categories and credit rings so that a participant will not share in a financial loss related to a service in which it does not participate. Furthermore, DTC provided the Commission with the materials it used to analyze the risks associated with the Canadian-Link Service and represented that in its risk analysis it found neither any unacceptable risk related to DTC becoming a member in CDS nor any other cause for concern regarding the proposed rule change. Accordingly, the Commission finds that neither DTC nor its participants should be exposed to any undue risks or burdens as a result of DTC's membership in CDS or DTC's offering the Canadian-Link Service.

Based on the DTC's history with CDS, the regulatory oversight and risk management framework of CDS's operations, and the risk analysis DTC performed with respect to the proposed rule change, the Commission is satisfied that DTC has taken adequate steps to design the Canadian-Link Service so that it can be offered by DTC in a manner that enables DTC to assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular section 17A of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act, that the proposed rule change (File No. SR–DTC–2005–08) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[8]

Jonathan G. Katz,

Secretary.

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[8] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–52786; File No. SR–NASD–2005–011]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto To Limit the Eligibility for Quotation on the OTCBB of the Securities of an Issuer That Is Repeatedly Delinquent in Its Periodic Reporting Obligations

November 16, 2005.

I. Introduction

On January 28, 2005, the National Association of Securities Dealers, Inc. (''NASD''), through its subsidiary, The Nasdaq Stock Market, Inc. (''Nasdaq''), filed with the Securities and Exchange Commission (''Commission''), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to limit the eligibility for quotation on the Over-the-Counter Bulletin Board (''OTCBB'') of the securities of an issuer that is repeatedly late or otherwise delinquent in filing required periodic reports.[3] Nasdaq submitted Amendment No. 1 to this filing on May 10, 2005.[4] Nasdaq submitted Amendment No. 2 to this filing on June 24, 2005.[5] Nasdaq submitted Amendment No. 3 to this filing on August 15, 2005.[6] The proposed rule change, as amended, was published for comment in the **Federal Register** on August 24, 2005.[7] The Commission received one comment letter on the proposal.[8] Nasdaq[9] and the NASD[10] each responded to the comment letter. This order approves the proposed rule change, as amended.

II. Description of the Proposal

Pursuant to current NASD Rule 6530 (the ''Eligibility Rule''), for an issuer's securities to be eligible and remain eligible for quotation on the OTCBB by an NASD member, the issuer must be current in its filings with the Commission or other appropriate regulator.[11] When a security becomes ineligible for quotation on the OTCBB due to the Eligibility Rule, either because a required periodic filing is not made or because a filing is incomplete,[12] Nasdaq appends an additional character ''E'' designator to the security's symbol.[13] If the issuer does not comply within the applicable grace period provided by the Eligibility Rule (typically 30 days),[14] the Rule prohibits NASD members from quoting the issuer's securities on the OTCBB.

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] The Commission notes that subsequent to publication of the Notice, the Commission approved the NASD's proposal to amend its Plan of Allocation and Delegation of Functions by the NASD to Subsidiaries, as well as certain corresponding NASD rules, to permit the NASD to assume direct authority for over-the-counter (''OTC'') equity operations, including the OTCBB, rather than continuing to delegate this authority to Nasdaq. Nasdaq, however, will continue to furnish the OTCBB quotation and trade reporting platform and certain other services that it provided with respect to over-the-counter equity operations. *See* Securities Exchange Act Release No. 52508 (September 26, 2005), 70 FR 57346 (September 30, 2005) (SR–NASD–2005–089).

[4] Amendment No. 1, which replaced the original filing in its entirety, made clarifying changes to the proposal's rule text; provided greater detail regarding how Nasdaq would notify issuers about the proposed rule; and stated that the proposed rule would be implemented for those filings for periods ending on or after June 1, 2005.

[5] Amendment No. 2, which replaced the original filing and Amendment No. 1 in their entirety, further clarified the proposal's rule text; and amended the proposal's rule text to provide that filings for reporting periods ending before June 1, 2005, would not be considered for purposes of the proposed rule change.

[6] Amendment No. 3, which supplemented the filing as modified by Amendment No. 2, amended the proposal's rule text to provide that filings for reporting periods ending before October 1, 2005, would not be considered for purposes of the proposed rule change.

[7] *See* Securities Exchange Act Release No. 52291 (August 18, 2005), 70 FR 49701 (''Notice'').

[8] *See* E-mail from John Meade to *rule-comments@sec.gov*, dated September 14, 2005.

[9] *See* Letter from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq, to Jonathan G. Katz, Secretary, Commission, dated September 29, 2005.

