

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52508; File No. SR-NASD-2005-089]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change and Amendment No. 1 Thereto, and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 2, 3, and 4 Thereto, Relating to NASD's Direct Authority for the Activities Related to or in Support of Trading in Over-the-Counter Equity Securities

September 26, 2005.

#### I. Introduction

On July 19, 2005, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule change to amend NASD's Plan of Allocation and Delegation of Functions by the NASD to Subsidiaries ("Delegation Plan") and certain NASD rules to reflect the NASD's direct authority for the activities related to or in support of trading in over-the-counter ("OTC") equity securities,<sup>3</sup> including, but not limited to, the OTC Bulletin Board ("OTCBB"). Currently, this authority is delegated to The Nasdaq Stock Market, Inc. ("Nasdaq"). On July 22, 2005, the NASD filed Amendment No. 1 to the proposed rule change.<sup>4</sup> The proposed rule change, as amended, was published for comment in the **Federal Register** on July 29, 2005.<sup>5</sup>

The Commission received two comment letters in response to the proposal.<sup>6</sup> On September 13, 2005, the

NASD filed Amendment No. 2 to the proposed rule change.<sup>7</sup> On September 23, 2005, the NASD filed Amendment Nos. 3 and 4 to the proposed rule change.<sup>8</sup> The amended rule text set forth in Amendment No. 2 and the text of Amendment Nos. 3 and 4 are available on the NASD's Web site (<http://www.nasd.com>), at the NASD's Office of the Secretary, and at the Commission's Public Reference Room.

This order approves the proposed rule change, as amended. In addition, the Commission provides notice of filing of Amendment Nos. 2, 3, and 4, grants accelerated approval to Amendment Nos. 2, 3, and 4, and solicits comments from interested persons on Amendment Nos. 2, 3, and 4.

#### II. Description of the Proposal

Pursuant to the Delegation Plan, activities related to or in support of the trading in OTC equity securities, including, but not limited to, operation of the OTCBB<sup>9</sup> (collectively, "OTC equity operations"), have been delegated from the NASD to Nasdaq. In this context, OTC equity operations include services such as trade reporting, comparison, quote collection and dissemination, as applicable, and the related rulemaking functions in this area.

Under the proposal to amend the Delegation Plan, the NASD would

York, Inc., to Jonathan G. Katz, Secretary, Commission, dated September 19, 2005 ("STANY Letter").

<sup>7</sup> In Amendment No. 2, the NASD revised the text of NASD Rule 11890 and IM-11890-2 to reflect amendments to those provisions that were approved by the Commission shortly before publication of the Notice. See Securities Exchange Act Release No. 52141 (July 27, 2005), 70 FR 44709 (August 3, 2005) (SR-NASD-2004-009). These recent revisions to NASD Rule 11890 and IM-11890-2 do not affect the substance of the instant proposed rule change. In addition, Amendment No. 2 changed the effective date of the proposed rule change from September 1, 2005 to October 1, 2005, and proposed amendments to NASD Rule 11890(b)(1) and (2) to clarify the time frame for action by Nasdaq or NASD officials under those paragraphs of NASD's clearly erroneous rule.

<sup>8</sup> In Amendment No. 3, the NASD made a non-substantive change to Exhibit 4 that was included in Amendment No. 2 to reflect changes to the text of NASD Rule 11890 submitted in Amendment No. 2. The NASD subsequently filed Amendment No. 4 to make a non-substantive edit to the formatting of the text of IM-11890-2.

<sup>9</sup> The OTCBB provides an electronic quotation medium for subscribing members to enter, update, and display quotations in individual securities on a real-time basis. Such quotation entries may consist of a priced bid and/or offer, an unpriced indication of interest, or a bid/offer accompanied by a modifier to reflect unsolicited customer interest. The OTCBB is not an issuer listing service and therefore does not maintain a relationship with quoted issuers or impose quantitative listing standards as do Nasdaq and the exchanges. To be eligible for quotation on the OTCBB, issuers must be current in their filings with the Commission or applicable regulatory authority.

assume direct authority for OTC equity operations rather than delegate this authority to Nasdaq. In addition, the NASD would delegate to NASD Regulation, Inc. ("NASDR") the rulemaking authority relating to trading practices for OTC equity securities. The NASD intends, however, to contract with Nasdaq to have it continue to provide certain operational systems and support, OTCBB quotation and trade reporting platform and certain other services that Nasdaq currently provides with respect to OTC equity operations.

