive the information;

(3) any application or other document relative to such securities submitted to the Association contained an untrue statement of a material fact or omitted to state a material fact necessary to make the statements therein not misleading; or

(4) failure to withdraw designation of such securities would for any reason be detrimental to the interests and welfare of PORTAL participants or the Association.

(b) The Association will promptly notify PORTAL participants of the suspension or termination of a security's designation as a PORTAL security. Such notification may be made through the facilities of the PORTAL Market. Suspension or termination shall become effective in accordance with the terms of notice by the Association. The Association also will promptly notify The Depository Trust Company of the suspension or termination.

(c) Notwithstanding the suspension or termination of designation of a security as a PORTAL security, such security shall remain subject to all rules of the Association applicable to the PORTAL Market until the security is sold in accordance with the terms of notice by the Association of the suspension or termination.

**[5324]6724. PORTAL Entry Fees**

When a PORTAL participant submits an application for designation of any class of securities as a PORTAL security, it shall pay to the Association a filing fee of \$2,000.00 for an application

covering a security or group of identifiable securities issuable as part of a single private placement covered by the same offering documents, plus \$200.00 per assigned security symbol that is in addition to the first symbol assigned.

**[5330]6730. Requirements Applicable to Members of the Association****[5331]6731. Limitations on Transactions in PORTAL Securities**

(a) No member shall sell a PORTAL security unless:

(1) The sale is to:

(A) an investor or member that the member reasonably believes is a "qualified institutional buyer" in a transaction exempt from registration under the Securities Act by reason of compliance with Rule 144A;

(B) an investor or member in a transaction that is exempt from registration under the Securities Act by reason of compliance with an applicable exemption under the Securities Act other than Rule 144A; or

(C) a member acting as an agent in a transaction that the member acting as agent determines is in compliance with subparagraphs (A) or (B) hereof, and the selling member determines is exempt from registration under the Securities Act by reason of compliance with SEC Rule 144A or an applicable exemption under the Securities Act other than SEC Rule 144A; and

(2) the member maintains in its files information demonstrating that the transaction is in compliance with Rule 144A or with any other applicable exemption from registration under the Securities Act.

**[5332]6732. Reporting Debt and Equity Transactions in PORTAL Securities**

(a) A transaction in a PORTAL security in which a PORTAL dealer or PORTAL broker participates shall be reported to the PORTAL Market system in a PORTAL transaction report complying with Rule [5334] 6734 by:

(1) The seller, if each party in the transaction is either a PORTAL dealer or a PORTAL broker;

(2) the PORTAL dealer or PORTAL broker participating in the transaction, if only one party in the transaction is a PORTAL dealer or PORTAL broker; provided, however, that with respect to transactions that are part of the initial offering by or on behalf of the issuer or an affiliate thereof, a PORTAL dealer or PORTAL broker may comply with its obligation to submit a PORTAL transaction report by submitting, instead, a PORTAL surveillance report [which] *that* reports such transaction to

the Market Regulation Department of the Association as set forth in Rule [5336] **6736**.

(b) A transaction in a PORTAL security in which a member participates, but in which no PORTAL dealer or PORTAL broker participates, shall be reported to the Market Regulation Department of the Association in a PORTAL non-participant report complying with Rule [5335] **6735** by:

(1) The seller, if each party in the transaction is a member; or

(2) The member, if only one party in the transaction is a member.

(c) The member responsible for submitting a PORTAL transaction report shall also submit to the Market Regulation Department of the Association a PORTAL surveillance report as set forth in Rule [5336] **6736**.

(d) The reporting requirements of this Rule shall apply to any transaction in a PORTAL security, including transactions in reliance on SEC Rule 144 and sales to or purchases from a non-U.S. securities market.

[Rule [5332] **6732** will not be effective until a date is announced by the NASD.]

#### [5333] **6733. PORTAL Settlement**

(a) Transactions in the PORTAL Market where the PORTAL dealer or PORTAL broker that enters the PORTAL transaction report in the PORTAL Market system designates settlement in the PORTAL clearance and depository systems will settle five (5) business days after the date of the execution of the transaction, except as otherwise agreed between the PORTAL participants, in any currency accepted by the PORTAL depository organization.

(b) PORTAL securities and funds will be transferred on the books of the PORTAL depository system upon receipt from the PORTAL clearing system of the necessary settlement instructions designating settlement in the PORTAL clearance and depository systems from the PORTAL transaction report entered in the PORTAL Market system by the appropriate PORTAL dealer or PORTAL broker and subject to the purchaser meeting the requirements of the relevant PORTAL depository organization concerning deposit and availability of funds in accordance with the depository organization's procedures.

(c) PORTAL dealers and PORTAL brokers that settle a PORTAL transaction outside the PORTAL clearance and depository systems assume responsibility for the prompt settlement of the transaction in accordance with the protocols of the

settlement method used and the transaction will not be compared in the PORTAL Market.

#### [5334] **6734. PORTAL Transaction Reports**

(a) Each PORTAL transaction report shall include: whether the report should be forwarded to the PORTAL depository and clearance systems for the clearance and settlement of the transaction; if the PORTAL depository and clearance system is to be used, the identity of the account where the transaction is to be settled; if the PORTAL depository and clearance system is not to be used and the contra-party is an Association member, the identity of the Association member that is the contra-party; whether the transaction is on an agency or principal basis; whether the transaction is a purchase or sale; whether a sale is a "short" sale; the quantity of the security; the price of the security expressed in the currency in which the security was quoted in the PORTAL Market; and such additional information as the Association may require.

(b) PORTAL transaction reports shall be entered within 15 minutes after execution of the transaction during hours that the PORTAL Market system accepts PORTAL transaction reports. The PORTAL Market system shall accept PORTAL transaction reports from 8:30 a.m. Eastern Time to 6:30 p.m. Eastern Time. If a transaction is executed during hours that the PORTAL Market system does not accept PORTAL transaction reports, the PORTAL transaction report shall be entered between 8:30 a.m. Eastern Time and 9:30 a.m. Eastern Time when the PORTAL Market system is next open, with the trade date [of] the date of execution of the transaction. The Association, in its discretion, will establish hours for and additional time limitations on the entry of PORTAL transaction reports.

(c) Modification, correction or cancellation of a PORTAL transaction report must be entered in the PORTAL Market system.

(d) The Association will not disseminate PORTAL transaction reports that are entered in the PORTAL Market system between 8:30 a.m. Eastern Time and 9:30 a.m. Eastern Time, and between 4:00 p.m. Eastern Time and 6:30 p.m. Eastern Time. The Association shall, however, display daily aggregate volume of transactions effected pursuant to SEC Rule 144A, including the volume of transactions that are entered in the PORTAL Market system between 8:30 a.m. Eastern Time and 6:30 p.m. Eastern Time.

[Rule [5334] **6734** will not be effective until a date is announced by the NASD.]

#### [5335] **6735. PORTAL Non-Participant Report**

(a) Each PORTAL non-participant report shall include: whether the transaction is on an agency or principal basis, whether the transaction is a purchase or sale; whether a sale is a "short" sale; the quantity of the security; the price of the security expressed in the currency in which the security was quoted in the PORTAL Market; a representation as to whether the buyer was a "qualified institutional buyer" under Rule 144A, a "non-qualified institutional buyer" institution, or an individual investor; and such additional information as the Association may require.

(b) PORTAL non-participant reports shall be submitted to the Market Regulation Department of the Association no later than the fifth day of the month following the month in which the transaction was effected.

(c) Modification, correction, or cancellation of a PORTAL non-participant report must be submitted in the manner specified by the Association.

[Rule [5335] **6735** will not be effective until a date is announced by the NASD.]

Selected Notices to Members: 95-34.

#### [5336] **6736. PORTAL Surveillance Report**

(a) Each PORTAL dealer or PORTAL broker shall submit to the Market Regulation Department of the Association, no later than the fifth day of each month, a PORTAL surveillance report [which] *that* reports every transaction effected during the preceding month (including transactions that are part of the initial offering by or on behalf of the issuer or an affiliate thereof) for which the PORTAL dealer or PORTAL broker was required to submit a PORTAL transaction report under Rule [5332] **6732**, including transactions that are part of the initial offering by or on behalf of the issuer or an affiliate thereof; provided, however, that a member shall not be required to submit a PORTAL surveillance report with respect to any transaction for which the member was not required to submit a PORTAL transaction report.

(b) The PORTAL surveillance report shall be submitted in the manner specified by the Association and shall include for each transaction reported: a representation as to whether the buyer was a "qualified institutional buyer" under Rule 144A, a "non-qualified

institutional buyer" institution, or an individual investor; the information required under Rule [5334] 6734; and such additional information as the Association may require.

(c) Modification, correction, or cancellation of a PORTAL surveillance report must be submitted in the manner specified by the Association.

[Rule [5336] 6736 will not be effective until a date is announced by the NASD.]

**[5337]6737. Comparison of PORTAL Transaction Reports Entered in the PORTAL Market System**

Each PORTAL dealer and PORTAL broker that executes a purchase transaction in a PORTAL security with another PORTAL dealer or PORTAL broker shall, within 30 minutes after execution of a transaction for which a report is entered into the PORTAL Market system that designates settlement in the PORTAL clearance and depository system:

(a) Accept a PORTAL transaction report entered by the seller by entering in the PORTAL Market system a matching PORTAL comparison report with the same terms as the seller's PORTAL transaction report;

(b) reject a PORTAL transaction report entered by the seller by entering a PORTAL comparison report in the PORTAL Market system with different terms than those included in the seller's PORTAL transaction report; or

(c) enter an affirmation or rejection in the PORTAL Market system with respect to the PORTAL transaction report entered by the seller.

**[5338]6738. Registration Requirements for PORTAL Dealers**

(a) A member of the Association that registers as a PORTAL dealer shall also be registered as a PORTAL qualified investor.

(b) To register as a PORTAL dealer, a member shall:

(1) Execute a participation agreement;

(2) demonstrate to the satisfaction of the Association that it is eligible to purchase securities under the financial criteria of SEC Rule 144A as it applies to a dealer registered under Section 15 of the Exchange Act by submission of the member's most recent Audited Financial Statements filed with the SEC pursuant to SEC Rule 17a-5(d) under the Exchange Act, with the supporting schedules required pursuant to subparagraph (3) thereof, and any other information that the Association, in its discretion, may require to be submitted to the Association;

(3) be a member of the Association and qualified to do business as a general securities firm; and

(4) agree to comply with the requirements of the PORTAL Rules, including the filing of such documents and the payment of such fees as may be required by the Association.

**[5339]6739. Registration Requirements for PORTAL Brokers**

To register as a PORTAL broker a member shall comply with Rule [5338] 6738(b)(1), (b)(3), and (b)(4).

**[5340]6740. Continuing Requirements for PORTAL Dealers and PORTAL Brokers**

(a) For a PORTAL dealer to continue to be eligible to participate as a PORTAL dealer in the PORTAL Market, the PORTAL dealer shall demonstrate to the satisfaction of the Association that it continues to be eligible to purchase securities under the financial criteria of SEC Rule 144A as it applies to a dealer registered under Section 15 of the Exchange Act by submitting to the Association, concurrent with the dealer's SEC filing, the dealer's Audited Financial Statements filed with the SEC pursuant to SEC Rule 17a-5(d) under the Exchange Act, with the supporting schedules required pursuant to subparagraph (3) thereof, and any other information that the Association, in its discretion, may require to be submitted to the Association.

(b) The Association may suspend or terminate the registration of a PORTAL dealer or PORTAL broker if:

(1) It fails to comply with any requirement of the PORTAL Rules with respect to any PORTAL security;

(2) any application or other document submitted by or on behalf of it contained an untrue statement of a material fact or omitted to state a material fact necessary to make the statements therein not misleading; or

(3) it fails to file any documents or to pay any fee as may be required by the Association.

(c) Nothing in paragraph (b) shall prohibit the Association from taking such other action as it deems necessary under the circumstances against a PORTAL dealer or a PORTAL broker for violations of the requirements of the PORTAL Rules, any other rule or regulation of the Association, or any rule or regulation of the SEC.

**[5350]6750. Requirements Applicable to PORTAL Qualified Investors**

**[5351]6751. Registration Requirements for PORTAL Qualified Investors**

(a) No investor other than a dealer registered under Section 15 of the Exchange Act shall subscribe to PORTAL Market information directly through the PORTAL Market system or

indirectly through a third-party distributor unless:

(1) The investor executes a subscriber agreement;

(2) a PORTAL dealer represents to the Association that it reasonably believes that the investor is a "qualified institutional buyer" under SEC Rule 144A; or

(3) the investor demonstrates to the satisfaction of the Association that it is a "qualified institutional buyer" under SEC Rule 144A; or

(4) the Association reasonably believes that the investor is a "qualified buyer" under SEC Rule 144A.

(b) The Association may classify PORTAL qualified investors in such manner as it deems advisable for the purpose of conforming with SEC Rule 144A.

(c) A PORTAL dealer that submits a representation to the Association pursuant to paragraph (a)(2) shall maintain in its files the basis for its representation that it reasonably believes that the investor satisfies the "qualified institutional buyer" requirements of SEC Rule 144A.

(d) No member of the Association may register as a PORTAL qualified investor unless the member is also registered as a PORTAL dealer.

**[5352]6752. Continuing Requirements for PORTAL Qualified Investors**

(a) For an investor other than a dealer registered under Section 15 of the Exchange Act, to continue to be eligible to subscribe to PORTAL Market information:

(1) A PORTAL dealer shall represent annually to the Association that it reasonably believes that the investor is a "qualified institutional buyer" under SEC Rule 144A; or

(2) the investor shall demonstrate to the satisfaction of the Association or the Association shall form a reasonable belief that the investor is a "qualified institutional buyer" under SEC Rule 144A.

(b) A PORTAL dealer that submits a representation to the Association pursuant to paragraph (a)(1) shall maintain in its files the basis for its representation that it reasonably believes that an investor satisfied the "qualified institutional buyer" requirements of SEC Rule 144A.

**[5353]6753. Suspension or Termination of the Registration of a PORTAL Qualified Investor**

(a) The Association shall suspend or terminate the registration of a PORTAL qualified investor if:

(1) Any application or document submitted by or on behalf of the

PORTAL qualified investor contained an untrue statement of material fact or omitted to state a material fact necessary to make the statements therein not misleading; or

(2) the investor fails to comply with any requirements of the PORTAL Rules, or to file any documents or to pay any fee as may be required by the Association.

(b) Nothing in paragraph (a) shall prohibit the Association from taking such action as it deems necessary under the circumstances against a PORTAL qualified investor that is also a member of the Association for violations of the requirements of the PORTAL Rules, any other rule or regulation of the Association, or any rule or regulation of the SEC.

**[5360]6760. Denial, Suspension or Termination Procedures**

A determination by the Association to deny, suspend or terminate the designation of a PORTAL security or registration of a PORTAL participant may be reviewed upon application by the aggrieved person pursuant to the provisions of the Rule [4800] 9700 Series.

**[5370]6770. PORTAL Market Transactions**

**[5371]6771. Normal PORTAL Market Hours of Operation**

The PORTAL Market shall be open for business from 9:30 a.m. Eastern Time to 4:00 p.m. Eastern Time, or as otherwise determined by the Association.

**[5372]6772. PORTAL Quotations**

The PORTAL Market will accept prices and quotations from PORTAL dealers and PORTAL brokers that are one- or two-sided, firm or indicative.

**[5373]6773. PORTAL Contracts**

The existence and terms of each PORTAL contract shall be conclusively established by a compared PORTAL transaction report pertaining to the underlying transaction in a PORTAL security. Notwithstanding the foregoing, the parties to any PORTAL contract may modify or correct the terms of any transaction in a PORTAL security in a manner consistent with the rules of the PORTAL Market.

**[5374]6774. PORTAL Fees**

PORTAL participants shall pay to the Association a fee for PORTAL transactions or such other fees as determined by the Association, including those set forth in Rule [5324] 6724. The Board of Governors shall have the power to impose, alter, or amend

such fees from time to time pursuant to Article VI, Section 1 of the By-Laws.

**[5375]6775. "When, As and If Issued" Trading**

PORTAL securities that are of a new issue of securities, primary or secondary, may trade "when, as and if issued" in the PORTAL Market subsequent to effectiveness of the designation of the securities as PORTAL securities, provided; however, that the lead manager shall:

(a) Establish a settlement date for the securities based on their anticipated availability; and

(b) in the event of any subsequent delay in the established settlement date, shall enter in the PORTAL Market a corrected PORTAL transaction report designating a substitute date for settlement and cancel the existing PORTAL transaction report.

**[5376]6576. "Short" Sales**

(a) "Short" sale transactions in PORTAL securities may be entered in the PORTAL Market. "Short" sale transactions shall be identified as such in the PORTAL transaction report.

(b) The settlement date for "short" sales in PORTAL securities shall be negotiated by the parties.

(c) The provisions of Rule [3370] 5100 and IM-5100 that relate to "short" sale transactions are applicable to transactions in PORTAL securities.

(d) The Association may adopt such restrictions on "short" sales, and the borrowing and return of securities, as it may deem necessary to prevent violation of the registration requirements of the Securities Act in connection with the transactions in the PORTAL Market.

**[5377]6577. Stabilizing Bids**

(a) A PORTAL dealer may enter a stabilizing bid in the PORTAL Market subject to compliance with SEC Rules 10b-6 and 10b-7 under the Exchange Act, which bid shall be identified in the PORTAL Market. When a stabilizing bid is entered, it shall be available for all outstanding securities in the PORTAL Market of the same class being offered.

(b) A PORTAL dealer shall notify the Association in writing prior to the first day in which the stabilizing bid is to appear in the PORTAL Market. The notice shall include:

(1) The name of the security and its PORTAL symbol;

(2) the date on which the distribution of the security will commence; and

(3) a copy of any offering document related to the distribution.

The PORTAL dealer shall contact the Association for authorization on the day

that the dealer wishes to enter the stabilizing bid.

(c) A PORTAL dealer shall not enter a stabilizing bid at the same time it is quoting any other bid or offer in the issue.

**[5378]6578. Partial Delivery**

A PORTAL qualified investor is required to accept a partial delivery on any PORTAL contract due, provided the portion remaining undelivered is not an amount that includes an odd-lot [which] *that* was not part of the original transaction.