[10] *See* Letter from Andrea Orr, Assistant General Counsel, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated October 14, 2005.

[11] *See* Securities Exchange Act Release No. 40878 (January 4, 1999), 64 FR 1255 (January 8, 1999) (SR–NASD–98–51).

[12] In order for a filing to be complete, it must, for example, contain all required certifications, attestations, and financial statements, including an auditor's review pursuant to SAS–100 (for quarterly reports) or an unqualified auditor's opinion (for annual reports). *See, e.g.*, Rule 13a–14 under the Act, 17 CFR 240.13a–14, and Rules 10–01(d) and 2–02(c) of Regulation S–X, 17 CFR 210.10–01(d) and 210.2–02(c). In addition, the auditor must be registered with the Public Company Accounting Oversight Board. *See* section 102(a) of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 7212(a).

[13] Nasdaq also appends an ''E'' to a security's symbol when it fails to receive notice that an issuer, which files with a regulator other than the Commission, has timely filed. In the case of those issuers, the Nasdaq generally receives notice of a regulatory filing from the applicable market maker or the issuer itself, and will investigate any instance where it has not received such notice. *See* Telephone conversation between Tim Fox, Attorney, Commission, and Arnold Golub, Associate Vice President, Nasdaq on May 20, 2005.

[14] The Eligibility Rule provides a 60-day grace period to banks, savings association and insurance companies that do not file with the Commission, but are required to file with other regulators. *See* NASD Rule 6530(a)(3) and (4).

Nasdaq notes that approximately 80% of issuers achieve compliance within the applicable grace period, while 20% are removed from quotation on the OTCBB.

Nasdaq reports that it has identified a high level of non-compliance with the Eligibility Rule. Specifically, over the two-year period ended August 31, 2004, Nasdaq identified over 3,000 instances of delinquent or otherwise incomplete filings by 1,806 OTCBB issuers, of which 1,067 were still quoted as of August 31, 2004. Of the 1,806 issuers, 1,035 were late in filing one time, 548 issuers were delinquent twice and 223 were delinquent three or more times. Given the high rate of recidivism, Nasdaq has proposed to amend NASD Rule 6530(e) to make certain OTCBB securities ineligible for quotation on the OTCBB for a period of one year. Specifically, the proposed rule change would prohibit NASD members from quoting on the OTCBB the securities of OTCBB issuers that have been delinquent in their filing obligations on the number of occasions and within the time frame specified in the proposed rule, as described below. Nasdaq has proposed to implement the rule change in connection with filings for reporting periods ending on or after October 1, 2005.[15]

Under proposed NASD Rule 6530(e)(1), an NASD member would be prohibited from quoting on the OTCBB for a period of one year the securities of those OTCBB issuers that submit a required filing late or in an incomplete form three times in the prior two-year period while the security was quoted on the OTCBB.[16] Accordingly, the securities of an OTCBB issuer would become ineligible for quotation on the OTCBB on the third time in the prior two-year period that the issuer does not file in complete form a required periodic report by the due date (including, if applicable, any extensions permitted by Rule 12b–25 under the Act,[17] but without the benefit of any grace period for this third delinquency).[18] In applying the look-back associated with this provision, Nasdaq would consider reports characterized by due dates (including, if applicable, any extensions permitted by Rule 12b–25 under the Act) that fell within the prior two-year period.

Under proposed NASD Rule 6530(e)(2), an NASD member would be prohibited from quoting on the OTCBB for a period of one year the securities of those OTCBB issuers that are removed from the OTCBB due to the issuer's failure to satisfy paragraphs (a)(2), (3) or (4) of NASD Rule 6530 twice in the prior two-year period.[19] According to Nasdaq, the more stringent test for this category reflects the greater length of the filing delinquencies, *i.e.*, these issuers were unable to regain compliance even within the applicable ''grace'' period. In applying the look-back associated with this provision, Nasdaq would consider the date the security is removed, without regard to when the delinquent reports were actually due.

Under the proposed rule change, as amended, only filings for which the grace period ends while the issuer's securities are quoted on the OTCBB would be considered.[20] Once they become ineligible for quotation on the OTCBB because the conditions in NASD Rule 6530(e)(1) or (e)(2) have occurred, the securities of an OTCBB issuer would not become eligible for re-inclusion on the OTCBB until the issuer has timely filed in a complete form all required annual and quarterly reports for a period of one year. Thus, the securities of, for example, most domestic issuers would not be eligible for re-inclusion until the issuer has timely filed at least one Form 10–K and three Forms 10–Q. While a late filing during the period when an issuer is ineligible for quotation on the OTCBB would reset the ineligibility period, once an issuer that is removed for failure to satisfy NASD Rule 6530(e)(1) or (e)(2) is re-included, Nasdaq would not consider late filings due prior to the date of re-inclusion under the proposed rule.