The NASD also proposes to: (1) Amend NASD Rule 6545 to transfer trading and quotation halt authority for OTCBB-eligible securities from Nasdaq to the NASD; (2) amend NASD Rule 11890 to transfer from Nasdaq to the NASD the ability to nullify or modify a transaction in an OTC equity security in certain circumstances; (3) amend NASD Rule 11890 to incorporate revisions to that rule that were approved by the Commission shortly before publication of the Notice and to clarify the time frame for action by NASD or Nasdaq officials to nullify or adjust the terms of a trade under paragraph (b) of NASD Rule 11890; <sup>10</sup> (4) amend NASD Rule 6620(f) to conform the portion of the rule governing reporting of cancelled trades to reflect the proposed changes to NASD Rule 11890; and (5) amend NASD Rule 7010(p)(3) to transfer the authority to set certain fees for historical research reports for OTCBB-eligible securities from Nasdaq to the NASD.

The NASD intends that the proposed rule change, as amended, will become effective on October 1, 2005, pending Commission approval prior to that date.

#### III. Summary of Comments and the NASD's Response

The Commission received two comment letters relating to the NASD's proposed rule change as modified by Amendment No. 1.<sup>11</sup> The Pink Sheets Letter and STANY Letter supported the NASD's proposed rule change.

The Pink Sheets Letter further suggested that the Nasdaq Quotation Dissemination Service ("Service") disseminate real-time trade and volume data for non-Nasdaq American Depositary Receipts ("ADRs") that are traded in the over-the-counter market, which currently are disseminated at the end of the trading day. In addition, the Pink Sheets Letter stated that the Service should disseminate real-time trade and volume data for odd-lot transactions in all OTC equity securities

<sup>10</sup> See Amendment No. 2, *supra* note 7.

<sup>11</sup> See Pink Sheets Letter and STANY Letter, *supra* note 6.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> The term "OTC equity securities" herein refers to OTC Equity Securities as defined in NASD Rule 6610, including, but not limited to, OTC Bulletin Board securities.

<sup>4</sup> Amendment No. 1, which replaced and superceded the original filing in its entirety, revised NASD Rule 11890 to transfer the authority to nullify or modify transactions in OTC equity securities under certain circumstances to the NASD; made conforming changes to Interpretive Material ("IM") 11890-1 and 11890-2; revised NASD Rule 6620 in light of the changes to NASD Rule 11890 contained in Amendment No. 1; and made several minor and technical changes to the filing.

<sup>5</sup> See Securities Exchange Act Release No. 52119 (July 25, 2005), 70 FR 43918 ("Notice").

<sup>6</sup> See Letter from R. Cromwell Coulson, Chief Executive Officer, Pink Sheets LLC, to Jonathan G. Katz, Secretary, Commission, dated August 31, 2005 ("Pink Sheets Letter"), and Letter from William A. Vance, President and Kimberly Unger, Executive Director, The Security Traders Association of New

that are sold for a price greater than \$200 per share. The Pink Sheets Letter noted that the Service currently disseminates such information for securities that are quoted on the OTCBB, but not for other OTC equity securities.

The STANY Letter shared the views presented in the Pink Sheets Letter relating to the dissemination of trade and volume data for OTC equity securities. Specifically, the STANY Letter stated that it believed that no valid reason existed for Nasdaq to distinguish between the data it disseminates for domestic OTC equity securities and ADRs traded in the over-the-counter market, and that Nasdaq should disseminate real-time trade and volume data for odd-lot transactions in OTC equity securities, including Pink Sheets securities, that are sold for a price greater than \$200 per share.