**[5379]6779. Close-out Procedures—"Buy-In"**

A PORTAL contract [which] *that* has not been completed by the seller according to its terms may be closed by the buyer not sooner than the third business day following the date delivery was due, in accordance with the following procedure:

(a) Notice of "Buy-In"

(1) Written notice of "buy-in" shall be delivered to the seller at the seller's office not later than 12 noon, the seller's local time, two business days preceding the execution of the proposed "buy-in."

(2) For purposes of this provision, written notice shall include an electronic notice through a medium that provides for an immediate return receipt capability. Such electronic media shall include but not be limited to facsimile transmission and a computerized network facility.

(b) Information Contained in the "Buy-In" Notice

(1) Every notice of "buy-in" shall state the date of the PORTAL contract to be closed, the quantity and contract price of the PORTAL securities covered by said contract, the settlement date of said PORTAL contract and any other information deemed necessary to properly identify the PORTAL contract to be closed. Such notice shall state further that unless delivery is effected at or before a certain specified time, which may not be prior to 2:30 p.m. Eastern Time, the PORTAL security may be "bought-in" on the date specified for the account of the seller.

(2) Notice may be redelivered immediately to another PORTAL dealer or PORTAL broker from whom the securities involved are due in the form of a re-transmitted notice (re-transmit). Re-transmitted notice of buy-in must be delivered to subsequent PORTAL dealers or PORTAL brokers not later than one business day preceding the time and date of execution of the proposed buy-in.

## (c) Seller's Failure to Deliver After Receipt of Notice

On failure of the seller to effect delivery in accordance with the "buy-in" notice, or to obtain a stay as hereinafter provided, the buyer may close the PORTAL contract by purchasing all or part of the PORTAL securities necessary to satisfy the amount requested in the "buy-in" notice. Securities delivered subsequent to the receipt of the "buy-in" notice should be considered as delivered pursuant to the "buy-in" notice. Delivery of the requisite amount of securities as stated in the "buy-in" notice or execution will also operate to close-out all PORTAL contracts covered under re-transmitted notices of buy-in issued pursuant to the original notice of buy-in. A "buy-in" may be executed by a PORTAL dealer from its long position and/or from customers' accounts maintained with such PORTAL dealer. In all cases, PORTAL dealers must be prepared to defend the price at which the "buy-in" is executed relative to the current market at the time of the "buy-in".

## (d) "Buy-In" Not Completed

In the event that a "buy-in" is not completed pursuant to the provisions of paragraph (b) hereof on the day specified in the notice of "buy-in," or as such date may be extended pursuant to the provisions of paragraph (f) hereof, said notice shall expire at the close of business on the day specified in the notice of buy-in.

## (e) Partial Delivery by Seller

Prior to the closing of a PORTAL contract on which a "buy-in" notice has been given, the buyer shall accept any portion of the PORTAL securities called for by the PORTAL contract, provided the portion remaining undelivered at the time the buyer proposes to execute the "buy-in" is not an amount which includes an odd-lot [which] *that* was not part of the original transaction.

## (f) Securities in Transit

If prior to the closing of a PORTAL contract on which a "buy-in" notice has been given, the buyer receives from the seller written or comparable electronic notice stating that the securities are: (1) In transfer; (2) in transit; (3) are being shipped that day; or (4) are due from a depository and giving the certificate numbers, except for those securities due from the depository, then the buyer must extend the execution date of the "buy-in" for a period of seven (7) calendar days from the date delivery was due under the "buy-in."

## (g) Notice of Executed "Buy-In"

The party executing the "buy-in" shall immediately upon execution, but not later than the close of business, local time where the seller maintains its office, notify the PORTAL dealer or PORTAL broker for whose account the securities were bought as to the quantity purchased and the price paid. Such notification should be in written or electronic form having immediate receipt capabilities. If this written media is not available, the telephone shall be used for the purpose of same day notification, and written or similar electronic notification having next day receipt capabilities must also be sent out simultaneously. In either case, formal confirmation of purchase along with a billing or payment (depending upon which is applicable) should be forwarded as promptly as possible after the execution of the buy-in. Notification of the execution of a "buy-in" shall be given to succeeding broker/dealers to whom a re-transmitted notice was issued pursuant to paragraph (b) using the same procedures stated herein. If a re-transmitted "buy-in" is executed, it will operate to close-out all contracts covered under the re-transmitted notices.

## (h) "Close-Out" under Association or Exchange Rulings

(1) When a national securities exchange makes a ruling that all open contracts with a particular member, who is also a PORTAL dealer or PORTAL broker, should be closed-out immediately (or any similar ruling), PORTAL dealers and PORTAL brokers may close-out contracts as directed by the exchange.

(2) When the Association issues notification that all open contracts with the PORTAL dealer or PORTAL broker in question should be closed-out immediately, PORTAL dealers or PORTAL brokers may close-out contracts as directed by the Association.

(3) Within the meaning of this section, to close-out immediately shall mean that (A) "buy-ins" may be executed without prior notice of intent to "buy-in" and (B) "sell-outs" may be executed without making prior delivery of the securities called for.

(4) All close-outs executed pursuant to the provisions of this subparagraph shall be executed for the account and liability of the PORTAL dealer or PORTAL broker in question. Notification of all close-outs shall immediately be sent to such PORTAL dealer or PORTAL broker.

## (i) Failure to Deliver and Liability Notice Procedures

(1) If a contract is for warrants, rights, convertible securities or other securities [which] *that* (A) have been called for redemption; (B) are due to expire by their terms; (C) are the subject of a tender or exchange offer; or (D) are subject to other expiring events such as the record date for the underlying security and the last day on which the securities must be delivered or surrendered (the "expiration date") is the settlement date of the contract or any later day, the receiving member may deliver a Liability Notice to the delivering member as an alternative to the close-out procedures set forth in paragraphs (a) through (g) of this Rule. Such Notice must be issued using written or comparable electronic media having immediate receipt capabilities no later than one business day prior to the latest time and date of the offer or other event in order to obtain the protection provided by this provision.

(2) If the delivering PORTAL dealer or PORTAL broker fails to deliver the securities on the expiration date, the delivering PORTAL dealer or PORTAL broker shall be liable for any damages [which] *that* may accrue thereby. A Liability Notice delivered in accordance with this provision shall serve as notification by the receiving member of the existence of a claim for damages. All claims for such damages shall be made promptly.

(3) If the above procedures are not utilized, contracts may be "bought-in" without prior notice, after normal delivery hours established in the community where the buyer maintains its office, on the expiration date. Such buy-in execution shall be for the account and risk of the defaulting PORTAL dealer or PORTAL broker.

## (j) Information on Notices

Notices of "buy-in" and "re-transmitted buy-in" shall include all information contained in the sample forms prescribed by the Association.

## (k) "Buy-In" Desk Required

PORTAL dealers or PORTAL brokers shall have a "buy-in" section or desk adequately staffed to process and research all "buy-ins" during normal business hours.

## (l) "Buy-In" of Accrued Securities

Securities in the form of stock, rights or warrants [which] *that* accrue to a purchaser shall be deemed due and deliverable to the purchaser on the payable date. Any such securities remaining undelivered at that time shall

be subject to the "buy-in" procedures as provided in this Rule.

**[5380]6780. Close-Out Procedures—  
"Selling-Out"**

A contract [which] *that* has not been completed by the buyer according to its terms may be closed by the seller in accordance with the following procedures:

(a) Conditions Permitting "Sell-Out"

Upon failure of the buyer to accept delivery in accordance with the terms of the contract, and lacking a properly executed Reclamation Form, the seller may, without notice, "sell-out" in the PORTAL Market and for the account and liability of the party in default all or any part of the securities due or deliverable under the contract.

(b) Notice of "Sell-Out"

The party executing a "sell-out" as prescribed above shall, as promptly as possible on the day of execution, by written or comparable electronic notice, notify the PORTAL dealer or PORTAL broker for whose account and risk such securities were sold of the quantity sold and the price received, and shall promptly mail or deliver formal confirmation of such sale.

**[5390]6790. Miscellaneous**

**[5391]6791. Arbitration**

The facilities of [the Association's Arbitration Department] *NASD Dispute Resolution, Inc.*, and the procedures of the Code of Arbitration Procedure shall be available to PORTAL participants to resolve disputes arising from PORTAL transactions and transfers or activities related thereto.

**[5392]6792. Rules of the Association**

(a) The following Rules of the Association and Interpretative Material thereunder are specifically applicable to transactions and business activities relating to the PORTAL Market:

(1) Rules 0113, 0114, 0115, 2110, 2120, 2230, 2240, 2250, 2260, 2270, 2310, 2410, 2420, 2430, 2440, 2510, 2760, 2770, 2780, 3010, 3120, 3310, 3320, 3330, 3370, and 8210;

(2) the Rule 8100 and 8300 Series; and

(3) IM-2310-2, IM-2420-1, IM-2440, IM-3310, and IM-3320.

(b) The following Rules of the Association and Interpretative Material thereunder are specifically applicable to transactions and business activities relating to the PORTAL Market, with the exceptions specified below:

(1) Rule 2320, except for paragraph

(g), which requires that a member obtain quotations from three dealers to

determine the best inter-dealer market for the subject security;

(2) Rule 2330, except for paragraph (d); and

(3) Rule 3110, except paragraph (b)(2).

(c) The following Rules of the Association are applicable to members and persons associated with members regardless of the member's participation in transactions in the PORTAL Market:

(1) Rules 0111, 0112, 0120, and 0121.

(2) Rules 2210, 3020, 3030, 3040, 3050, 3060, 3130, 3140, and 3340.

(d) The following Rules of the Association and Interpretative Material thereunder are not applicable to transactions and business activities relating to the PORTAL Market:

(1) Rules 1130, 2450, 2520, 2710, 2730, 2740, 2750, 2810, 2820, 2830, 2860, 3210, and 3360; and

(2) IM-2110-1.

\* \* \* \* \*

**5400. Clearance and Settlement**

(a) A market maker shall clear and settle transactions effected otherwise than on an exchange in ADF-eligible securities that are eligible for net settlement through the facilities of a registered clearing agency that uses a continuous net settlement system. This requirement may be satisfied by direct participation, use of direct clearing services, or by entry into a correspondent clearing arrangement with another member that clears trades through such an agency.

(b) Notwithstanding paragraph (a), transactions in listed securities may be settled "ex-clearing" provided that both parties to the transaction agree.

*Selected NASD Notices to Members:*  
94-73.

\* \* \* \* \*

**6000. NASD SYSTEMS AND PROGRAMS**

The 6100 Series is replaced in its entirety by the following proposed rule language:

**6100. TRACS TRADE COMPARISON SERVICE**

**6110. Definitions**

(a) The term "Browse" shall mean the function of TRACS that permits a Participant to review (or query) for trades in the system identifying the Participant as a party to the transaction, subject to the specific uses contained in the TRACS Users Guide.

(b) The term "Clearing Broker/Dealer" or "Clearing Broker" shall mean the member firm that has been identified in the TRACS system as principal for clearing and settling a trade, whether for its own account or for a correspondent firm.

(c) The term "Correspondent Executing Broker/Dealer" or "Correspondent Executing Broker" shall mean the member firm that has been identified in the TRACS system as having a correspondent relationship with a clearing firm whereby it executes trades and the clearing function is the responsibility of the clearing firm.

(d) The term "Introducing Broker/Dealer" or "introducing broker" shall mean the member firm that has been identified in the TRACS system as a party to the transaction, but does not execute or clear trades.

(e) The term "Participant" shall mean any member of NASD in good standing that uses the TRACS system as an NASD Registered Market Maker or CQS Market Maker according to the requirements of Rule 4611 or Rule 6320, an ECN registered in accordance with Rule 4623, an Order Entry Firm, or a clearing broker/dealer, correspondent executing broker/dealer, or introducing broker/dealer.

(f) The terms "Participant," "TRACS Order Entry Firm," "correspondent executing broker/dealer," "correspondent executing broker," "introducing broker/dealer," "introducing broker," "clearing broker/dealer," and "clearing broker" shall also include, where appropriate, the Non-Member Clearing Organizations listed in Rule 6120(a)(5) below and their qualifying members.

(g) The term "Parties to the Transaction" shall mean the executing brokers, introducing brokers and clearing brokers, if any.

(h) The term "Reportable TRACS Transaction" shall mean those transactions in a TRACS eligible security that are required to be submitted to NASD pursuant to the Rule 4630, 6400, and 6620 Series. The term shall also include transactions in TRACS eligible securities that are for less than one round lot, and those transactions that are to be compared and locked-in for settlement.

(i) The term "Reporting Party" shall mean the TRACS Participant that is required to input the trade information, according to the requirements in NASD Rule 4633.

(j) The term "Trade Reporting and Comparison Service" or "TRACS" shall mean the automated system owned and operated by NASD that reports trades and compares trade information entered by TRACS participants and submits "locked-in" trades to Depository Trust Clearing Corporation (DTCC) for clearance and settlement; transmits reports of the transactions automatically to the Securities Information Processor, if required, for dissemination to the

public and the industry; and provides participants with monitoring capabilities to facilitate participation in a "locked-in" trading environment.

(k) The term "TRACS ECN" shall mean a member of NASD that is an electronic communications network ("ECN") that elects to display orders in the NASD Alternative Display Facility pursuant to Rule 4623 and is a member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member. This term shall also include an NASD member that is an alternative trading system ("ATS") that displays orders in the NASD Alternative Display Facility pursuant to Rule 4623 and is a member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member.

(l) The term "TRACS Eligible Security" shall mean all Nasdaq securities, all Consolidated Quotation Service (CQS) securities traded pursuant to unlisted trading privileges, all non-exchange-listed securities as defined in the Rule 6600 series, and all Direct Participation Programs as defined in the Rule 6900 series.

(m) The term "TRACS Market Maker" shall mean a member of NASD that is registered as an NASD or CQS Market Maker and is a member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member.

(n) The term "TRACS Order Entry Firm" shall mean a member of NASD that is a firm that executes orders but does not act as a market maker in the instant transaction and is a member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member.

**6120. Participation in TRACS Trade Comparison Feature by Participants in the NASD Alternative Display Facility**

The following Rules 6120 through 6190 apply to members that effect transactions in ADF-eligible securities otherwise than on an exchange.

**(a) Mandatory Participation for Clearing Agency Members**

(1) Participation in TRACS trade comparison feature is mandatory for any NASD member that effects transactions in ADF-eligible securities otherwise than on an exchange that are not locked-in and sent directly to Deposit Trust Clearing Corporation ("DTCC") by that member. All members, whether or not they must participate in the TRACS trade comparison feature,

must comply with the trade reporting requirements described in Rule 4633.

(2) Participation in the TRACS trade comparison feature as a Market Maker shall be conditioned upon the TRACS Market Maker's initial and continuing compliance with the following requirements:

(A) Execution of, and continuing compliance with, a TRACS trade comparison Participant Application Agreement;

(B) membership in, or maintenance of, an effective clearing arrangement with a member of a clearing agency registered pursuant to the Act;

(C) registration as an NASD Market Maker or ECN for Nasdaq or CQS securities pursuant to Rule 4611 or Rule 6320, if applicable, and compliance with all applicable rules and operating procedures of NASD and the Commission;

(D) maintenance of the physical security of the equipment located on the premises of the TRACS Market Maker to prevent unauthorized entry of information into the TRACS trade comparison feature; and

(E) acceptance and settlement of each trade that the TRACS trade comparison feature identifies as having been effected by such TRACS Market Maker, or if settlement is to be made through a clearing member, guarantee or the acceptance and settlement of each TRACS identified trade by the clearing member on the regularly scheduled settlement date.

(3) Participation in the TRACS trade comparison feature as an Order Entry Firm shall be conditioned upon the Order Entry Firm's initial and continuing compliance with the following requirements:

(A) Execution of, and continuing compliance with, a TRACS trade comparison Participant Application Agreement;

(B) membership in, or maintenance of, an effective clearing arrangement with a member of a clearing agency registered pursuant to the Act;

(C) compliance with all applicable rules and operating procedures of NASD and the Commission;

(D) maintenance of the physical security of the equipment located on the premises of the TRACS Order Entry Firm to prevent the unauthorized entry of information into the TRACS trade comparison feature; and

(E) acceptance and settlement of each trade that the TRACS trade comparison feature identifies as having been effected by such TRACS Order Entry Firm, or if settlement is to be made through a clearing member, guarantee of the acceptance and settlement of each

TRACS identified trade by the clearing member on the regularly scheduled settlement date.

(4) Participation in the TRACS trade comparison feature as a Clearing Broker shall be conditioned upon the Clearing Broker's initial and continuing compliance with the following requirements:

(A) Execution of, and continuing compliance with, a TRACS trade comparison Participant Application Agreement;

(B) membership in a clearing agency registered pursuant to the Act;

(C) compliance with all applicable rules and operating procedures of NASD and the Commission;

(D) maintenance of the physical security of the equipment located on the premises of the TRACS Clearing Broker to prevent the unauthorized entry of information into the TRACS trade comparison feature; and

(E) acceptance and settlement of each trade that the TRACS trade comparison feature identifies as having been effected by itself or any of its correspondents on the regularly scheduled settlement date.

(5) Participation in the TRACS trade comparison feature as an ECN shall be conditioned upon the ECN's initial and continuing compliance with the following requirements:

(A) execution of, and continuing compliance with, a TRACS trade comparison Participant Application Agreement;

(B) membership in, or maintenance of an effective clearing arrangement with a member of, a clearing agency registered pursuant to the Act;

(C) compliance with all applicable rules and operating procedures of NASD and the Commission;

(D) maintenance of the physical security of the equipment located on the premises of the ECN to prevent the unauthorized entry of information into the TRACS trade comparison feature; and

(E) acceptance and settlement of each trade that the TRACS trade comparison feature identifies as having been effected by such TRACS ECN, or if settlement is to be made through a clearing member, guarantee of the acceptance and settlement of each TRACS identified trade by the clearing member on the regularly scheduled settlement date.

(6) Each TRACS trade comparison Participant shall be obligated to inform NASD of non-compliance with any of the participation requirements set forth above.

*(b) Participant Obligations in TRACS**(1) Access to TRACS*

Upon execution and receipt by NASD of the TRACS trade comparison Participant Application Agreement, a TRACS trade comparison Participant may commence input and validation of trade information in TRACS eligible securities. TRACS trade comparison Participants may access the service via NASD terminals or Workstations or through computer interface during the hours of operation specified in the TRACS Users Guide. Prior to such input, all TRACS comparison Participants, including those that have trade report information submitted to NASD by any third party, must obtain from NASD a unique identifying Market Participant Symbol ("MMID" or "MPID"), and use that identifier for trade reporting and audit trail purposes.