Finally, Nasdaq has proposed to clarify its current position that the 60-day grace period applicable to banks and savings associations also applies to holding companies for such entities. Nasdaq believes that this clarification is appropriate because, like banks and savings associations, these holding companies must also file publicly available periodic reports with the appropriate state or federal regulator.

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

The Commission received one comment in response to the proposed rule change, as amended.[21] The commenter urged the Commission and the NASD to ''start properly regulating the smallcap market.'' Specifically, the commenter advocated that all public companies, regardless of size, be required to file periodic financial reports. In addition, the commenter recommended that if a reporting issuer is delinquent with respect to a required filing for 60 days, then trading in its securities should be halted in all venues until such time as it files the late report.

In its response to the comment letter,[22] Nasdaq affirmed the importance of timely filing periodic financial reports. Nasdaq explained that an NASD rule governing the OTCBB already imposes a requirement that all issuers of securities quoted on the OTCBB file periodic reports and be current in those filings with the appropriate regulator. Nasdaq does not believe, however, that halting the trading of the securities of delinquent OTCBB issuers would be appropriate, since other OTC marketplaces, including the Pink Sheets, do not require reporting issuers to be current in their filings. Nasdaq reiterated its view that the proposed rule change strikes an appropriate balance, because it is designed to increase the timeliness of disclosure available to investors and to prevent the securities of issuers who repeatedly fail to comply with their disclosure obligations from being quoted on the OTCBB, subject to an appropriate grace period for companies that only

[15] *See* Amendment No. 3, *supra* note 6. Filings for reporting periods ending before October 1, 2005, would not be considered in determining the applicability of proposed NASD Rule 6530(e).

[16] A filing would not be considered late for the purposes of this proposed rule if it is made within any applicable extensions permitted pursuant to Rule 12b–25 under the Act, 17 CFR 240.12b–25. Nasdaq also appends an ''E'' to a security's symbol when it does not receive notice that an issuer that files with a regulator other than the Commission has timely filed. Nasdaq would not consider such occurrences to be a late filing for purposes of the proposed rule if the issuer did, in fact, timely file with the appropriate regulator. Nonetheless, Nasdaq states that these issuers can help alleviate confusion by providing Nasdaq with a copy of the filing made with the appropriate regulator on or before its due date.

[17] 17 CFR 240.12b–25.

[18] Prior to such removal, Nasdaq intends to provide issuers with 7 calendar days to request review of the determination by a hearings panel. *See* File No. SR–NASD–2005–067, which proposes to clarify the availability of a process to review eligibility determinations under NASD Rule 6530.

[19] An issuer that is not removed because it files a late report after requesting a hearing pursuant to the NASD Rule 9700 Series but before a decision has been issued in the matter would not be considered to have failed to file pursuant to proposed NASD Rule 6530(e)(2), but would be considered to have filed late for purposes of proposed NASD Rule 6530(e)(1).

[20] Thus, for example, an OTCBB-quoted issuer that has no prior late filings fails to file its Form 10–K for the period ended December 31, 2005, prior to the end of the applicable grace period. The issuer is removed from the OTCBB under existing NASD Rule 6530(a)(2), and thereafter also files its Form 10–Q for the period ended March 31, 2006, after the due date. The issuer is subsequently re-included on the OTCBB. Only the late filing for the period ended December 31, 2005, would count for purposes of the proposed rule change because the issuer was not quoted on the OTCBB when the grace period for the March 31, 2006 filing expired. *See* Telephone conversation between Tim Fox, Attorney, Division of Market Regulation, Commission, and Arnold Golub, Associate Vice President, Nasdaq, on August 17, 2005.

[21] *See supra* note 8.

[22] *See supra* note 9.

occasionally experience problems in submitting complete filings in a timely manner.

The NASD also responded to the single comment letter received on the proposal.[23] In its response, the NASD noted, among other things, that it regulates trading in both the OTCBB and the Pink Sheets, and that there are, in certain instances, rules that are applicable only to trading in OTCBB securities. Further, the NASD noted that, as part of the recent transfer of direct authority over the OTCBB from Nasdaq to NASD,[24] the NASD is currently analyzing whether certain distinctions across quotation services in the OTC market are appropriate.