The Pink Sheets Letter also recommended that the NASD prepare a Notice to Members to remind broker-dealers about their obligation not to participate in unlawful securities distributions. Further, the Pink Sheets Letter recommended that NASDR review this issue with a view to proposing rules that would preclude the participation of broker-dealers in unlawful distributions of securities by their customers. In addition, the Pink Sheets Letter advocated extending trade halt authority under NASD Rule 6545 to all OTC equity securities, rather than limiting it to OTCBB-eligible securities, and to extend the authority to situations where fraudulent or manipulative acts are strongly suspected, rather than relying on actions by other markets. Further, the Pink Sheets Letter suggested limiting such trade halt authority to four days so that "piggyback" eligibility under Rule 15c2-11 under the Act<sup>12</sup> is not affected. Finally, the Pink Sheets Letter recommended that the NASD's authority to cancel clearly erroneous trades pursuant to NASD Rule 11890 should extend until the settlement date for the transactions in question.

In Amendment No. 2, the NASD noted that because the recommendations in the Pink Sheets Letter are outside the scope of the proposed rule change, it is not specifically responding to those recommendations in the context of the proposed rule change. The NASD, however, indicated that it will review and analyze the recommendations set forth in the Pink Sheets Letter in the same manner in which it would consider any requests for rulemaking,

and, based on such review and analysis, will determine whether further action on those recommendations is appropriate.<sup>13</sup>

#### IV. Discussion and Commission Findings

The Commission finds that the proposed rule change, as amended, is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>14</sup> which requires, among other things, that NASD rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.<sup>15</sup>

Under the proposal, the NASD will assume direct authority for OTC equity operations that it previously had delegated to Nasdaq. The NASD represents that, pursuant to a contractual arrangement with Nasdaq, Nasdaq will continue to provide certain operational systems and support, including the OTCBB quotation and trade reporting platform and certain other services that Nasdaq currently provides with respect to OTC equity operations. In addition, the NASD proposes to delegate to NASDR the authority to develop and adopt rule changes to establish trading practices with respect to OTC equity securities. The Commission believes that the proposal by the NASD to assume direct responsibility for OTC equity operations, including operation of the OTCBB, and to delegate to NASDR the authority to develop and adopt rule changes to establish trading practices with respect to OTC equity securities is consistent with the Act. In the Commission's view, since the NASD is the self-regulatory organization with authority over and responsibility for the oversight of the OTC equity market, it is reasonable for the NASD to revise its Delegation Plan to assume direct authority for OTC equity operations and to delegate to NASDR rulemaking authority for trading practices involving OTC equity securities.

In addition, the proposal would amend NASD Rule 11890 to grant the NASD direct authority to determine, on

its own motion, whether certain transactions in OTC equity securities should be modified or nullified in the event of a disruption or malfunction of any NASD quotation, communication, or trade reporting system or in the event of extraordinary market conditions in which nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest. The proposal also provides a process by which a determination under NASD Rule 11890 could be appealed to the Uniform Practice Code ("UPC") Committee, unless the Executive Vice President who makes the initial determination specifies at that time that the number of affected transactions is such that immediate finality is necessary to maintain a fair and orderly market and to protect investors and the public interest. The Commission believes that the assumption of direct authority by the NASD to nullify or modify the terms of trades in OTC equity securities under certain conditions is appropriate and should help clarify for OTC equity market participants the NASD's authority to nullify or modify the terms of clearly erroneous transactions in OTC equity securities.

The proposal would amend certain other rules, including NASD Rule 6620(f) and NASD Rule 7010(p)(3), to reflect the transfer of authority from Nasdaq to the NASD with respect to the reporting of trades cancelled pursuant to NASD Rule 11890 and the authority to set fees for historical research reports for OTCBB-eligible securities, respectively. The Commission believes that these changes are appropriate to conform the applicable rule text to reflect the assumption of direct responsibility for OTC equity securities by the NASD.