*(2) Market Maker Obligations*

(A) TRACS Market Makers shall commence participation in the TRACS trade comparison feature by initially contacting the TRACS Operation Center to verify authorization for submitting trade data to the TRACS system for TRACS eligible securities.

(B) A TRACS Market Maker that is a self-clearing firm shall be obligated to accept and clear each trade that the TRACS trade comparison feature identifies as having been effected by that Market Maker.

(C) A TRACS Market Maker that is an introducing broker or a correspondent executing broker shall identify its clearing broker when it becomes a TRACS trade comparison participant and notify the TRACS Operation Center if its clearing broker is to be changed; this will necessitate execution of a revised TRACS trade comparison Participant Application Agreement.

(D) If at any time a TRACS Market Maker fails to maintain a clearing arrangement, it shall be removed from the TRACS trade comparison feature, and be precluded from participation as a Market Maker in Nasdaq and CQS securities pursuant to the requirements of 6300 Series until such time as a clearing arrangement is reestablished and notice of such arrangement, with an amended TRACS trade comparison Participant Application Agreement, is filed with NASD. If, however, the NASD finds that the TRACS Market Maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused pursuant to Rule 4619.

*(3) Order Entry Firm Obligations*

(A) TRACS Order Entry Firms shall commence participation in the TRACS trade comparison feature by initially contacting the TRACS Operation Center to verify authorization for submitting trade data to the TRACS system for TRACS eligible securities.

(B) A TRACS Order Entry Firm that is a self-clearing firm shall be obligated to accept and clear each trade that the TRACS trade comparison feature identifies as having been effected by the Order Entry Firm.

(C) A TRACS Order Entry Firm that is an introducing broker or a correspondent executing broker shall identify its clearing broker when it becomes a TRACS trade comparison Participant and notify the TRACS Operations Center if its clearing broker is to be changed; this change will necessitate execution of a revised TRACS trade comparison Participant Application Agreement.

(D) If at any time a TRACS Order Entry Firm fails to maintain a clearing arrangement, it shall be removed from the TRACS trade comparison feature until such time as a clearing arrangement is reestablished, and notice of such arrangement, with an amended TRACS trade comparison Participant Application Agreement, is filed with NASD.

*(4) Clearing Broker Obligation*

TRACS clearing brokers shall be obligated to accept and clear as a party to the transaction each trade that the system identifies as having been effected by itself or any of its correspondent executing brokers. Clearing brokers may cease to act as principal for a correspondent executing broker at any time provided that notification has been given to, received and acknowledged by the TRACS Operations Center and affirmative action has been completed by the Center to remove the clearing broker from the TRACS trade comparison feature for that correspondent executing broker. The clearing broker's obligation to accept and clear trades for its correspondents shall not cease prior to the completion of all of the steps detailed in this subparagraph (4).

*(5) ECN Obligations*

(A) TRACS ECNs shall commence participation in the TRACS trade comparison feature by initially contacting the TRACS Operations Center to verify authorization for submitting trade data to the TRACS trade comparison feature for TRACS eligible securities.

(B) A TRACS ECN that is a self-clearing firm shall be obligated to accept and clear each trade that the TRACS trade comparison feature identifies as having been effected by the ECN.

(C) A TRACS ECN that is an introducing broker or a correspondent executing broker shall identify its clearing broker when it becomes a TRACS trade comparison Participant and notify the TRACS Operations Center if its clearing broker is to be changed; this change will necessitate execution of a revised TRACS trade comparison Participant Application Agreement.

(D) If at any time a TRACS ECN fails to maintain a clearing arrangement, it shall be removed from the TRACS trade comparison feature until such time as a clearing arrangement is reestablished, and notice of such arrangement, with an amended TRACS trade comparison Participant Application Agreement, is filed with NASD.

Selected NASD Notices to Members: Notice to Members 98-82.

**6130. Trade Report Input***(a) Reportable TRACS Transactions*

A member choosing to submit a trade to the NASD for comparison shall report the trade to TRACS. TRACS will also process trades that are submitted on an automatic locked-in basis for transmission to NSCC. All trades that are reportable transactions pursuant to NASD Rule 4633 will be transmitted to the applicable securities information processor; however, only those trades that are subject to regular way settlement and are not already locked-in trades will be compared and locked-in through TRACS. Trades that are reported as other than regular way settlement (i.e., Cash, Next-Day, Seller's Option) will not be compared in TRACS or reported to DTCC. All transactions in Direct Participation Program securities shall be reported to TRACS pursuant to the Rule 6900 Series as set forth therein.

*(b) When and How Trade Reports Are Submitted to TRACS*

(1) TRACS trade comparison Participants who are Reporting Members that choose to submit a trade for comparison shall transmit to TRACS the information required by Rule 4633 (e) or (f), as applicable, within 90 seconds of execution.

(2) A TRACS trade comparison Participant who is a Non-Reporting Member to a transaction shall, within twenty (20) minutes after execution accept (or decline, if applicable) a transaction submitted by the Reporting



Member for comparison through TRACS. A Non-Reporting Member has an obligation to ensure that the information that it transmits or accepts in TRACS is timely, accurate and complete. Therefore, if a Non-Reporting Member accepts a transaction in TRACS transmitted by the Reporting Member for comparison through TRACS, then the Non-Reporting Member shall be deemed to have adopted all of the data elements required by Rule 4633(e) or (f), as applicable, concerning the Non-Reporting Member's side of the transaction, absent any subsequent modification of the trade through TRACS.

(3) Trades not required to be reported for public dissemination may still be compared and locked-in through TRACS.

(4) Reporting NASD Members may conduct the following functions in TRACS pursuant to TRACS specifications established by the NASD: (i) MMID Trade Entry; (ii) Trade Cancellation; and (iii) Trade Break.

(5) Non-Reporting NASD Members may conduct the following functions in TRACS pursuant to TRACS specifications established by the NASD: (i) Trade Accept; (ii) Trade Decline; and (iii) Trade Break.

(6) If a TRACS Report from a Reporting Member did not include a necessary OATS order number for OATS/TRACS matching from the Non-Reporting Member's perspective, the Non-Reporting Member shall submit a non-published TRACS Report to compare the trades.

(7) A party entering a trade report into the TRACS trade comparison feature shall use a designated symbol to denote whether the party is submitting the trade report as the Reporting Member or the Non-Reporting Member.

#### **6140. TRACS Processing**

Locked-in trades may be determined through the TRACS trade comparison feature through one of the following methods:

##### **(a) Trade Acceptance**

The reporting party enters its version of the trade into the system and the contra party reviews the trade report and accepts or declines the trade. An acceptance results in a locked-in trade; a declined trade report is purged from the TRACS system at the end of trade date processing;

##### **(b) Aggregate Volume Match**

A batch type comparison will be run at the end of trade date and will aggregate volume of previously entered un-compared trade reports (if all other

matching fields agree) in order to effect matching;

##### **(c) T+N Trade Processing**

T+N entries may be submitted until 5:15 p.m. each business day. At the end of daily matching, all declined trade entries will be purged from the TRACS system. TRACS will not purge any open trade (i.e. unmatched or unaccepted) at the end of its entry day, but will carry-over such trades to the next business day for continued comparison and reconciliation. TRACS will automatically lock in and submit to NSCC as such any carried-over T to T+21 (calendar day) trade if it remains open as of 2:30 p.m. on the next business day. TRACS will not automatically lock in T+22 (calendar day) or older open "as-of" trades that were carried-over from the previous business day; these trades will be purged by TRACS at the end of the carry-over day if such trades remain open. Members may re-submit these T+22 or older "as-of" trades into TRACS on the next business day for continued comparison and reconciliation for up to one calendar year.

Selected NASD Notices to Members 94-73.

6150. Reserved

#### **6160. Obligation to Honor Trades**

If a TRACS trade comparison Participant is reported by TRACS as a party to a trade that has been treated as locked-in and sent to DTCC, notwithstanding any other agreement to the contrary, that party shall be obligated to act as a principal to the trade and shall honor such trade on the scheduled settlement date.

#### **6170. Audit Trail Requirements**

The data elements specified in Rule 6130(b) are critical to NASD's compilation of a transaction audit trail for regulatory purposes. As such, all member firms using the TRACS Service have an ongoing obligation to input Rule 6130(b) information accurately and completely.

6180. Reserved

#### **6190. Termination of TRACS Service**

NASD may, upon notice, terminate TRACS service as to a Participant in the event that a TRACS Participant fails to abide by any of the rules or operating procedures of the TRACS service or NASD, or fails to honor contractual agreements entered into with NASD or its subsidiaries, or fails to pay promptly

for services rendered by the TRACS Service.

\* \* \* \* \*

6200. To be replaced in its entirety by SR-NASD-99-65, which currently is expected to be effective on February 1, 2002.

\* \* \* \* \*

The 6300 through 6500 Series are replaced in their entirety by the following proposed rule language.

#### **6300. CONSOLIDATED QUOTATIONS SERVICE (CQS)**

##### **6310. General**

The Rule 6300 through 6500 Series govern trading by members in CQS/CTA securities otherwise than on an exchange.

##### **6320. Registration as a CQS Market Maker**

(a) Quotations and quotation sizes in reported securities may be entered into the Consolidated Quotations Service (CQS) through the NASD Alternative Display Facility only by an NASD member registered with it as a CQS market maker.

(b) An NASD member, including an operator of an ECN/ATS seeking registration as a CQS market maker, shall file an application with NASD. The application shall certify the member's good standing with NASD and shall demonstrate compliance with the net capital and other financial responsibility provisions of the Act. A member's registration as a CQS market maker shall become effective upon receipt by the member of notice of approval of registration by NASD. It shall be sufficient to obtain registration as a CQS market maker with NASD for a member to demonstrate proof that it is a registered CQS market maker with Nasdaq in good standing.

(c) A CQS market maker registered in a reported security may become registered in additional reported securities by entering a registration request via an NASD Alternative Display Facility terminal. Registration shall become effective at the time the registration request is entered.

(d) An NASD member that becomes registered as a CQS market maker in an issue shall enter quotations in the issue on the effective date of the issue's authorization. If quotations are not entered on the effective date of authorization and the CQS market maker remains inactive in the issue for five (5) business days, the CQS market maker's registration in the issue will be terminated.

(e) Any CQS market makers registered in reported securities that are eligible

for inclusion in the Intermarket Trading System (ITS) may be registered as market makers in ITS and, if they so choose, shall be subject to the Rule 6500 Series.

### **6330. Obligations of CQS Market Makers**

(a) Pursuant to SEC Rule 11Ac1-1, a CQS market maker's quotations in reported securities are required to be firm for the size displayed or, if no size is displayed, for a normal unit of trading. If a market maker displays quotations in a reported security in both a national securities exchange and NASD's CQS System, the market maker shall maintain identical quotations in each system.

(b) A CQS market maker's quotation must be at least one normal unit of trading.

(c) A CQS market maker shall be obligated to have available in close proximity to the NASD Alternative Display Facility terminal at which it makes a market in a CQS security a quotation service that disseminates the bid price and offer price then being furnished by or on behalf of other national securities exchanges and CQS market makers trading and quoting that CQS security.

#### **(d) Computer-Generated Quotations**

(1) **General Prohibition**—Except as provided below, this Rule prohibits the automatic updating or tracking of inside quotations in CQS by computer-generated quote systems. This ban is necessary to offset the negative impact on the capacity and operation of NASD systems regarding certain systems that track changes to the inside quotation and automatically react by generating another quote to keep the market maker's quote away from the best market, without any cognizable human intervention.

(2) **Exceptions to the General Prohibition**—Automated updating of quotations is permitted when:

(A) The update is in response to an execution in the security by that firm (such as execution of an order that partially fills a market maker's quotation size);

(B) it requires a physical, cognizable entry (such as a manual entry to the market maker's internal system which then automatically forwards the update to the NASD system);

(C) the update is to reflect the receipt, execution, or cancellation of a customer limit order;

(D) it is used to expose a customer's market or marketable limit order for price improvement opportunities; or

(E) it is used to equal or improve either or both sides of the national best bid or offer ("NBBO"), or add size to the NBBO.

#### **(e) Minimum Price Variation for Decimal-Based Quotations**

(1) The minimum quotation increment for securities authorized for decimal pricing as part of the SEC-approved Decimals Implementation Plan for the Equities and Options Markets shall be \$0.01.

(f) Members that display priced quotations on a real-time basis for CQS securities in two or more market centers that permit quotation updates on a real-time basis must display the same priced quotations for the security in each market center.

Cross Reference—IM-4613, Autoquote Policy

### **6340. Normal Business Hours**

A CQS market maker shall be open for business as of 9:30 a.m. Eastern Time and shall close no earlier than 4:00 p.m. Eastern Time. An NASD market maker may remain open for business on a voluntary basis for any period of time between 4:00 p.m. Eastern time and 6:30 p.m. Eastern Time. A CQS market maker whose quotes are open after 4:00 p.m. Eastern Time shall be obligated to comply, while their quotes are open, with all NASD Rules that are not by their express terms, or by an official interpretation of NASD, inapplicable to any part of the 4:00 p.m. to 6:30 p.m. Eastern Time period.

### **6350. Withdrawal of Quotations**

(a) Any registered CQS market maker (excluding ECNs) that initiates a pre-opening application and does not enter and maintain continuous two-sided quotations in the security on the same trading day may not re-register to enter quotations in such security for twenty (20) business days unless NASD Alternative Display Facility Operations grants an excused withdrawal.

(b) A CQS market maker that wishes to withdraw quotations in a reported security shall contact NASD Alternative Display Facility Operations to obtain excused withdrawal status prior to withdrawing its quotations. Excused withdrawal status based on illness, vacations or physical circumstances beyond the CQS market maker's control may be granted for up to five (5) business days, unless extended by NASD Alternative Display Facility Operations. Excused withdrawal status based on investment activity or advice of legal counsel, accompanied by a

representation that the condition necessitating the withdrawal of quotations is not permanent in nature, may, upon written request, be granted for not more than sixty (60) days. The withdrawal of quotations because of pending news, a sudden influx of orders or price changes, or to effect transactions with competitors shall not normally constitute acceptable reasons for granting excused withdrawal status, unless NASD has initiated a trading halt for ITS Market Makers in the security, pursuant to Rule 5200.

### **6360. Voluntary Termination of Registration**

A CQS market maker may voluntarily terminate its registration in a reported security by withdrawing its quotations from the NASD Alternative Display Facility. A CQS market maker that voluntarily terminates its registration in a reported security may not, however, re-register as a CQS market maker in that security for two (2) business days.

### **6370. Suspension and Termination of Quotations by NASD Action**

NASD may, pursuant to the procedures set forth in NASD's Code of Procedure as set forth in the Rule 9000 Series, suspend, condition, limit, prohibit or terminate a CQS market maker's authority to enter quotations in one or more reported securities for violations of the applicable requirements or prohibitions of the Rule 4000, 5000 and 6300 Series. Selected NASD Notices to Members: 94-81.

### **6400. REPORTING TRANSACTIONS IN CTA-ELIGIBLE SECURITIES**

The provisions of this Rule 6400 Series shall apply to all transactions effected by members otherwise than on an exchange in securities listed on an exchange (other than Nasdaq) that are required to be reported to the Consolidated Tape ("eligible securities"), as provided in the Plan filed by NASD pursuant to SEC Rule 11Aa3-1 under the Act ("Plan"). Rule 6420 shall not apply to transactions executed through the Intermarket Trading System by market makers registered as CQS market makers.

Selected NASD Notices to Members: 94-81.

### **6410. Definitions**

(a) Unless the context requires otherwise, terms used herein shall have the meaning below. Terms not specifically defined below shall have the meaning in the By-Laws and NASD Rules, SEC Rule 11Aa3-1 and the Plan.

(b) "Consolidated Tape" means the consolidated transaction reporting system for the dissemination of last sale reports in eligible securities required to be reported pursuant to the Plan.

(c) "Eligible securities" means all common stocks, preferred stocks, long-term warrants, and rights entitling the holder to acquire an eligible security, listed or admitted to unlisted trading privileges on the American Stock Exchange or the New York Stock Exchange, and securities listed on regional stock exchanges, which substantially meet the original listing requirements of the New York Stock Exchange or the American Stock Exchange. A list of eligible securities listed on regional stock exchanges is contained in Rule 6450. An updated list of eligible securities will be provided to members from time to time.

(d) "Initial Public Offering"—a security is subject to an "initial public offering" if: (1) the offering of the security is registered under the Securities Act of 1933; and (2) the issuer of the security, immediately prior to filing the registration statement with respect to such offering, was not subject to the reporting requirements of Section 13 or 15(d) of the Act.

(e) "Non-Registered Member" shall have the meaning as defined in NASD Rule 4200.

(f) "Transaction effected through the NASD Alternative Display Facility" shall have the meaning as defined in Rule 4100.

(g) "Registered Member" means a member of NASD that is registered as a CQS market maker, pursuant to Rule 6320, in a particular eligible security. A member is a Registered Member in only those eligible securities for which it has registered as a CQS market maker. A member shall cease being a Registered Member in an eligible security when it has withdrawn or voluntarily terminated its quotations in that security or when its quotations have been suspended or terminated by action of NASD.

(h) "Registered ECN" means a member of NASD that is an electronic communications network ("ECN") that has chosen to register with NASD and meets the terms of registration set forth in the NASD-provided agreement. A member is a Registered ECN in only those eligible securities for which it is registered with NASD. A member shall cease being a Registered ECN in an eligible security when it has withdrawn or voluntarily terminated its quotations in that security or when its quotations have been suspended or terminated by action of NASD. The term "Registered ECN" shall also include NASD members that are alternative trading systems

("ATS"), subject to SEC Regulation ATS, that comply with the requirements of this paragraph.

#### **6420. Transaction Reporting**

##### **(a) General**

(1) This Rule governs the reporting of trades in eligible securities through the NASD's Trade Reporting and Comparison Service ("TRACS").

(2) All times referenced in this Rule are Eastern time.

(3) For Purposes of this Rule, the term "Reporting NASD Member" or "Reporting Member" shall mean an NASD member with the trade reporting obligation as set forth in Rule 6420(c).

(4) For purposes of this Rule, the term "Non-Reporting NASD Member" or "Non-Reporting Member" shall mean the contra side of a trade reported by a Reporting Member.

(5) For purposes of this Rule, the term "normal market hours" means from 9:30 a.m. to 4:00 p.m. All times referenced in this Rule are Eastern Time.