IV. Discussion and Commission Findings

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association and, in particular, the requirements of section 15A of the Act [25] and the rules and regulations thereunder. The Commission finds specifically that the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Act,[26] which requires, among other things, that the NASD's rules 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.[27]

Under the proposed rule change, the securities of an OTCBB issuer that submits a required periodic filing late or in an incomplete form three times during a two-year period, and the securities of an OTCBB issuer that are removed from the OTCBB as a result of the issuer's failure to file a required report with the appropriate regulatory agency two times in a two-year period, would become ineligible for continued quotation on the OTCBB by an NASD member. The issuer's securities, however, would become again eligible for quotation on the OTCBB when the issuer has timely filed, in a complete form, all required annual and quarterly reports for a one-year period.

In the Commission's view, the proposed rule change is designed to protect investors and the public interest by setting forth conditions upon which an NASD member would be precluded from quoting on the OTCBB for a period of one year the securities of those OTCBB issuers that have failed to meet their reporting obligations on the number of occasions and within the time frame specified in the proposed rule change. The Commission believes that the proposed rule change's imposition of a one-year ban from quotation on the OTCBB upon the issuer's third failure during a two-year period to file a complete required annual or quarterly report by its due date (including any extension permitted by Rule 12b–25 under the Act), or upon the second removal of the issuer's securities from the OTCBB during a two-year period, are designed to foster the timeliness of disclosure available to the public by OTCBB issuers. Once such issuer has timely filed in a complete form all required annual and quarterly reports for a one-year period, its securities would become re-eligible for quotation on the OTCBB.

The Commission believes that the proposal provides measures that are designed to exclude from its applicability those OTCBB issuers that occasionally and inadvertently fail to comply with their reporting obligations. The securities of OTCBB issuers would not be precluded from quotation on the OTCBB, unless the issuer failed to file annual or quarterly reports or filed incomplete reports three times during the prior two-year period or unless the issuer's securities were removed from the OTCBB twice in the prior two-year period due to the issuer's failure to file required reports. A required periodic filing would not be considered delinquent if the issuer files a complete Form 12b–25 with the Commission and submits the report within the applicable time frame specified in Rule 12b–25 under the Act.

With respect to the procedural rights of OTCBB issuers adversely affected by the operation of the proposed rule change, the Commission notes that OTCBB issuers retain the right to initiate the hearing process under NASD Rule 9700 Series, through which an issuer could request a review of an ineligibility determination made pursuant to NASD Rule 6530. Moreover, Nasdaq has represented that it would provide OTCBB issuers that file late or are otherwise delinquent a third time in a two-year period with seven calendar days' notice prior to removal of the issuer's securities from the OTCBB in order to allow the issuer to request a review of the determination by a hearings panel under the NASD Rule 9700 Series. In addition, Nasdaq has represented that, upon implementation, it plans to provide an OTCBB issuer notification whenever Nasdaq determines that the issuer is late in a periodic filing, along with an explanation of the consequences of the OTCBB issuer's delinquent status.[28]

Finally, NASD staff has advised of plans to identify on the OTCBB Web site, *http://www.otcbb.com,* those OTCBB issuers that are subject to removal from quotation on the OTCBB for a one-year period if the issuer fails to satisfy the requirements of NASD Rule 6530(e)(1) or (e)(2). In the event that an issuer's securities are to be removed from the OTCBB because the security has become ineligible for quotation pursuant to NASD Rule 6530(e), the NASD staff has advised of plans to indicate the date on which the issuer's securities no longer will be eligible for quotation on the OTCBB.[29] In the Commission's view, this information will help broker-dealers and investors to ascertain those securities that are at risk of being removed from the OTCBB for a one-year period, if the issuer fails to keep current in its reporting obligations.

V. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,[30] that the proposed rule change (SR–NASD–2005–011), as amended, be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[31]

Jonathan G. Katz,

Secretary.

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[23] *See supra* note 10.

[24] *See supra* note 3.

[25] 15 U.S.C. 78*o*–3.

[26] 15 U.S.C. 78*o*–3(b)(6).

[27] 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).

[28] Telephone conversation between Arnold Golub, Associate Vice President, Nasdaq and Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, and Tim Fox, Special Counsel, Division of Market Regulation, Commission on November 15, 2005.

[29] Telephone conversation among Arnold Golub, Associate Vice President, Nasdaq, Andrea Orr, Assistant General Counsel, NASD, Nancy Sanow, Assistant Director, Division of Market Regulation, Commission and Tim Fox, Special Counsel, Division of Market Regulation, Commission on November 16, 2005.

[30] 15 U.S.C. 78s(b)(2).

[31] 17 CFR 200.30–3(a)(12).