The Commission finds good cause for approving Amendment Nos. 2, 3, and 4 to the proposed rule change prior to the thirtieth day after the date of the publication of notice thereof in the **Federal Register**. The Commission notes that Amendment No. 2 is a non-substantive amendment to revise the effective date of the proposed rule change; to reflect changes to NASD Rule 11890 and IM-11890-2 that were approved by the Commission shortly before publication of the Notice; and to clarify the timeframe for NASD or Nasdaq officials to act on their own motion to nullify or modify the terms of a trade under NASD Rule 11890. Further, Amendment No. 3 is a non-substantive amendment to revise Exhibit 4 contained in Amendment No. 2 to reflect the changes to the text of NASD Rule 11890 submitted in

<sup>13</sup> The Commission notes that the NASD did not respond to the STANY Letter because it was submitted after the NASD had filed Amendment No. 2. As noted above, the STANY Letter adopted the views of the Pink Sheets Letter with respect to the dissemination of trade and volume data for OTC equity securities.

<sup>14</sup> 15 U.S.C. 78o-3(b)(6).

<sup>15</sup> In approving this proposed rule change, as amended, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>12</sup> 17 CFR 240.15c2-11.

Amendment No. 2, and Amendment No. 4 is a non-substantive amendment to IM-11890-2. The Commission therefore believes that it is appropriate to accelerate approval of Amendment Nos. 2, 3, and 4 so that the proposed rule change, as amended, may be implemented in full without delay.

## V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment Nos. 2, 3, and 4 to the proposed rule change, as amended, are consistent with the Act. Comments may be submitted by any of the following methods:

### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2005-089 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2005-089. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Nasdaq. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2005-089 and

should be submitted on or before October 21, 2005.

## VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>16</sup> that the proposed rule change (SR-NASD-2005-089), as amended, be, and it hereby is, approved, and Amendment Nos. 2, 3, and 4 are hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

**Jonathan G. Katz,**

*Secretary.*

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**BILLING CODE 8010-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52502; File No. SR-PCX-2005-19]

### Self-Regulatory Organizations; Pacific Exchange, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 Thereto Relating to Proposed New Listing Fees

September 23, 2005.

## I. Introduction

On February 28, 2005, the Pacific Exchange, Inc. ("PCX" or "Exchange"), through its wholly-owned subsidiary PCX Equities, Inc., filed with the Securities and Exchange Commission ("Commission") a proposed rule change 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> to increase certain portions of its listing fees and to make a number of related modifications. On June 15, 2005, PCX amended the proposed rule change. The proposed rule change, as modified by Amendment No. 1, was published for comment in the **Federal Register** on August 16, 2005.<sup>3</sup> The Commission received no comments on the proposal. This order approves the proposed rule change.

## II. Description of the Proposal

PCX is proposing to amend its Schedule of Fees and Charges, as follows: (1) Implement new initial listing fees specifically for common stock issued in initial public offerings and listed exclusively by PCX for

trading on the Archipelago Exchange ("ArcaEx"), a facility of PCX, and make related modifications to the initial listing fees; (2) exempt from initial listing fees already-public issues which are listed and/or quoted on other marketplaces, whether or not dually listed; (3) exempt from annual maintenance fees transfer listings for the first 12 calendar months after listing, whether or not dually listed; (4) revise the annual maintenance fees; and (5) revise the additional shares listing fees.

## III. Discussion

After careful consideration, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of Section 6(b) of the Act<sup>4</sup> and the rules and regulations thereunder applicable to a national securities exchange.<sup>5</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(4) of the Act,<sup>6</sup> which requires, among other things, that an exchange's rules provide for the equitable allocation of reasonable dues, fees, and other charges among issuers and other persons using its facilities. The Commission notes that the Exchange does not believe that the proposed listing fee changes, including the proposed exemptions from certain listing fees, would negatively impact the Exchange's regulatory program. Further, the Commission notes that PCX has committed extensive resources to its listings program since the ArcaEx began operating as a facility of PCX. Finally, the Commission believes that the proposal might also serve to enhance competition among listing markets.

## IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>7</sup> that the proposed rule change (SR-PCX-2005-19), as amended, be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

**Jonathan G. Katz,**

*Secretary.*

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<sup>1</sup> 15 U.S.C. 78f(b).

<sup>2</sup> In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>3</sup> 15 U.S.C. 78f(b)(4).

<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> 17 CFR 200.30-3(a)(12).

<sup>16</sup> 15 U.S.C. 78s(b)(2).

<sup>17</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 52225 (August 8, 2005), 70 FR 48224.