##### **(b) When and How Transactions are Reported**

(1) Reporting NASD Members shall transmit to TRACS, within 90 seconds after execution, last sale reports of transactions in eligible securities effected by members otherwise than on an exchange during the trading hours of the Consolidated Tape. Transactions not reported within 90 seconds after execution shall be designated as late and such trade reports must include the time of execution. Reporting NASD Members shall also transmit to TRACS, within 90 seconds after execution, last sale reports of transactions in eligible securities effected by members otherwise than on an exchange between 4:00 p.m. and 6:30 p.m.; trades executed and reported after 4:00 p.m. shall be designated as "T" trades to denote their execution outside normal market hours. Transactions not reported within 90 seconds after execution must include the time of execution on the trade report.

(2) (A) Reporting NASD Members shall report transactions in eligible securities effected otherwise than on an exchange outside the hours of 9:30 a.m. and 6:30 p.m. Eastern Time as follows:

(i) By transmitting the individual trade reports to TRACS on the next business day (T+1) between 8:00 a.m. and 6:30 p.m. Eastern Time;

(ii) by designating the entries "as/of" trades to denote their execution on a prior day; and

(iii) by including the time of execution.

##### **(c) Which Party Reports Transaction**

(1) Transactions executed on an exchange are reported by the exchange and shall not be reported by members.

(2) For transactions between two Registered Members or Registered ECNs, the Registered Market Maker or ECN representing the sell side shall report the transaction.

(3) For transactions between a Registered Member or Registered ECN and a Non-Registered Member, the Registered Member or Registered ECN shall report the transaction.

(4) For transactions between two Non-Registered Members, the Non-Registered Member representing the sell side shall report the transaction.

(5) For transactions between a member and a customer, the member shall report the transaction.

(6) For transactions between a member and a broker-dealer that is not a member of NASD, the member shall report the transaction.

(7) For all transactions between an NASD member and an NASD member that is also a member of Nasdaq or another national securities exchange, where the reporting party has a choice of reporting venues and chooses not to report to Nasdaq or another national securities exchange, the reporting party described in (1) through (6) above shall report the transaction to the NASD.

##### **(d) Information To Be Reported—Two Party Trade Reports**

(1) A two party trade report is a last sale report that denotes a trade between one Reporting NASD member and one Non-Reporting Member. The Reporting NASD Member is denoted as the ("MMID") side of the trade report and the Non-Reporting Member is denoted as the ("OEID") side of the report.

(2) Each Two Party Last Sale Report Submitted by a Reporting NASD Member Should Contain:

(A) Security identification symbol (SECID);

(B) Number of shares or bonds;

(C) Price of the transaction as required by paragraph (g) below;

(D) A designated symbol denoting whether the transaction, from the Reporting NASD Member's perspective, is a buy, sell, sell short, sell short exempt, or cross;

(E) If known, a designated symbol denoting whether the transaction, from the perspective of the Non-Reporting Member, is a buy, sell, sell short, or sell short exempt;

(F) A designated symbol denoting whether the transaction, from the perspective of the Reporting Member, is as principal, riskless principal, or agent;

(G) If known, a designated symbol denoting whether the transaction, from the perspective of the Non-Reporting Member, is as principal, riskless principal, or agent;

(H) Execution time for any transaction not reported within 90 seconds of execution;

(I) The market participant identifier of the Reporting Member and the Non-Reporting Member;

(J) Reporting Member clearing broker;

(K) Reporting Member Executing Broker in case of a "give up;"

(L) Non-Reporting Member Executing Broker;

(M) Non-Reporting Member introducing broker in case of a "give up;"

(N) Non-Reporting Member clearing broker;

(O) A designated symbol denoting whether the trade report should be published;

(P) A designated symbol denoting whether the trade report should be compared in TRACS;

(Q) If the contra side to the trade report is a customer of the Reporting Member, the Reporting Member shall denote that the trade is an internalized trade with the designated symbol;

(R) If the contra side to the trade report is a Non-NASD member, the Reporting Member shall indicate with the designated symbol that the contra side is a non-member.

(S) For two party trade reports submitted pursuant to an Automated Give Up ("AGU") arrangement or a Qualified Service Representative ("QSR") Agreement, subparagraphs (d) (2) (E) and (G) are mandatory.

#### (e) Information To Be Reported—Three Party Trade Reports

(1) A three party trade report is a single last sale trade report that denotes one Reporting Member and two contra parties. The Reporting Member is denoted as the MMID side of the trade report and the two non-reporting sides are denoted as the OEID side of the trade report. In a three party report, the Reporting Member is the buyer to one OEID and the seller to the other OEID. Registered ECNs shall only submit three party trade reports. Risklennqess principal trades may be submitted as three party trade reports.

(2) Each Three Party Trade Report Submitted by a Reporting Member shall contain the following information:

#### Transaction Information

(A) Security Identification Symbol (SECID);

(B) Number of shares or bonds;

(C) Price of the transaction as required by paragraph (g) below;

(D) Execution time for any transaction not reported within 90 seconds of execution;

(E) The market participant identifies of the Reporting Member and the two Non-Reporting Members;

(F) A designated symbol denoting whether the trade should be published;

#### MMID Side

(G) All three party trade reports from ECNs must be marked as agency cross transactions;

(H) All three party trade reports from Non-ECNs must be denoted as riskless principal trade reports and shall include a designated symbol denoting whether the trade between the non-ECN and the buy-side OEID is a sell, sell short, or sell short exempt transaction;

(I) Reporting Member clearing broker;

(J) Reporting Member Executing Broker in the case of a "give up," if applicable;

#### Buy Side OEID

(K) Buy Side OEID executing broker;

(L) Buy Side OEID introducing broker in case of a "give up;"

(M) Buy Side OEID clearing broker;

(N) If known, a designated symbol denoting whether the trade, from the Buy Side OEID's perspective, is as principal, riskless principal, or agent;

(O) If the Buy Side OEID is a customer of the Reporting Member, the Reporting Member shall denote that the trade is an internalized trade with the designated symbol;

(P) If the Buy Side OEID is a non-NASD member, the Reporting Member shall indicate with the designated symbol that the buy side OEID is a non-member;

(Q) A designated symbol denoting whether the trade between the MMID and the Buy Side OEID shall be compared in TRACS;

#### Sell Side OEID

(R) Sell Side OEID executing broker;

(S) Sell Side OEID introducing broker in case of a "give up;"

(T) Sell Side OEID clearing broker;

(U) If known, a designated symbol denoting whether the trade, from the Sell Side OEID's perspective, is as principal, riskless principal, or agent;

(V) If known, a symbol denoting whether the trade, from the Sell Side OEID's perspective, is a sell, sell short, or sell short exempt transaction;

(W) If the Sell Side OEID is a customer of the Reporting Member, the Reporting Member shall denote that the trade is an internalized trade with the designated symbol;

(X) If the Sell Side OEID is a non-NASD Member, the Reporting Member

shall indicate with the designated symbol that the buy side OEID is a non-member; and

(Y) A designated symbol denoting whether the trade between the MMID and the Sell Side OEID shall be compared in TRACS.

(Z) If the transactions between the Buy Side OEID and the Reporting Member is reported pursuant to an AGU arrangement or a QSR agreement, subparagraphs (e) (2) (N) is mandatory.

(AA) If the transaction between the Sell Side OEID and the Reporting Member is reported pursuant to an AGU arrangement or a QSR agreement, subparagraphs (e) (2) (U) and (V) are mandatory.

#### (f) Trade Report Modifiers

(1) Reporting Members shall append the following trade report modifiers to a last sale report if applicable:

(A) .SLD, if the trade is executed during normal market hours and it is reported later than 90 seconds after execution;

(B) .SNN, if the trade is a Seller's Option Trade, .NN denotes the number of days for delivery;

(C) .C, if the trade is a Cash Trade;

(D) .ND, if the trade is a Next Day Trade;

(E) .W, if the trade occurs at a price based on an average weighting or another special pricing formula;

(F) .T, if the trade is executed outside of normal market hours;

(G) .O, if the trade is price beyond certain price validation parameters as established by the NASD; and

(H) Any other trade report modifier approved for use by the Securities and Exchange Commission.

(2) It will be a violation of this Rule for a Reporting Member to fail to append a required trade modifier or to append a modifier that is not required.

(3) A Reporting Member shall not append a .O modifier to a trade report unless the trade price is beyond certain price validation parameters as established by the NASD.

(4) The Association seeks to emphasize the obligations of members to report securities transactions within 90 seconds after execution. All reportable transactions not reported within 90 seconds after execution shall be reported as late, and the Association routinely monitors members' compliance with the 90 second requirement. If the Association finds a pattern or practice of unexcused late reporting, that is, repeated reports of executions after 90 seconds without reasonable justification or exceptional circumstances, the member may be found to be in violation of Rule 2110.

Exceptional circumstances will be determined on a case by case basis and may include instances of system failure by a member or service bureau, or unusual market conditions, such as extreme volatility in a security, or in the market as a whole. Timely reporting of all transactions is necessary and appropriate for the fair and orderly operation of the Association's marketplace, and the Association will view noncompliance as a rule violation.

(g) Procedures for Reporting Price and Volume

Members that are required to report pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in eligible securities in the following manner:

(1) For agency transactions, report the number of shares and the price excluding the commission charged.

Example:

SELL as agent 100 shares at 40 less a commission of \$12.50; REPORT 100 shares at 40.

(2) For dual agency transactions, report the number of shares only once, and report the price excluding the commission charged.

Example:

SELL as agent 100 shares at 40 less a commission of \$12.50; BUY as agent 100 shares at 40 plus a commission of \$12.50; REPORT 100 shares at 40.

(3) (A) For principal transactions, except as provided below, report each purchase and sale transaction separately and report the number of shares and the price. For principal transactions that are executed at a price that includes a mark-up, mark-down or service charge, the price reported shall exclude the mark-up, mark-down or service charge.

Example:

BUY as principal 100 shares from another member at 40 (no mark-down included).

REPORT 100 shares at 40.

Example:

BUY as principal 100 shares from a customer at 39<sup>3</sup>/<sub>4</sub>, which includes a 1<sup>1</sup>/<sub>8</sub> mark-down from prevailing market of 39<sup>7</sup>/<sub>8</sub>; REPORT 100 shares at 39<sup>7</sup>/<sub>8</sub>.

Example:

BUY as principal 100 shares from a customer at 39.75, which includes a \$0.10 mark-down from prevailing market at \$39.85; REPORT 100 shares at 39.85.

Example:

SELL as principal 100 shares to a customer at 40<sup>1</sup>/<sub>8</sub>, which includes a 1<sup>1</sup>/<sub>8</sub> mark-up from the prevailing market of 40; REPORT 100 shares at 40.

Example:

SELL as principal 100 shares to a customer at 40.10, which includes a .10

mark-up from the prevailing market of 40;

REPORT 100 shares at 40.

(B) Exception: A "riskless" principal transaction in which a member, after having received from a customer an order to buy, purchases the security as principal from another member or customer to satisfy the order to buy or, after having received from a customer an order to sell, sells the security as principal to another member or customer to satisfy the order to sell, shall be reported as one three party transaction in the same manner as an agency transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee. Alternatively, a member may report a riskless principal transaction by submitting the following report(s) to the NASD:

(i) The member with the obligation to report the transaction pursuant to paragraph (b) above must submit a last sale report for the initial leg of the transaction.

(ii) Regardless of whether a member has a reporting obligation pursuant to paragraph (b) above, the firm must submit, for the offsetting, "riskless" portion of the transaction, either:

a. a clearing-only report with a capacity indicator of "riskless principal," if a clearing report is necessary to clear the transaction; or

b. a non-tape, non-clearing report with a capacity indicator of "riskless principal," if a clearing report is not necessary to clear the transaction.

A riskless principal transaction in which a member purchases or sells the security on an exchange to satisfy a customer's order will be reported by the exchange and the member shall not report.

Example:

BUY as principal 100 shares from another member at 40 to fill an existing order;

SELL as principal 100 shares to a customer at 40 plus mark-up of \$12.50;

REPORT 100 shares at 40 by submitting to the NASD either a single trade report marked with a "riskless principal" capacity indicator or by submitting the following reports:

(1) Where required by this Rule, a tape report marked with a "principal" capacity indicator; and

(2) either a non-tape, non-clearing report or a clearing-only report marked with a "riskless principal" capacity indicator.

Example:

BUY as principal 100 shares on an exchange at 40 to fill an existing order; SELL as principal 100 shares to a customer at 40 plus a mark-up of \$12.50.

DO NOT REPORT (will be reported by exchange).

(h) Reporting Transactions on Form T

All Reporting NASD Members required (or that elect) to report transactions in eligible securities to the NASD shall report, as soon as practicable to NASD Regulation's Market Regulation Department on Form T, last sale reports of transactions in designated securities for which electronic submission into the NASD is not possible (e.g., the ticker symbol for the security is no longer available, a market participant identifier is no longer active, or the NASD will not accept the date of execution because the NASD Alternative Display Facility was closed on that date). Transactions that can be reported into the NASD, whether on trade date or on a subsequent date on an "as of" basis (T+N), shall not be reported on Form T.

(i) Trade Tickets

All trade tickets for transactions in eligible securities shall be time-stamped at the time of execution.

(j) Special Trade Indicator

A Reporting Member shall append the designated symbol for special trades, step out trades, reversals, and as-of trades.

(k) Clearing Indicators

A Reporting Member shall use a designated symbol to denote whether the trade is to be: (i) Compared in TRACS; (ii) not compared in TRACS; (iii) compared in TRACS pursuant to an Automatic Give Up Agreement ("AGU"); or (iv) not compared in TRACS, but locked in pursuant to a Qualified Service Representation Agreement ("QSR").

(l) Transactions Not Required To Be Reported

The following types of transactions shall not be reported for inclusion on the Consolidated Tape:

(1) Transactions executed on an exchange;

(2) odd-lot transactions;

(3) transactions that are part of a primary distribution by an issuer or of a registered secondary distribution (other than shelf distributions) or of an unregistered secondary distribution effected off the floor of an exchange;

(4) transactions made in reliance on Section 4(2) of the Securities Act of 1933;

(5) transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security, e.g., to enable the seller to make a gift;

(6) the acquisition of securities by a member as principal in anticipation of making an immediate exchange distribution or exchange offering on an exchange;

(7) purchases of securities off the floor of an exchange pursuant to a tender offer, and

(8) purchases or sales of securities effected upon the exercise of an option pursuant to the terms thereof or the exercise of any other right to acquire securities at a pre-established consideration unrelated to the current market.

Selected Notices to Members: 94-71; 99-66.

6430. Reserved

#### 6440. Trading Practices

(a) No member shall execute or cause to be executed or participate in an account for which there are executed purchases of any eligible security at successively higher prices, or sales of any such security at successively lower prices, for the purpose of creating or inducing a false, misleading or artificial appearance of activity in such security or for the purpose of unduly or improperly influencing the market price for such security or for the purpose of establishing a price that does not reflect the true state of the market in such security.

(b) No member shall, for the purpose of creating or inducing a false or misleading appearance of activity in an eligible security or creating or inducing a false or misleading appearance with respect to the market in such security:

(1) Execute any transaction in such security which involves no change in the beneficial ownership thereof; or

(2) enter any order or orders for the purchase of such security with the knowledge that an order or orders of substantially the same size, and at substantially the same price, for the sale of any such security, has been or will be entered by or for the same or different parties; or

(3) enter any order or orders for the sale of any such security with the knowledge that an order or orders of substantially the same size, and at substantially the same price, for the purchase of such security, has been or will be entered by or for the same or different parties.

(c) No member shall execute purchases or sales of any eligible security for any account in which such member is directly or indirectly interested, which purchases or sales are excessive in view of the member's financial resources or in view of the market for such security.

(d) No member shall participate or have any interest, directly or indirectly, in the profits of a manipulative operation or knowingly manage or finance a manipulative operation.

(1) Any pool, syndicate or joint account organized or used intentionally for the purpose of unfairly influencing the market price of an eligible security shall be deemed to be a manipulative operation.

(2) The solicitation of subscriptions to or the acceptance of discretionary orders from any such pool, syndicate or joint account shall be deemed to be managing a manipulative operation.

(3) The carrying on margin of a position in such securities or the advancing of credit through loans to any such pool, syndicate or joint account shall be deemed to be financing a manipulative operation.

(e) No member shall make any statement or circulate and disseminate any information concerning any eligible security that such member knows or has reasonable grounds for believing is false or misleading or would improperly influence the market price of such security.

(f) (1) No member shall:

(A) Personally buy or initiate the purchase of an eligible security for its own account or for any account in which it or any person associated with it is directly or indirectly interested, while such member holds or has knowledge that any person associated with it holds an unexecuted market order to buy such security in the unit of trading for a customer; or

(B) sell or initiate the sale of any such security for any such account, while it personally holds or has knowledge that any person associated with it holds an unexecuted market order to sell such security in the unit of trading for a customer.

(2) No member shall:

(A) Buy or initiate the purchase of any eligible security for any such account, at or below the price at which it personally holds or has knowledge that any person associated with it holds an unexecuted limited price order to buy such security in the unit of trading for a customer; or

(B) sell or initiate the sale of any eligible security for any such account at or above the price at which it personally holds or has knowledge that any person associated with it holds an unexecuted limited price order to sell such security in the unit of trading for a customer.

(3) The provisions of this paragraph shall not apply:

(A) To any purchase or sale of any eligible security in an amount less than the unit of trading made by a member to offset odd-lot orders for customers,

(B) to any purchase or sale of any eligible security upon terms for delivery other than those specified in such unexecuted market or limited price order,

(C) to any unexecuted order that is subject to a condition that has not been satisfied.

(g) No member or person associated with a member shall, directly or indirectly, hold any interest or participation in any joint account for buying or selling an eligible security, unless such joint account is promptly reported to NASD. The report should contain the following information for each account:

(1) Name of the account, with names of all participants and their respective interests in profits and losses;

(2) a statement regarding the purpose of the account;

(3) name of the member carrying and clearing the account; and

(4) a copy of any written agreement or instrument relating to the account.

(h) No member shall offer that a transaction or transactions to buy or sell an eligible security will influence the closing transaction on the Consolidated Tape.

(i)(1) A member may, but is not obligated to, accept a stop order in an eligible security.

(A) A buy stop order is an order to buy that becomes a market order when a transaction takes place at or above the stop price.

(B) A sell stop order is an order to sell that becomes a market order when a transaction takes place at or below the stop price.

(2) A member may, but is not obligated to, accept stop limit orders in eligible securities. When a transaction occurs at the stop price, the stop limit order to buy or sell becomes a limit order at the limit price.

(j) No member or person associated with a member shall execute or cause to be executed, directly or indirectly, an over-the-counter transaction in a security subject to an initial public offering until such security has first opened for trading on the national securities exchange listing the security, as indicated by the dissemination of an opening transaction in the security by the listing exchange via the Consolidated Tape.

#### 6450. Eligible Securities

Transactions required to be reported on the Consolidated Tape (eligible securities) include all common stocks, preferred stocks, long-term warrants, and rights entitling the holder to acquire an eligible security, listed on the American Stock Exchange and/or the

New York Stock Exchange and the following securities listed on regional stock exchanges.

Symbol	Security
ALK\$	Alaska Airlines \$2.77 Pfd.
ADN	Alden Electronic
AFISD	Amer. Financial Corp. Pfd.D
AFISE	Amer. Financial Corp. Pfd.E
AFISF	Amer. Financial Corp. Pfd.F
AFISG	Amer. Financial Corp. Pfd.G
AFISH	Amer. Financial Corp. Pfd.H
BPP	Ballys Park Place
BSI	Bastian Inds., Inc.
BSIS	Bastian Inds., Inc. \$1.00 Pfd
BBM	Berkeley Bio Medical
CSW	Canada Southern Petroleum
CNO	Casco Northern Corp.
CJI	Central Jersey Industries
CTE	Columbia Chase Corp.
DCT	DC Trading Development Corp.
EDG	Enterprise Devel. Group, Inc.
GEO	Geothermal Resources
GLR	Grolier Inc.
HWK	Hardwicke Companies, Inc.
MOD	Modine Manufacturing Company
OKC	OKC Limited Partnership
OGS	O's Gold Seed Company
PRI	Pacific Resources
PJH	Piper Jaffray, Inc.
PRB	Provident Bancorp, Inc.
RELZ	Reliance Group 87 Wts.
SOU\$A	Southern Cal Gas 6% A Pfd.
SOU\$Q	Southern Cal Gas 6% Pfd.
SYN\$B	Syntex Corp. Pfd.B
TEP\$	Tucson Elec. Power Pfd.
UTC	United Canso Oil and Gas
WH	White Motor Corporation

Selected Notices to Members: 85-27, 87-12, 93-9, 93-25.

\* \* \* \* \*

**6600. REPORTING TRANSACTIONS IN [OVER-THE-COUNTER EQUITY] NON-EXCHANGE-LISTED SECURITIES**

This Rule 6600 Series sets forth the trade reporting requirements applicable to members' transactions in equity securities effected otherwise than on an exchange for which real-time trade reporting is not otherwise required (hereinafter referred to as "non-exchange-listed securities [OTC Equity Securities]"). Members shall [utilize] use the Automated Confirmation Transaction (ACT) for trade reporting in non-exchange-listed securities [OTC Equity Securities].

Those members effecting transactions otherwise than on an exchange in non-exchange-listed securities shall have in place contractual agreements with Nasdaq to use ACT for trade reporting. Members who use ACT to compare trades must comply with the applicable Nasdaq trade comparison rules. Members should refer to the Nasdaq rules for the specific rules that govern trade comparison through ACT.

**6610. Definitions**

(a) Terms used in this Rule shall have the same meaning as those defined in the Association's By-Laws and Rules unless otherwise specified herein.

(b) "Automated Confirmation Transaction Service" or ACT is the Nasdaq service that, among other things, accommodates reporting and dissemination of last sale reports in non-exchange-listed securities [OTC Equity Securities]. Regarding those non-exchange-listed securities [OTC Equity Securities] that are not eligible for clearance and settlement through the facilities of the National Securities Clearing Corporation, the ACT comparison function will not be available. However, ACT will support the entry and dissemination of last sale data on such securities.

(c) "Non-Market Maker" means a member of the Association that is not an OTC Market Maker with respect to a particular non-exchange-listed security [OTC Equity Security].

(d) "Non-exchange-listed security" ["OTC Equity Security"] means any equity security that is not traded on any national securities exchange. [not classified as a "designated security," for purposes of the Rule 4630 and 4640 Series. This term also includes certain exchange-listed securities that do not otherwise qualify for real-time trade reporting because they are not "eligible securities" as defined in Rule 6410(d).] The term "non-exchange-listed securities" ["OTC Equity Security"] shall not include "restricted securities," as defined by SEC Rule 144(a)(3) under the Securities Act of 1933, nor any securities designated in the PORTAL Market, the Rule [5300] 6700 Series.

(e) "OTC Market Maker" means a member of the Association that holds itself out as a market maker by entering proprietary quotations or indications of interest for a particular non-exchange-listed security [OTC Equity Security] in any inter-dealer quotation system, including any system that the Commission has qualified pursuant to Section 17B of the Act. A member is an OTC Market Maker only in those non-exchange-listed securities [OTC Equity Securities] in which it displays market making interest via an inter-dealer quotation system.

**6620. Transaction Reporting**

(a) When and How Transactions are Reported

(1) OTC Market Makers shall, within 90 seconds after execution, transmit through ACT last sale reports of transactions in non-exchange-listed securities [OTC Equity Securities]

executed during normal market hours. Transactions not reported within 90 seconds after execution shall be designated as late.

(2) Non-Market Makers shall, within 90 seconds after execution, transmit through ACT or the Nasdaq ACT service desk (if qualified pursuant to Rule 7010(i)), or if ACT is unavailable due to system or transmission failure, by telephone to the Nasdaq Market Operations Department, last sale reports of transactions in non-exchange-listed securities [OTC Equity Securities] executed during normal market hours. Transactions not reported within 90 seconds after execution shall be designated as late.

**(3) Transaction Reporting Outside Normal Market Hours**

(A) Last sale reports of transactions in Non-exchange-listed securities [OTC Equity Securities] executed between 8:00 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Last sale reports of transactions in non-exchange-listed securities [OTC Equity Securities] executed between the hours of 4:00 p.m. and 5:15 p.m. Eastern Time shall also be transmitted through the NASD [ACT] within 90 seconds after execution; trades executed and reported after 4:00 p.m. Eastern Time shall be designated as ".T" to denote their execution outside normal market hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(B) Last sale reports of transactions in non-exchange-listed securities [OTC Equity Securities] executed outside the hours of 8:00 a.m. and 5:15 p.m. Eastern Time shall be reported as follows:

(i) Last sale reports of transactions in American Depository Receipts (ADRs), Canadian issues, or domestic non-exchange-listed securities [OTC Equity Securities] that are executed between midnight and 8:00 a.m. Eastern Time shall be transmitted through ACT between 8:00 a.m. and 9:30 a.m. Eastern Time on trade date, be designated as ".T" trades to denote their execution outside normal market hours, and be accompanied by the time of execution. The party responsible for reporting on trade date, the trade details to be reported, and the applicable procedures shall be governed, respectively, by paragraphs (b), (c), and (d) below;

(ii) Last sale reports of transactions in ADRs, Canadian issues, or domestic non-exchange-listed securities [OTC Equity Securities] that are executed between 5:15 p.m. and midnight Eastern

Time shall be transmitted through ACT on the next business day (T+1) between 8:00 a.m. and 5:15 p.m. Eastern Time, be designated "as/of" trades to denote their execution on a prior day, and be accompanied by the time of execution. The party responsible for reporting on T+1, the trade details to be reported, and the applicable procedures shall be governed, respectively, by paragraphs (b), (c), and (d) below; and

(iii) Last sale reports of transactions in foreign securities (excluding ADRs and Canadian issues) shall be transmitted through ACT on T+1 regardless of time of execution. Such reports shall be made between 8:00 a.m. and 1:30 p.m. Eastern Time in the same manner as described in subparagraph (3)(B)(ii) above.

(4) All members shall report as soon as practicable to the Market [Surveillance] Regulation Department on Form T, last sale reports of transactions in *non-exchange-listed securities* [OTC Equity Securities] for which electronic submission into ACT is not possible (e.g., the ticker symbol for the security is no longer available or a market participant identifier is no longer active). Transactions that can be reported into ACT, whether on trade date or on a subsequent date on an "as of" basis (T+N), shall not be reported on Form T.

(5) A pattern or practice of late reporting without exceptional circumstances may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Rule 2110.

(6) All members shall append a trade report modifier as designated by the Association to transaction reports that reflect a price different from the current market when the execution is based on a prior reference point in time, which shall be accompanied by the prior reference time.

#### (b) Which Party Reports Transaction

(1) In a transaction[s] between two OTC Market Makers, only the member representing the sell side shall report *the transaction*.

(2) In a transaction[s] between an OTC Market Maker and a Non-Market Maker, only the OTC Market Maker shall report *the transaction*.

(3) In a transaction[s] between two Non-Market Makers, only the member representing the sell side shall report *the transaction*.

(4) In a transaction[s] between a member and a customer, the member shall report *the transaction*.

#### (c) Information To Be Reported

Each last sale report shall contain the following information:

(1) Symbol of the *non-exchange-listed security* [OTC Equity Security];

(2) Number of shares;

(3) Price of the transaction as required by paragraph (d) below; and

(4) A symbol indicating whether the transaction is a buy, sell, or cross.

#### (d) Procedures for Reporting Price and Volume

Members that are required to report pursuant to paragraph (b) above shall transmit last sale reports for all purchases and sales in *non-exchange-listed securities* [OTC Equity Securities] in the following manner:

(1) For agency transactions, report the number of shares and the price excluding the commission charged.

(2) For dual agency transactions, report the number of shares only once, and report the price excluding the commission charged.

(3) (A) For principal transactions, except as provided in subparagraph (B) hereof, report each purchase and sale transaction separately and report the number of shares and the price. For principal transactions that are executed at a price [which] *that* includes a mark-up, mark-down or service charge, the price reported shall exclude the mark-up, mark-down or service charge. Such reported price shall be reasonably related to the prevailing market, taking into consideration all relevant circumstances including, but not limited to, market conditions with respect to the *non-exchange-listed securities* [OTC Equity Security], the number of shares involved in the transaction, the published bids and offers with size displayed in any inter-dealer quotation system at the time of the execution (including the reporting firm's own quotation), the cost of execution and the expenses involved in clearing the transaction.

(B) Exception: A "riskless" principal transaction in which a member, after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy or, after receiving an order to sell, sells the security as principal at the same price to satisfy the order to sell, shall be reported as one transaction in the same manner as an agency transaction, excluding the mark-up or mark-down, commission-equivalent, or other fee.

#### (e) Transactions Not Required To Be Reported

The following types of transactions shall not be reported:

(1) Transactions [which] *that* are part of a primary distribution by an issuer or a registered secondary distribution (other than "shelf distributions") or of an unregistered secondary distribution;

(2) Transactions made in reliance on Section 4(2) of the Securities Act of 1933;

(3) Transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security;

(4) Purchases or sales of securities effected upon the exercise of an option pursuant to the terms thereof or the exercise of any other right to acquire securities at a pre-established consideration unrelated to the current market.

\* \* \* \* \*

### [6700. REPORTING TRANSACTIONS IN NON-NASDAQ SECURITIES]

#### [6710. Definitions]

[For the purposes of this Rule 6700 Series, unless the context requires otherwise:]

[(a) "Issuer," in the case of quotations for American Depository Receipts (ADRs), shall mean the issuer of the deposited shares represented by such ADRs.]

[(b) "Non-Nasdaq Reporting System" means the electronic price and volume reporting system operated by the Association for non-Nasdaq securities.]

[(c) "Non-Nasdaq security" means any equity security that is neither included in The Nasdaq Stock Market nor traded on any national securities exchange. For purposes of Rules 6720 and 6730 of this Series, the term "non-Nasdaq security" shall also mean any Nasdaq security, if transactions in that security are effected by market makers that are not registered Nasdaq market makers pursuant to Rule 4611, and any security listed on an exchange, if transactions are required to be reported pursuant to the Rule 6400 Series.]

[(d) "Priced entry" shall mean a quotation consisting of a bid, offer, or both at a specified price.]

[(e) "Quotation" shall mean any bid or offer at a specified price with respect to a non-Nasdaq security, or any indication of interest by a broker or dealer in receiving bids or offers from others for such a security, or any indication by a broker or dealer that it wishes to advertise its general interest in buying or selling a particular non-Nasdaq security.]

[(f) "Quotation medium" means any inter-dealer quotation system (except for the PORTAL Market) or any publication or electronic communications network or other device that is used by brokers



or dealers to make known to others their interest in transactions in any non-Nasdaq security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell.]

**[6720. Price and Volume Reporting]**

[(a) Each member shall report through the Non-Nasdaq Reporting System the following information on all principal transactions in non-Nasdaq securities:]

[(1) The highest price at which it sold and the lowest price at which it purchased each non-Nasdaq security;]

[(2) the total volume of purchases and sales executed by it in each non-Nasdaq security; and]

[(3) whether the trades establishing the highest price at which the member sold and the lowest price at which the member purchased the security represented an execution with a customer or with another broker/dealer. The price to be reported for principal sales and purchases from customers shall be inclusive of mark-up or mark-down.]

[(b) Members shall report the price and volume information required by paragraph (a) of this Rule through the Non-Nasdaq Reporting System between the hours of 4 p.m. and 6:30 p.m. Eastern Time on the trade date or between 7:30 a.m. and 9 a.m. Eastern Time on the next business day, or at such other time as determined by the Association.]

[(c) The reporting requirements contained in paragraphs (a) and (b) of this Rule shall not apply to any non-Nasdaq security for which members are required to report individual transactions pursuant to the Rule 6600 Series.]

**[6730. Automated Submission of Trade Data]**

[RESERVED FOR FUTURE USE. REDESIGNATED AS 8213 BY SR-NASD-97-81 EFF. JAN. 16, 1998.]

**6630[6740]. Submission of Rule 15c2-11 Information on [Non-Nasdaq] Non-Exchange-Listed Securities**

(a) Except as provided in SEC Rule 15c2-11(f)(1), (2), (3) and (5) under the Act, no member shall initiate or resume the quotation of a non-exchange-listed [Nasdaq] security in any quotation medium unless the member has demonstrated compliance with this Rule and the applicable requirements for information maintenance under Rule 15c2-11. A member shall demonstrate compliance by making a filing with, and in the form required by, the Association, which filing must be received at least three business days before the member's

quotation is published or displayed in the quotation medium.

(b) The information to be filed shall contain one copy of all information required to be maintained under SEC Rule 15c2-11(a)(1), (2), (3)(iii), (4)(ii), or (5), including any information that may be required by future amendments thereto. In addition, this filing shall identify the issuer, the issuer's predecessor in the event of a merger or reorganization within the previous 12 months, the type of non-exchange-listed [Nasdaq] security to be quoted (e.g., ADR, warrant, unit, or common stock), the quotation medium to be used, the member's initial or resumed quotation, and the particular subsection of Rule 15c2-11 with which the member is demonstrating compliance. Additionally, if a member is initiating or resuming quotation of a non-exchange-listed [Nasdaq] security with a priced entry, the member's filing must specify the basis upon which that priced entry was determined and the factors considered in making that determination.

(c) If a member's initial or resumed quotation does not include a priced entry, a member shall supplement its prior filing under this Rule, in the form required by the Association, before inserting a priced entry for the affected non-exchange-listed [Nasdaq] security in a quotation medium. The supplemental filing shall specify the basis upon which the proposed priced entry was determined and the factors considered in making that determination. The supplemental filing must be received by the Association at least three business days before the member's priced entry first appears in a quotation medium.

(d) No Change.

**6640. Limit Order Protection**

(a) *Members shall be prohibited from "trading ahead" of customer limit orders that a member accepts in non-exchange-listed securities quoted on a quotation medium. Members handling customer limit orders, whether received from their own customers or from another member, are prohibited from trading at prices equal or superior to that of the customer limit order without executing the limit order. Members are under no obligation to accept limit orders from any customer.*

(b) *Members may avoid the obligation specified in paragraph (a) through the provision of price improvement. If a customer limit order is priced at or inside the current inside spread, however, the price improvement must be for a minimum of the lesser of \$0.01 or one-half (1/2) of the current inside*

*spread. For purposes of this rule, the inside spread shall be defined as the difference between the best reasonably available bid and offer in the subject security.*

(c) *Notwithstanding subparagraph (a) of this rule, a member may negotiate specific terms and conditions applicable to the acceptance of limit orders only with respect to such orders that are:*

(1) *For customer accounts that meet the definition of an "institutional account" as that term is defined in Rule 3110(c)(4); or*

(2) *for 10,000 shares or more, and greater than \$200,000 in value.*

(d) *Contemporaneous trades.*

*A member that trades through a held limit order must execute such limit order contemporaneously, or as soon as practicable, but in no case later than five minutes after the member has traded at a price more favorable than the customer's price.*

(e) *Application.*

(1) *This rule shall apply only to non-exchange-listed securities specifically identified as such on the NASD website.*

(2) *This rule shall apply from 9:30 a.m. to 4:00 p.m. Eastern Time.*

(3) *This rule shall be in effect until February 8, 2002.*

**[67]6650. Minimum Quotation Size Requirements For [OTC] Non-Exchange-Listed Equity Securities**

[(a)] Every member firm that functions as a market maker in [OTC] Non-Exchange-Listed Equity Securities by entering firm quotations into [the OTC Bulletin Board Service (OTCBB) (or) any [other] inter-dealer quotation system that permits quotation updates on a real-time basis[] must honor those quotations for the minimum size defined in the table below. In this regard, it is the market maker's responsibility to determine the minimum size requirement applicable to its firm bid and/or offer in each of its registered securities [(excluding OTC Equity Securities for which the OTCBB will not accept firm quotations)]. Depending on the price level of the bid or offer, a different minimum size can apply to each side of the market being quoted by the member firm in a given security.

Price (bid or offer)	Minimum quote size
0-.50*	5,000
.51-1.00	2,500
1.01-10.00	500
10.01-100.00	200
100.01-200.00	100
200.01+→	50

An [Nasdaq] NASD officer at the Executive Vice President level or above, within its discretion may modify the minimum quotation size for those securities with a price exceeding \$200.

[(b) For purposes of this Rule, the term "OTC Equity Security" means any equity security not classified as a "designated security" for purposes of the Rule 4630 and 4640 Series, or as an "eligible security," for purposes of the Rule 6400 Series. The term does not include "restricted securities," as defined by SEC Rule 144(a)(3) under the Securities Act of 1933, nor any securities designated in the PORTAL Market.SM]

\* \* \* \* \*

#### 6900. REPORTING TRANSACTIONS IN DIRECT PARTICIPATION PROGRAMS

All secondary market transactions by members in Direct Participation Program securities other than transactions executed on a registered national securities exchange [or through Nasdaq] shall be reported to the Association in accordance with the procedures set forth below. All trade tickets shall be time-stamped at the time of execution.

\* \* \* \* \*

#### 6920. Transaction Reporting

(a) through (d) No Changes.

(e) Transactions Not Required To Be Reported

The following transactions are not required to be reported under the foregoing procedures:

(1) through (2) No Changes.

(3) Transactions executed on a registered national securities exchange [or through Nasdaq].

\* \* \* \* \*

#### 7000. CHARGES FOR SERVICES AND EQUIPMENT—TO BE DETERMINED

\* \* \* \* \*

#### 8200. INVESTIGATIONS

8210. No Change.

#### [8212. Automated Submission of Trading Data for the Nasdaq International Service Requested by the Association] *Reserved*

[(a) Every Association member and approved affiliate that participates in the Nasdaq International Service as defined in the Rule 5100 Series ("Nasdaq International") as a Service market maker or an order-entry firm shall submit to the Association the trade data specified below in automated format as may be prescribed by the Association from time to time. This

information shall be supplied with respect to any transaction or transactions that are the subject of a request for information made by the Association. In this rule the terms "participating firm" and "firm" include both Association members and approved affiliates that utilize the Service.]

[(b) If the transaction was a proprietary transaction effected or caused to be effected by the participating firm for any account in which such firm, or person associated with the firm, is directly or indirectly interested, the participating firm shall submit or cause to be submitted the following information:]

[(1) Clearing house number, or alpha symbol as used by the participating firm submitting the data;]

[(2) Clearing house number(s), or alpha symbol(s) as may be used from time to time, of the participating firm on the opposite side of the transaction;]

[(3) Identifying symbol assigned to the security;]

[(4) Date transaction was executed;]

[(5) Number of shares, ADRs, units, warrants or rights for each specific transaction and whether each transaction was a purchase, sale or short sale;]

[(6) Transaction price;]

[(7) Account number; and]

[(8) Market center where transaction was executed.]

[(c) If the transaction was effected or caused to be effected by the participating firm for any customer account, such firm shall submit or cause to be submitted the following information:]

[(1) The data described in subparagraphs (b)(1) through (8);]

[(2) Customer name, address(es), branch office number, registered representative number, whether order was solicited or unsolicited, date account opened and employer name, and the tax identification number(s); and]

[(3) If the transaction was effected for another Association member or participating firm, whether the other party was acting as principal or agent on the transaction or transactions that are the subject of the Association's request.]

[(d) In addition to the above trade data, a participating firm shall submit such other information in such automated format as may from time to time be required by the Association.]

[(e) Pursuant to the Rule 9600 Series, the Association may exempt a person from the requirement that the data prescribed in paragraphs (b) through (d) above be submitted to the Association in

an automated format for good cause shown.]

#### 8213. Automated Submission of Trading Data for Non-Exchange-Listed [Nasdaq] Securities Requested by the Association

Each member shall submit trade data specified in Rule 8211 in automated format as may be prescribed by the Association from time to time with respect to any transaction or transactions involving non-exchange-listed [Nasdaq] securities as defined in the Rule [6700]6600 Series that are the subject of a request for information made by the Association. Pursuant to the Rule 9600 Series, the Association may exempt a member from the requirement that the data prescribed in paragraphs (b) through (d) of Rule 8211 be submitted to the Association in an automated format for good cause shown.

\* \* \* \* \*

#### 9000. CODE OF PROCEDURE

##### 9100. APPLICATION AND PURPOSE

##### 9110. Application

(a) through (b) No Change.

(c) Incorporation of Defined Terms and Cross References

Unless otherwise provided, terms used in the Rule 9000 Series shall have the meaning as defined in Rule 0120 and Rule 9120. References within the Rule 9000 Series to Association offices or departments refer to offices so designated by the NASD[,] or NASD Regulation [or Nasdaq].

\* \* \* \* \*

##### 9120. Definitions

(a) through (r) No Change.

(s) "Market Regulation Committee"

The term "Market Regulation Committee" means the committee of NASD Regulation designated to consider the federal securities laws and the rules and regulations adopted thereunder and various Rules of the Association and policies relating to:

(1) through (3) No Change.

(4) trading practices, including rules prohibiting manipulation and insider trading, and those Rules designated as Trading Rules (Rule 3300 Series), [the Nasdaq Stock Market Rules] *the NASD Alternative Display Facility Rules* (Rule 4000 Series), other [Nasdaq and] NASD [Market] *Reporting Facility Rules* (Rule 5000 Series), NASD Systems and Programs Rules (Rule 6000 Series), and Charges for Services and Equipment Rules (Rule 7000 Series).

(t) through (cc) No Change.

\* \* \* \* \*

**9160. Recusal or Disqualification**

No person shall participate as an Adjudicator in a matter governed by the Code as to which he or she has a conflict of interest or bias, or circumstances otherwise exist where his or her fairness might reasonably be questioned. In any such case the person shall recuse himself or herself, or shall be disqualified as follows:

- (a) through (c) No Change.
- (d) Rule 9514 Hearing Panel

The NASD Regulation Board [or Nasdaq Board] shall have authority to order the disqualification of a member of a Hearing Panel appointed by such Board under Rule 9514(b);

- (e) through (g) No Change.

**9230. Appointment of Hearing Panel, Extended Hearing Panel**

**9231. Appointment by the Chief Hearing Officer of Hearing Panel or Extended Hearing Panel**

(a) No Change.  
 (b) Hearing Panel  
 The Hearing Panel shall be composed of a Hearing Officer and two Panelists, except as provided in Rule 9234 (a), (c), (d), or (e). The Hearing Officer shall serve as the chair of the Hearing Panel. Each Panelist shall be associated with a member of the Association or retired therefrom.

- (1) Except as provided in (2), the Chief Hearing Officer shall select as a Panelist a person who:
  - (A) through (C) No Change.
  - (D) previously served as a Director[, a director of the Nasdaq Board of Directors,] or a Governor, but does not serve currently in any of these positions.
- (2) No Change.
- (c) through (d) No Change.

**9500. OTHER PROCEEDINGS**

**9510. Summary and Non-Summary Proceedings**

9511. No Change

**9512. Initiation of Summary Proceeding**

- (a) Authorization
  - (1) No Change.
  - (2) The NASD Board may authorize the President of NASD Regulation [or the President of Nasdaq] to issue on a case-by-case basis a written notice that summarily limits or prohibits any person with respect to access to services offered by the Association if paragraph (a)(1) applies to such person or, in the case of a person who is not a member, if the NASD Board determines that such person does not meet the qualification

requirements or other prerequisites for such access and such person cannot be permitted to continue to have such access with safety to investors, creditors, members, or the Association.

- (b) through (c) No Change.

**9514. Hearing and Decision**

- (a) No Change.
- (b) Designation of Party for the Association and Appointment of Hearing Panel

If a member, associated person, or other person subject to a notice under Rule 2210, 2220, 9512, or 9513 files a written request for a hearing, an appropriate department or office of the Association shall be designated as a Party in the proceeding, and a Hearing Panel shall be appointed.

[(1)] If the President of NASD Regulation or NASD Regulation staff issued the notice initiating the proceeding under Rule 2210, 2220, 9512(a), or 9513(a), the President of NASD Regulation shall designate an appropriate NASD Regulation department or office as a Party. For proceedings initiated under Rule 9513(a) concerning failure to comply with an arbitration award or a settlement agreement related to an NASD arbitration or mediation, the Chief Hearing Officer shall appoint a Hearing Panel composed of a Hearing Officer. For any other proceedings initiated under Rule 2210, 2220, 9512(a), or 9513(a) by the President of NASD Regulation or NASD Regulation staff, the NASD Regulation Board shall appoint a Hearing Panel composed of two or more members; one member shall be a Director of NASD Regulation, and the remaining member or members shall be current or former Directors of NASD Regulation or Governors. The President of NASD Regulation may not serve on a Hearing Panel.

[(2)] If the President of Nasdaq or Nasdaq staff issued the notice under Rule 9512(a) or 9513(a), the President of Nasdaq shall designate an appropriate Nasdaq department or office as a Party, and the Nasdaq Board shall appoint a Hearing Panel. The Hearing Panel shall be composed of two or more members. One member shall be a director of Nasdaq, and the remaining member or members shall be current or former directors of Nasdaq or Governors. The President of Nasdaq may not serve on the Hearing Panel.]

- (c) through (e) No Change.
- (f) Hearing Panel Consideration
  - (1) through (4) No Change.

(5) Custodian of the Record

If the President of NASD Regulation or NASD Regulation staff initiated the proceeding under Rule 2210, 2220, 9512, or 9513, the Office of the General Counsel of NASD Regulation shall be the custodian of the record, except that the Office of Hearing Officers shall be the custodian of record for proceedings initiated under Rule 9513(a) concerning failure to comply with an arbitration award or a settlement agreement related to an NASD arbitration or mediation. [If the President of Nasdaq or Nasdaq staff initiated the proceeding under Rule 9512 or 9513, the Office of the General Counsel of Nasdaq shall be the custodian of the record.]

- (6) No Change.
- (g) No Change.

**9700. PROCEDURES ON GRIEVANCES CONCERNING THE AUTOMATED SYSTEMS**

**9710. Purpose**

The purpose of this Rule 9700 Series is to provide, where justified, redress for persons aggrieved by the operations of any automated quotation, execution, or communication system owned or operated by the Association, or any subsidiary thereof, and approved by the Commission, not otherwise provided for by the Code of Procedure as set forth in the Rule 9000 Series, the Uniform Practice Code as set forth in the Rule 11000 Series, or the Procedures for Review of Nasdaq Listing Determinations as set forth in the Rule 4800 Series.]

**9720. Form of Application**

All applications shall be in writing, and shall specify in reasonable detail the nature of and basis for the redress requested. If the application consists of several allegations, each allegation shall be stated separately. All applications must be signed and shall be directed to the NASD [Nasdaq].

**9730. Request for Hearing**

Upon request, the applicant shall be granted a hearing after reasonable notice. In the absence of such request for a hearing, [Nasdaq] the NASD may, in its discretion, have any application set down for hearing or consider the matter on the basis of the application and supporting documents.

**9760. Reserved [Review by the Nasdaq Listing and Hearing Review Council]**

[The decision shall be subject to review by the Nasdaq Listing and

Hearing Review Council on its own motion within 45 calendar days after issuance of the written decision. Any such decision shall also be subject to review upon application of any person aggrieved thereby, filed within 15 calendar days after issuance. The institution of a review, whether on application or on the initiative of the Nasdaq Listing and Hearing Review Council, shall not operate as a stay of the decision.]

\* \* \* \* \*

**9770. Reserved [Findings of the Nasdaq Listing and Hearing Review Council on Review]**

[Upon consideration of the record, and after such further hearings as it shall order, the Nasdaq Listing and Hearing Review Council shall affirm, modify, reverse, dismiss, or remand the decision. The Nasdaq Listing and Hearing Review Council shall set forth specific grounds upon which its determination is based.]

\* \* \* \* \*

**9780. Reserved [Discretionary Review by the Board]**

[Determinations of the Nasdaq Listing and Hearing Review Council may be reviewed by the NASD Board of Governors solely upon the request of one or more Governors not later than the NASD Board meeting next following the Nasdaq Listing and Hearing Review Council's decision but which is 15 calendar days or more following the decision of the Nasdaq Listing and Hearing Review Council.

Notwithstanding the preceding sentence, the NASD Board may determine it is advisable to call for review any decision of the Nasdaq Listing and Hearing Review Council within the 15 calendar day period following the decision of the Nasdaq Listing and Hearing Review Council. Such review, which may be undertaken solely at the discretion of the Board, shall be in accordance with resolutions of the Board governing the review of Nasdaq Listing and Hearing Review Council determinations. The Board shall affirm, modify or reverse the determinations of the Nasdaq Listing and Hearing Review Council or remand the matter to the Nasdaq Listing and Hearing Review Council with appropriate instructions. The institution of discretionary review by the Board shall not operate as a stay of the decision.]

\* \* \* \* \*

**11300. DELIVERY OF SECURITIES**

**11310. Book-Entry Settlement**

(a) through (c) No Change.

(d) (1) No Change.

(2) A determination under r[R]ules [4310(c)(23) or under the corresponding rule] of a national securities exchange that a security depository has included a CUSIP number identifying a security in its file of eligible issues does not render the security "depository eligible" under this Rule until:

(A) in the case of any new issue distributed by an underwriting syndicate on or after the date a securities depository system for monitoring repurchases of distributed shares by the underwriting syndicate is available, the date of the commencement of trading in such security on [The Nasdaq Stock Market] *the exchange*; or

(B) in the case of any new issue distributed by an underwriting syndicate prior to the date a securities depository system for monitoring repurchases of distributed shares by the underwriting syndicate is available where the managing underwriter elects not to deposit the securities on the date of the commencement of trading in such security on [The Nasdaq Stock Market] *the exchange*, such later date designated by the managing underwriter in a notification submitted to the securities depository; but in no event more than three (3) months after the commencement of trading in such security on [The Nasdaq Stock Market] *the exchange*.

(e) through (g) No Change.

\* \* \* \* \*

**11500. DELIVERY OF SECURITIES WITH RESTRICTIONS**

**11580. Transfer of Limited Partnership Securities**

(a) Each member [who] *that* participates in the transfer of limited partnership securities, as defined in Rule 2810, shall use standard transfer forms in the same form as set forth in IM-11580. This Rule shall not apply to limited partnership securities [which] that are traded on [The Nasdaq Stock Market or] a registered national securities exchange, or are on deposit in a registered securities depository and settle regular way.

\* \* \* \* \*

**11800. CLOSE-OUT PROCEDURES**

11810. No Change

**IM-11810. Sample Buy-In Forms**

(a) through (b) No Change.

(c) Seller's Failure to Deliver After Receipt of Notice

(1) (A) No Change.

(B) For transactions in [Nasdaq] *exchange-listed* [S] securities where the buyer is a customer (other than another member), upon failure of a clearing corporation to effect delivery in accordance with a buy-in notice, the contract must be closed by purchasing for "cash" in the best available market, or at the option of the buyer for guaranteed delivery, for the account and liability of the party in default all or any part of the securities necessary to complete the contract.

(2) No Change.

(d) through (m) No Change.

\* \* \* \* \*

**[11890. Clearly Erroneous Transactions]**

[(a) Authority to Review Transactions]

[(1) For the purposes of this Rule, the terms of a transaction are clearly erroneous when there is an obvious error in any term, such as price, number of shares or other unit of trading, or identification of the security.]

[(2) Officers of The Nasdaq Stock Market, Inc. ("Nasdaq") designated by the President of Nasdaq shall, pursuant to the procedures set forth in paragraph (b) below, have the authority to review any transaction arising out of the use or operation of any automated quotation, execution, or communication system owned or operated by Nasdaq and approved by the Commission, excluding transactions arising from use of the Nasdaq Application of OptiMark. A Nasdaq officer shall review transactions with a view toward maintaining a fair and orderly market and the protection of investors and the public interest. Based upon this review, the officer shall decline to act upon a disputed transaction if the officer believes that the transaction under dispute is not clearly erroneous, or, if the officer determines the transaction in dispute is clearly erroneous, he or she shall declare that the transaction is null and void or modify one or more terms of the transaction. When adjusting the terms of a transaction, the Nasdaq officer shall seek to adjust the price and/or size of the transaction to achieve an equitable rectification of the error that would place the parties to a transaction in the same position, or as close as possible to the same position, that they would have been in had the error not occurred. Nasdaq shall promptly provide oral notification of a determination to the parties involved in a disputed transaction and thereafter issue a

written confirmation of the determination.]

[(b) Procedures for Reviewing Transactions]

[(1) Any member or person associated with a member that seeks to have a transaction reviewed pursuant to paragraph (a) hereof, shall submit a written complaint, via facsimile or otherwise, to Nasdaq Market Operations in accordance with the following time parameters:]

[(A) For transactions occurring at or after 9:30 a.m., Eastern Time, but prior to 10:00 a.m., Eastern Time, complaints must be submitted by 10:30 a.m., Eastern Time; and]

[(B) for transactions occurring prior to 9:30 a.m., Eastern Time and at or after 10:00 a.m., Eastern Time, complaints must be submitted within thirty minutes.]

[(2) Once a complaint has been received in accord with subparagraph (b)(1) above:]

[(A) The complainant shall have up to thirty (30) minutes, or such longer period as specified by Nasdaq staff, to submit any supporting written information concerning the complaint necessary for a determination under paragraph (a)(2), via facsimile or otherwise;]

[(B) the counterparty to the trade shall be verbally notified of the complaint by Nasdaq staff and shall have up to thirty (30) minutes, or such longer period as specified by Nasdaq staff, to submit any supporting written information concerning the complaint necessary for a determination under paragraph (a)(2), via facsimile or otherwise; and]

[(C) either party to a disputed trade may request the written information provided by the other party pursuant to this subparagraph.]

[(3) Notwithstanding paragraph (b)(2) above, once a party to a disputed trade communicates that it does not intend to submit any further information concerning a complaint, the party may not thereafter provide additional information unless requested to do so by Nasdaq staff. If both parties to a disputed trade indicate that they have no further information to provide concerning the complaint before their respective thirty-minute information submission period has elapsed, then the matter may be immediately presented to a Nasdaq officer for a determination pursuant to paragraph (a)(2) above.]

[(4) Each member and/or person associated with a member involved in the transaction shall provide Nasdaq with any information that it requests in order to resolve the matter on a timely basis notwithstanding the time

parameters set forth in paragraph (b)(2) above.]

[(5) Once a party has applied to Nasdaq for review, the transaction shall be reviewed and a determination rendered, unless both parties to the transaction agree to withdraw the application for review prior to the time a decision is rendered pursuant to paragraph (a)(2).]

[(c) Procedures for Reviewing Transactions Executed During System Disruptions or Malfunctions]

[In the event of a disruption or malfunction in the use or operation of any automated quotation, execution, or communication system owned or operated by Nasdaq and approved by the Commission, Nasdaq acting through an officer designated by the President of Nasdaq pursuant to paragraph (a)(2), may, on its own motion pursuant to the standards set forth in paragraph (a), declare transactions arising out of the use or operation of such systems during the period of such disruption or malfunction null and void or modify the terms of these transactions; provided that, in the absence of extraordinary circumstances, a Nasdaq officer must take action pursuant to this paragraph within thirty (30) minutes of detection of the erroneous transaction(s), but in no event later than 6:00 p.m., Eastern Time, on the next trading day following the date of the trade at issue. When Nasdaq takes action pursuant to this subparagraph, the member firms involved in the transaction shall be notified as soon as is practicable and shall have a right to appeal such action in accordance with paragraph (d)(1) below.]

[(d) Review by the Market Operations Review Committee ("MORC")]

[(1) A member or person associated with a member may appeal a determination made under paragraphs (a)(2) or (c) to the MORC provided such appeal is made in writing, via facsimile or otherwise, within thirty (30) minutes after the member or person associated with a member receives verbal notification of such determination, except that if Nasdaq notifies the parties of action taken pursuant to paragraph (c) after 4:00 p.m., either party has until 9:30 a.m. the next trading day to appeal. Once a written appeal has been received, the counterparty to the trade will be notified of the appeal and both parties shall be able to submit any additional supporting written information, via facsimile or otherwise, up until the time the appeal is considered by the Committee. Either party to a disputed trade may request

the written information provided by the other party during the appeal process. An appeal to the Committee shall not operate as a stay of the determination made pursuant to paragraph (a)(2) or (c) above. Once a party has appealed a determination to the Committee, the determination shall be reviewed and a decision rendered, unless both parties to the transaction agree to withdraw the appeal prior to the time a decision is rendered by the Committee. Upon consideration of the record, and after such hearings as it may in its discretion order, the Committee, pursuant to the standards set forth in paragraph (a), shall affirm, modify, reverse, or remand the determination made under paragraph (a)(2) or (c) above.]

[(2) The decision of the Committee shall be final and binding upon any member or person associated with a member and shall constitute final Association action on the matter in issue. Any adverse determination by a Nasdaq officer pursuant to paragraph (a)(2) or (c) or any adverse decision by the Committee pursuant to paragraph (d)(1) shall be rendered without prejudice as to the rights of the parties to the transaction to submit their dispute to arbitration.]

\* \* \* \* \*

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

In its filing with the Commission, the NASD included statements concerning the purpose of, and statutory 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. The NASD 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

#### Background

The purpose of the proposed rule change is twofold: (1) to amend the Association's rules to reflect the anticipated approval of Nasdaq as a national securities exchange<sup>4</sup> and its resultant separation from NASD; and (2) to establish the rules that would govern trading otherwise than on an exchange, including the implementation and

<sup>4</sup> Securities Exchange Act Release No. 44396 (June 7, 2001), 66 FR 31952 (June 13, 2001).

operation of the ADF. The ADF is a quotation collection, trade comparison, and trade reporting facility being developed by NASD in accordance with the Commission's SuperMontage Approval Order<sup>5</sup> and in conjunction with Nasdaq's anticipated registration as a national securities exchange.

#### Proposed Rule Change Relating to the Separation of Nasdaq

The NASD is in the process of spinning off its Nasdaq subsidiary as an independent, for-profit company. As the result of a second private placement of Nasdaq shares completed on January 18, 2001, the NASD's ownership interest in Nasdaq was reduced to a minority interest. Before Nasdaq can fully separate from the NASD, it must become registered as a national securities exchange with the SEC. Nasdaq has filed a Form 1 with the SEC requesting such registration. Notice and a request for comments on Nasdaq's completed application for exchange registration was published for comment in the *Federal Register* on June 13, 2001,<sup>6</sup> and the comment period expired on August 29, 2001.

Upon Nasdaq's registration as a national securities exchange, the NASD will no longer control the voting rights in the common stock of Nasdaq. At that point, Nasdaq and the NASD will be unaffiliated corporate entities, and therefore each will need separate rules applicable to their respective members. To effectuate that change, the NASD must modify existing NASD rules, effective upon Nasdaq's registration as an exchange, to reflect this separation of Nasdaq from the NASD. These changes include deleting Nasdaq-specific rules, such as listing and qualification requirements; replacing references to "Nasdaq" with "NASD" or "exchange," as applicable; and renaming and renumbering certain rules. The proposed rule change also includes corrections of minor grammatical or typographical errors and other miscellaneous non-substantive changes.

**Deleted Rules:** The Association proposes to delete the following rules in their entirety because they either relate exclusively to participation in, and operation of, the Nasdaq Stock Market or would no longer be applicable upon the establishment of the ADF: 2852, 2854, 2870 through 2885; 5100 through 5113; 6700 through 6740; 8212 and 11890.

**IM-2110-2 and Rule 6640 Trading Ahead of Customer Orders:** The proposed rule change would eliminate an exemption in IM-2110-2 for certain customer limit orders received prior to September 1, 1995. The passage of time has rendered this exemptive language obsolete and therefore it no longer bears on the existing application of the interpretation. This change is consistent with Nasdaq's rule filing in connection with its exchange registration application, which contains an identical proposed rule change.

Existing Rule 6541 extends the principles of IM-2110-2 to certain OTC Bulletin Board stocks as part of a pilot program that will continue at least until February 8, 2002. Rule 6541 is renumbered in the rule proposal as new Rule 6640, and the language is changed to include "non-exchange-listed" securities, rather than "Bulletin Board" securities. Initially, Rule 6640 would cover the same Bulletin Board stocks that are part of the ongoing pilot program. The language change is made in anticipation of the Bulletin Board becoming part of the Nasdaq-listed stock market,<sup>7</sup> and its listed securities becoming subject to IM-2110-2. At that time, the NASD may extend the scope of Rule 6640 to include additional non-exchange-listed securities. The language change in the rule proposal would allow NASD that flexibility without having to amend the rule.

**IM-2310-2 SEEDS Transactions:** As a result of Nasdaq's anticipated separation from the NASD, the proposed rule change deletes Rule 4420, which primarily involves quantitative listing criteria for Nasdaq National Market securities. However, existing Rule 4420(g)(5) describes an obligation on the part of the Association to distribute a circular to member firms that provides guidance when handling Hybrid Securities and Selected Equity-linked Debt Securities ("SEEDS") transactions. Since that provision applies to the NASD and is regulatory in nature, it has been retained and moved to IM-2310-2. The proposed rule change also would allow either Nasdaq or the NASD to distribute the compliance circular.

**Rule 2840 Trading in Index Warrants:** The proposed rule change would delete language in Rule 2840 related to index warrants listed on the Nasdaq Stock Market. The existing rule was promulgated because Nasdaq expected eventually to list such index warrants. However, as evidenced by Nasdaq's proposed rule filing in connection with its application for

exchange registration, Nasdaq no longer intends to list index warrants. The remainder of Rule 2840 remains unchanged, as it has continued applicability to NASD members that are not also members of an exchange on which they trade index warrants.

**Rules 2850 through 2885 Position Limits and Options Trading:** To reflect Nasdaq's separation from the NASD, the proposed rule change deletes from Rules 2850 through 2885 all language related to position limits and transactions in index warrants and options traded on Nasdaq. However, the rule change retains all provisions related to options trading in the over-the-counter market.

**Rule 6600 Transactions in Non-Exchange-Listed Securities:** The proposed rule change would combine the existing Rule 6600 and 6700 Series into a single Rule 6600 Series that governs transactions in non-exchange-listed equity securities. The proposed combination is intended to eliminate redundancies in the existing rules, while maintaining all of the regulatory requirements for trading and reporting transactions in such securities.

Proposed Rule 6620 also would require those NASD members that effect trades otherwise than on an exchange in non-exchange-listed securities to enter into contractual agreements to use Nasdaq's ACT system for trade comparison and trade reporting. The NASD has determined that this contractual agreement with Nasdaq would be the most practical, efficient and fair means to provide access to the ACT system for members that effect such trades.

First, most NASD members are already connected to ACT, since ACT is used currently to report these transactions. Second, this approach would relieve the NASD of significant additional cost to process and administer these services, and Nasdaq already has these operations in place. Third, the subject securities do not trade on Nasdaq; therefore, no competitive issues would be raised. Finally, the NASD would maintain regulatory responsibility to monitor and enforce compliance with the ACT rules by its members that effect transactions in non-exchange-listed securities. Nasdaq would function only as a vendor and systems operator.

The proposed rule change also would amend the minimum quotation size requirements required by Rule 6750 to reflect the fact that upon Nasdaq exchange registration, the NASD would no longer operate the OTC Bulletin Board Service. Therefore, references to the OTC Bulletin Board would be deleted from the rule.

<sup>5</sup> Securities Exchange Act Release No. 43863 (Jan. 19, 2001), 66 FR 8020 (Jan. 26, 2001).

<sup>6</sup> Securities Exchange Act Release No. 44396 (June 7, 2001), 66 FR 31952 (June 13, 2001) (File No. 10-131).

<sup>7</sup> See SR-NASD-2001-82, which is currently being reviewed by the Commission.

### Proposed Rule Change Relating to Trading Otherwise Than on an Exchange

The proposed rule change generally would clarify that NASD rules that relate to trading practices (*e.g.*, quotations, trade reporting, short selling, trading halts) apply only to transactions otherwise than on an exchange. To achieve this, the proposal would add a definition of the term "otherwise than on an exchange" in Rule 4200 and also specify in particular rules where the rule applies only to trading otherwise than on an exchange.<sup>8</sup> The term "otherwise than on an exchange" is defined in the proposal to mean a trade effected by an NASD member otherwise than on or through a national securities exchange. The determination of what constitutes a trade "on or through" a national securities exchange would be left to the respective exchanges and applicable statutes, rules and regulations, as approved by the SEC.

The rule proposal, for the most part, maintains the same organization as the existing NASD rules. For example, rules related to trading Nasdaq securities otherwise than on an exchange are found in the Rule 4600 Series. Rules related to trading in Consolidated Quotation Service ("CQS") securities otherwise than on an exchange similarly remain in the Rule 6300 Series. While the rules governing CQS securities are similar to those governing Nasdaq securities (*e.g.*, the trade reporting rules) the proposal maintains the historically separate rule structure that has been considered helpful by many market participants.

The NASD is considering combining the similar rules, where possible, and placing them in a section that would encompass all rules related to trading otherwise than on an exchange. The current rule proposal begins such a process by establishing a new Rule 5000 Series, Trading Otherwise Than On An Exchange, that would contain some rules that apply both to Nasdaq and CQS securities, such as the short sale rule, trading halts, transactions involving initial public offerings, and clearance and settlement. Rules that previously resided in the Rule 5000 Series, and have not otherwise been deleted, have been moved. Under the proposal, rules related to the Intermarket Trading System ("ITS")

(Rule 5200 Series) would be moved to the Rule 6500 Series. Rules related to The Portal Market (Rule 5300 Series) would be moved to the Rule 6700 Series.

*The NASD Alternative Display Facility:* The NASD would build a quote collection, trade comparison and trade reporting facility that meets specific performance and security standards and provides users with the necessary functionality to make it a viable alternative display facility to Nasdaq.

The facility would provide market participants—market makers, ECNs and order entry firms—the ability to collect and view quotations, and to report transactions to the appropriate Securities Information Processor ("SIP")<sup>9</sup> for consolidation and dissemination of data to vendors and ADF market participants. The facility also would provide for trade comparison through the Trade Comparison and Reporting Service ("TRACS"), the details of which are described below. The facility further would provide for real-time data delivery to NASD Regulation for regulatory purposes, including enforcement of firm quote and related rules.

The ADF is expected to launch by the end of the first quarter of calendar year 2002, provided that Nasdaq has been approved as a national securities exchange. The NASD or a vendor (other than Nasdaq) would maintain and operate the facility. The NASD would establish the rules that govern the ADF, and NASD Regulation will enforce the rules and provide market surveillance.

The proposed rule change also includes a number of changes that more specifically reflect the implementation and operation of the ADF. Most significantly, the proposed rule change would replace in their entirety the existing Rule 4000 Series and Rules 6100, 6300, 6400 and 6500 with a new set of rules to govern the ADF. For the most part, the proposed ADF rules closely track existing Nasdaq rules or rules proposed by Nasdaq in its exchange registration and existing rules that govern the CQS.<sup>10</sup> The ADF would provide trade comparison and trade reporting services that would be similar to Nasdaq's ACT system. However, the

proposed ADF rules have been refined to reflect the more limited functionality of the ADF, most particularly the absence of an automatic execution or order routing system. Instead, the proposed rule change would require ADF market participants to provide direct or indirect access to their quotations, as described in more detail below.

As required by existing Nasdaq rules, ADF participants would be required to register as market makers or ECNs for each security in which they make a market or display orders. Market makers would receive approval for registration upon demonstration that they are members in good standing and comply with the net capital and other financial responsibility requirements of the Act. To ease the administrative burden on NASD members, the NASD rules initially would allow registration as a market maker in the ADF upon proof that a firm is a registered Nasdaq market maker. Eventually, members seeking to become an NASD registered market maker would have to comply either with Rule 1017(a)(5) (which requires an application for approval for a material change in business operations) or Rule 1010 (application for initial membership in the NASD).

Additionally, the proposed rule change tracks Nasdaq requirements that market makers maintain continuous two-sided, firm quotations and prescribes market maker obligations when a bid or offer locks or crosses the market. However, as described in more detail below, the rule proposal does not provide for stabilizing or penalty bids, as existing Nasdaq rules do. The proposal generally adopts Nasdaq's anticipated approach to trade reporting: the seller reports both intramarket and intermarket trades between market makers, the market maker reports trades between it and a customer, and an NASD member reports trades between it and a non-member.<sup>11</sup> ECNs would report all trades effected within the ECN (*i.e.*, when a market maker sells through an ECN). As described below, the ADF also would support a "three party trade report" for ECNs.

**Order Access Rule:** The ADF rules differ from existing Nasdaq rules most significantly with respect to participants' ability to reach quotes displayed in the ADF. The NASD would not provide ADF market participants an order routing capability, other than

<sup>8</sup> See *e.g.*, the new Rule 5000 Series, which sets forth rules that apply generally to trading otherwise than on an exchange (short selling and trading halts) and Rule 4633, which governs specifically transactions effected otherwise than on an exchange in Nasdaq securities.

<sup>9</sup> Nasdaq initially will be the designated SIP for all transactions in Nasdaq securities, while the Securities Industry Automation Corporation will continue to function as the SIP for transactions in listed securities.

<sup>10</sup> Should Nasdaq amend its exchange registration with respect to matters such as trade reporting, short selling, or quotation obligations, we anticipate making similar amendments to the proposed NASD rules.

<sup>11</sup> Securities Exchange Act Release No. 44396 (June 7, 2001), 66 FR 31952 (June 13, 2001) (File No. 10-131). *But see* note 10, *supra*.

ITS.<sup>12</sup> In order to provide a means to enforce compliance with firm quote obligations, locked and crossed quotation obligations,<sup>13</sup> and to provide other market participants within the ADF and in other markets the ability to provide best execution, in the absence of an NASD-provided router, the proposed rule change contains new Rule 4300. This rule would require market participants to provide direct electronic access to other market participants and direct or indirect electronic access to all other NASD members seeking access. Proposed Rule 4300 defines “direct electronic access” as the ability to deliver an order for execution directly against an individual NASD market participant’s best bid and offer without the need for voice communication, and with the equivalent speed, reliability, availability and cost as are made available to the NASD market participant’s own customer broker/dealers or other active customers or subscribers. The proposal would not, however, preclude market participants from charging more for the access required by the rule—sometimes called “hit or take” access—than for full service access, so long as hit or take access is not charged discriminatorily, *i.e.*, charged differently for one group of users (*e.g.*, subscribers) than for others (*e.g.*, non-subscribers). While “hit or take” is more limited functionally than full book access, it also is a liquidity taking function and some markets—including Nasdaq—charge more for taking liquidity than providing it.<sup>14</sup>

The proposed rule change defines “indirect electronic access” as the ability to route an order through customer broker/dealers of an NASD market participant for execution against the NASD market participant’s best bid and offer, without the need for voice

communication, and with equivalent speed, reliability, availability and cost as are available to the market participant’s customer broker/dealer providing the indirect access or other active customers or subscribers. Market participants would be prohibited from influencing the prices that customer broker/dealers impose for providing indirect access or in any way discouraging the provision of indirect access.

ADF market participants could satisfy these requirements either by providing their own bilateral linkages or by participating in multilateral linkage facilities provided by private vendors. In addition, with respect to links with exchanges, market participants could satisfy these requirements either by linking with the exchange or by linking with market participants operating within those exchanges.

To allow NASD Regulation to monitor compliance with certain trading rules, such as the firm quote rule and “trade or move” rules, the proposed rule also requires that all NASD market participants that display quotations or orders in the ADF record specified items of information pertaining to orders they receive via direct or indirect electronic access, and report this information to NASD Regulation on a real-time basis. The proposed rule requires this information to be provided to NASD Regulation within 10 seconds of the receipt of an order and, if applicable, when an order is acted upon or responded to. As part of the subscriber agreement approval process, market participants would be required to provide the terms and methods by which they would comply with these rules. The NASD would review these terms prior to approving a subscriber agreement.

*Trade Reporting and Trade Comparison Service:* As noted above, the NASD intends to operate trade reporting and comparison services as part of the ADF. The trade reporting service would collect trade reports for NASD registered market participants, as well as any NASD member required to report transactions occurring otherwise than on an exchange. The service would transmit the reports automatically to the respective SIPs, if required, for dissemination to the public and the industry. This mechanism would operate similar to the trade reporting functions of Nasdaq’s ACT Service,<sup>15</sup>

but would contain one notable distinguishing feature.

The ADF would support a “three party trade report” that would make it easier for ECNs to submit trade reports involving their subscribers and for market makers to submit riskless principal trade reports. A three party trade report would be a single last sale trade report that would denote one reporting member (*i.e.*, the party with the trade reporting responsibility as defined in Rules 4633 and 6420) and two contra parties. The ADF would be designed to split the three party trade report into two separate reports that would then be processed independently in accordance with existing trade reporting rules. Each of these reports would contain its own identifier and a reference to the original three party trade report, so that the separate reports can be mapped to the same transaction.

Therefore, the ADF trade reporting system would streamline the reporting process by reducing from three or two to one the number of trade reports for most ECN and riskless principal transactions. The proposed rules would require three party trade reports when the reporting party is a registered ECN, and would permit such reports by market makers that execute riskless principal transactions.

The NASD also intends to operate a trade comparison service as part of TRACS that would: (1) Compare trade information entered by TRACS participants and submit “locked-in” trades to Depository Trust Clearing Corporation (“DTCC”) for clearance and settlement; (2) transmit reports of the transactions automatically to the respective SIPs, if required, for dissemination to the public and the industry; and (3) provide participants with monitoring capabilities to facilitate participation in a “locked-in” trading environment. The proposed trade comparison rules are found in proposed Rule 6100.

The NASD expects that a significant volume of trades would be locked-in and submitted directly to DTCC by way of agreements between market participants and Qualified Service Representatives (“QSR”). As a result, NASD expects the volume of trades sent through TRACS to be relatively low.<sup>16</sup> The proposed TRACS rules would apply only to those members that from time to

<sup>12</sup> The NASD does not intend to provide an order routing capability other than ITS because it believes it can better perform our core investor protection mission by focusing on regulation rather than market operations. The NASD also believes that market participants already do, and can continue to, establish and run order linkage facilities that are more efficient and innovative than a facility the NASD could provide. The ITS “exception” is based upon the fact that ITS is in place and is the current accepted mechanism for intermarket linkage for CQS securities. As discussed below, we would make use of ITS optional.

<sup>13</sup> This order access rule would be the basis for satisfying, among other things, locked and crossed quotation obligations. While this rule would require intermarket links with other market centers, as well as intra-ADF links, the proposed locked and crossed rule, Rule 4612(d), unlike other market center locked and crossed rules, is based on the ADF’s own quotations. In the event that the markets agree on a locked and crossed rule approach that encompasses quotations in all markets, proposed Rule 4300 would still facilitate compliance.

<sup>14</sup> See Securities Exchange Act Release No. 44918 (Oct. 10, 2001), 66 FR 52814 (Oct. 17, 2001).

<sup>15</sup> The NASD service would not perform risk management services that are provided by Nasdaq’s ACT service.

<sup>16</sup> The NASD has not yet resolved how to compare and report trades between an ADF market participant and a Nasdaq market participant that has access to Nasdaq’s ACT service. The NASD is engaged in discussions with DTCC about the possibility of DTCC continuing its existing trade comparison service for over-the-counter equity securities to provide for those intermarket trades.



time need to compare trades in Nasdaq or CQS securities that are effected otherwise than on an exchange and are not subject to QSR agreements that result in direct submission to DTCC.

*Rules 4633(c) and 6420(b) Which Party Reports a Transaction:* The proposed rule change adopts what the NASD understands to be the current Nasdaq approach to trade reporting. In its exchange application rule proposal, Nasdaq provides that the seller reports trades between market makers, the market maker reports trades between it and a customer, and an ECN reports only those trades where it is deemed to be the liquidity provider. The NASD's current best understanding is that Nasdaq has decided that the seller, rather than the liquidity provider, should report transactions between two market makers or ECNs.<sup>17</sup>

*Rule 5100 Short Sale Rule and Rule 4612 Primary Market Maker Standards:* The proposed rule change would amend the short sale rule and its accompanying interpretation to make them applicable to trading in Nasdaq-listed issues otherwise than on an exchange (including through the ADF), rather than Nasdaq. The rule proposal would renumber the rule and interpretation as Rule 5100 and IM-5100-1, respectively.

The proposed rule change would establish a different bid on which to base the applicability of the short sale rule. The existing rule prohibits members from effecting short sales in Nasdaq National Market securities at or below the best bid, when the current best bid as displayed in the Nasdaq Stock Market is below the preceding best bid in that security. The proposed amendment would substitute the national best (inside) bid for the Nasdaq best bid as the basis for determining when the rule applies. Although a best (inside) bid would be calculated for the ADF, the NASD believes that for the purposes of the short sale rule, the national best (inside) bid would be more reflective of market-wide trading in a security and therefore would better further the purposes of the rule.

Aside from the changes noted above, the NASD intends to have a short sale rule that mirrors Nasdaq's short sale rule. The rule proposal represents NASD's best understanding as to the content of Nasdaq's short sale rule. The existing Nasdaq rule provides an exemption from the rule for a "qualified market maker" engaged in bona fide market making activity. The existing

rule—and Nasdaq's proposed rule filing in connection with its exchange registration—defines "qualified market maker" as a registered market maker that meets the requirement set forth in Rule 4612 to be deemed a Primary Market Maker. The proposed rule change would eliminate the "qualified market maker" and "Primary Market Maker" standards, and consequently delete Rule 4612. The existing Primary Market Maker Standards rule has been suspended since implementation of the SEC's Order Handling Rules in early 1997. In the event that Nasdaq makes the current Primary Market Maker Standard rule—or an amended rule—effective, the NASD would amend its rules accordingly. Until then, the NASD intends to have a short sale rule that reflects the current exemption for registered market makers engaged in bona fide market making activity.

*Rule 5200 Trading Halts:* Proposed Rule 5200 would provide NASD with authority to halt trading otherwise than on an exchange in securities quoted (*i.e.*, listed securities) through the ADF. The rule proposal also would provide NASD with the authority to halt trading in non-exchange-listed foreign securities that trade in a quotation medium other than a national securities exchange or through the ADF.

As under current NASD rules, trading halts require NASD members to cease effecting trades as agent or principal, but do not preclude customer-to-customer trades. For ADF-eligible securities, the proposed rule would mandate a trade halt when another market halts trading in a security for regulatory reasons and would give the NASD discretionary authority to halt trading when another market halts trading for operational reasons. Any trading halt initiated by the NASD would become effective simultaneously with notification via an administrative message sent through the ADF terminal or interface. Trading similarly would resume after an administrative notice has been issued.

Specifically, the proposed rule would require that the NASD halt trading through the ADF of a security listed on a national securities exchange whenever a market eligible to trade that security imposes a trading halt, or suspends a listing, for one of the following reasons: (1) To permit dissemination of material news; (2) to obtain information from the issuer related to material news; (3) to obtain information related to an issuer's ability to meet listing qualifications; or (4) to obtain other information that is necessary to protect investors and the public interest. The proposed rule change would further require the NASD

to halt trading through the ADF in an American Depository Receipt ("ADR"), if that security is listed on a national securities exchange or foreign securities exchange, and one of those exchanges, or an overseeing regulatory authority, halts trading in the security. Finally, the rule would require the NASD to halt trading through the ADF whenever that system is unable to transmit real-time quotation or trade reporting information to the applicable SIP, or whenever a market-wide trading halt is in effect under circuit breaker rules of a primary exchange.

Since the proposed trading halt rules do not differentiate between Nasdaq and other exchange-listed securities, there no longer is a need for the separate trading halt provisions of existing Rule 6430, which apply only to those securities eligible for trading and reporting to the Consolidated Tape, as described in Rule 6400. Accordingly, Rule 6430 would be deleted and its provisions would be absorbed in Rule 5200, including the obligation of members to notify the NASD whenever they have knowledge of information related to a security or issuer that has not been adequately disclosed to the public.

The rule proposal would grant discretionary authority to the NASD to halt trading otherwise than on an exchange by its members through the ADF whenever another national securities exchange halts trading in a security for operational reasons, defined as an order imbalance or influx. Similar discretionary authority would extend to circumstances where a security traded through the ADF is a derivative or component of a security that has been halted by a national securities exchange. In the event that NASD chooses not to halt trading under the aforementioned discretionary circumstances, market participants could continue to trade through the ADF and would be required to meet all applicable trade reporting requirements.

With respect to non-exchange-listed foreign securities, which do not trade through the ADF but only over-the-counter, the proposed rule allows the NASD to impose halts for over-the-counter trading in conjunction with regulatory halts imposed by foreign regulatory authorities because of potential fraudulent conduct. The proposal would not give the NASD authority to impose a trading and quotation halt if the foreign regulatory halt was imposed solely for the dissemination of material news, a regulatory filing deficiency, or operational reasons. Currently, the NASD has no authority to impose

<sup>17</sup> Securities Exchange Act Release No. 44396 (June 7, 2001), 66 FR 31952 (June 13, 2001) (File No. 10-131). *But see* note 10, *supra*.

trading and quotation halts in securities that are quoted and traded in other quotation media, such as the National Quotation Bureau's Pink Sheets. This proposed rule would grant such authority with respect to foreign securities in circumstances in which it is necessary to protect investors and the public interest.

**Rule 4619 Withdrawal of Quotations and Passive Market Making:** The proposed rule change eliminates a condition in existing Rule 4619(b)(3) for a market maker seeking excused withdrawal status based on vacation. Under the current rule, excused withdrawal status may only be granted to a market maker that has three or fewer Nasdaq Level 3 terminals. The proposal does not replicate that requirement for ADF market makers because the ADF will not operate as a primary market. As such, the absence of a market maker with more than three ADF terminals would not have a significant impact on the liquidity in those securities in which it makes a market.

**Rules 4614 and 4624 Stabilizing Bids and Penalty Bids:** The proposed rule change would delete existing Rules 4614 and 4624 relating to stabilizing and penalty bids. These rules allow a market maker—usually the underwriter of a securities offering—to enter these special bids in connection with a distribution of securities under Rules 101 and 104 of SEC Regulation M. The NASD believes such activity should occur on the market listing the issue and thus proposes to delete these rules.

**Obligations When Quoting in Multiple Market Centers:** Existing Rule 2320(g)(2) requires members that display quotations for non-Nasdaq securities in two or more quotation mediums to post the same priced quotations in each medium. To reflect Nasdaq's registration as an exchange, the proposed rule change would amend the language of that provision to apply to "non-exchange-listed" securities. At the same time, the rule proposal would add a similar obligation for members that display quotations for Nasdaq and CQS securities in two or more market centers, including the ADF. The obligations for members quoting Nasdaq and CQS securities are found in proposed Rules 4613(e)(1) and 6330(f), respectively. Note that the proposed rules do not prohibit displaying different size quotations in two or more mediums or market centers, provided that the price displayed is the same.

**Obligation To Have Quotations From Other Market Centers in Close Proximity:** Proposed Rule 4613(e)(2) would require a registered NASD market

maker to have in close proximity to the ADF terminal or interface at which it makes a market in a Nasdaq security, a quotation service that disseminates quotations in that security on behalf of national securities exchanges and other market centers. A similar rule, Rule 6330(c), currently exists with respect to CQS market makers. As with the CQS rule, it is the NASD's intention for the quotations displayed in the ADF terminals or interfaces to function as a verification mechanism whereby ADF market participants can monitor their current ADF quotations and ensure that the NASD is timely updating and disseminating their quotations. The NASD would not disseminate to ADF market participants any consolidated quotation or trade data in a security from securities exchanges and market centers. To ensure that ADF participants have the data necessary to make sound order routing decisions and to satisfy the Vendor Display Rule,<sup>18</sup> the NASD would require ADF market participants to obtain from vendors dynamic quotations and last-sale information on the securities they trade through the ADF, and to display this data in close proximity to the ADF data displayed on their terminals—just as is currently required by Nasdaq of CQS market makers in Rule 6330(c).<sup>19</sup>

A requirement to disseminate consolidated quotation and trade data from securities exchanges and other market centers would result in significantly increased costs to build the ADF because it would necessitate substantially greater capacity and would require a more complex technical design of the ADF terminals and user interfaces to allow for receipt of that information.

**Rule 4620 Voluntary Termination of Registration:** The proposal contains a new provision related to voluntary termination as an NASD market maker. Proposed Rule 4620 provides that registration as a market maker in a security is voluntarily terminated where the market maker (1) withdraws its quotations from the ADF and does not re-enter quotations in the security for five minutes or (2) fails to re-enter quotations within 30 minutes of the end of a trading halt. In either circumstance, a market maker would be prohibited from re-registering as a market maker in that security for twenty (20) business days, unless the market maker meets the conditions for excused withdrawal specified in Rule 4619.

<sup>18</sup> See Rule 11Ac1-1 under the Act. 17 CFR 240.11Ac1-1.

<sup>19</sup> Concurrent with this filing, the NASD plans to request an exemption from the Vendor Display Rule, as Nasdaq did with its similar CQS rule.

**Rules 6350(a) and 6520(e) Obligations of CQS and ITS Market Makers Related to Pre-Opening Applications:** The proposed rule change contains new obligations on registered CQS and ITS market makers that participate in the pre-opening application process. Proposed Rule 6350(a) (CQS) and Rule 6520(e) (ITS) would provide that a registered market maker that participates in the pre-opening application process and does not enter and maintain two-sided quotations in the security on that same trading day may not re-register to participate as a market maker in that security for twenty (20) business days, unless the market maker is granted an excused withdrawal from the NASD.

**Rule 6500 Intermarket Trading System:** The proposed rule change reflects the NASD's anticipated participation in the ITS through the ADF. In many respects, the NASD anticipates participating in ITS in a manner similar to Nasdaq's current participation in ITS. However, the ITS rules have been amended in the proposal to reflect that the ADF will not use Nasdaq's Computer Assisted Execution System ("CAES") to effect ITS trades. As such, the proposed rule change deletes all references to "CAES" in the ITS rules and elsewhere. In addition, the proposal refers to market makers and ECNs participating in ITS as ITS/ADF market makers.

The rule proposal would renumber and move the ITS rules to the 6500 Series. Furthermore, unlike Nasdaq, NASD market participants that register to enter quotations in CQS securities would not be obligated to participate in ITS. Participation in ITS, with the associated obligations such as compliance with the trade-through rule and the market probing requirement, would be completely voluntary. If a market participant determines to participate in ITS, then it must abide by all rules applicable to ITS, including the trade-through rule and the market probing requirement. Also, the NASD would not provide an intra-market order routing system such as CAES. Accordingly, market participants would be responsible under Rule 4300 to establish links to facilitate execution of CQS securities in the intra-market and, in the case of non-ITS participants, direct or indirect linkages to the exchanges.

The quote access requirements of proposed Rule 4300 would not extend to intermarket access for trading Nasdaq securities. Unlike for CQS securities, the Commission has not mandated an intermarket linkage like ITS for Nasdaq securities. Moreover, intermarket

linkage for trading Nasdaq securities is fundamentally a multilateral, intermarket structural issue. Accordingly, the NASD does not believe it appropriate for the NASD to unilaterally impose such an intermarket linkage obligation. Rather, the NASD would propose—as is the case today—that members of another market that desire to access an ADF market participant's quotes in Nasdaq securities establish an execution arrangement with that ADF market participant or, alternatively, become a member of the NASD.

Additionally, the proposed rule change would add the option of a 30-second commitment to trade period for ITS/ADF Market Makers. This option is permitted under an ongoing ITS Plan pilot program, and the NASD believes it would benefit our member participants.

*Fees and Assessments:* The proposed rule change does not include any proposed fees or assessments specifically related to the ADF. Existing fees and assessments, including the gross assessment and Section 8 fees, would continue to apply to NASD members. Any specific fees or assessments with respect to the ADF would be the subject of a future rule filing.

## 2. Statutory Basis

The NASD believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act,<sup>20</sup> which requires a national securities association to have rules that prevent fraudulent and manipulative acts, promote just and equitable principles of trade, foster cooperation and coordination among persons engaged in regulating, clearing, settling, processing information and facilitating transactions in securities, 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. In addition, this rule proposal is consistent with Section 15A(b)(6) because it does not permit unfair discrimination between customers, issuers, brokers, or dealers, fix minimum profits, impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by members, or regulate matters not related to the purposes of the Act or the administration of the Association.

Moreover, in the SuperMontage Order,<sup>21</sup> the SEC required the NASD to create a facility that “permits NASD

members to comply with their obligations under Commission and NASD rules (including Exchange Act Rule 11Ac1-1(c)(5) and Regulation ATS) without participating in the Nasdaq execution facility. The facility will identify through the central processor the identity of the NASD member that is the source of each quote,” as is required by Exchange Act Rule 11Ac1-1(b)(1)(ii).<sup>22</sup> Furthermore, the Commission stated that “[t]he facility will provide a market neutral linkage to the Nasdaq and other marketplaces, but not an execution service.” The NASD believes that the proposed rule change fulfills the obligations specified by the Commission in the SuperMontage Order. In particular, the NASD believes that this proposal would provide a market neutral linkage by requiring market participants to link, either directly or indirectly, to all those seeking access to the market participants' quotations as required in proposed Rule 4300.

### B. Self-Regulatory Organization's Statement on Burden on Competition

The NASD does not believe that the proposed rule change, as amended, will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments on the proposed rule change were not solicited or received.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the NASD consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

The NASD has requested that the proposed rule change become effective upon the later of Commission approval or the effectiveness of Nasdaq's Exchange Registration.<sup>23</sup> The NASD has

waived the requirement that the Commission either approve the proposed rule change, or institute disapproval proceedings, within thirty-five days of publication of the proposed rule change in the **Federal Register**.<sup>24</sup>

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal, as amended, is consistent with the Act. In particular, the Commission solicits comment on whether the proposed rules are sufficient to meet the NASD's obligations under Sections 15A(b)(11)<sup>25</sup> and 11A(c)(1)<sup>26</sup> of the Act with respect to the over-the-counter market, including providing NASD market makers and ECNs with the ability to comply with their obligations under the Commission's Order Handling Rules and Regulation ATS.<sup>27</sup>

In addition, in Rule 4300 the NASD proposes certain quote and order access obligations. The Commission requests comment on whether this rule will provide potential users with adequate access to quotations displayed through the ADF and will allow the NASD to effectively enforce its access requirements. In particular, the Commission requests comment on what it means to make indirect electronic access “readily available” (see proposed Rule 4300(a)(2)).

Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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

registration will be approved before SuperMontage launches. If that turns out not to be the case, the NASD would have to revisit the effective date of the proposed rule change, including whether the rules related to the ADF should become effective at a different time from the rules resulting from Nasdaq separation.

<sup>24</sup> See Amendment No. 1, *supra* note 3.

<sup>25</sup> 15 U.S.C. 78o-3(b)(11).

<sup>26</sup> 15 U.S.C. 78k-1(c)(1); See also Section 11A(c)(3)(A) of the Act.

<sup>27</sup> See Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996) (Order Handling Rules); Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) (Regulation ATS).

<sup>20</sup> 15 U.S.C. 78o-3(b)(6).

<sup>21</sup> Securities Exchange Act Release No. 43863 (Jan. 19, 2001), 66 FR 8020 (Jan. 26, 2001).

<sup>22</sup> 17 CFR 240.11Ac1-1(b)(1)(ii).

<sup>23</sup> The proposed effective date is based upon NASD's assumption that Nasdaq's exchange

the Commission's Public Reference Room. Copies of the filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the File No. SR-NASD-2001-90 and should be submitted by January 21, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>28</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

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<sup>28</sup> 17 CFR 200.30-3(a)(12).