



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

July 28, 2006

T. Grant Callery
Executive Vice President and General Counsel
National Association of Securities Dealers, Inc.
1735K Street, NW
Washington, D.C. 20006-1506

Re: Limited Exemption from Rule 602 of Regulation NMS

Dear Mr. Callery:

On January 13, 2006, the Commission approved The Nasdaq Stock Market LLC's ("Nasdaq's") application to register as a national securities exchange.¹ In anticipation of Nasdaq commencing operation as an exchange, the Division has received inquiries regarding the application of certain provisions of Rule 602 of Regulation NMS (the "Quote Rule") under the Securities Exchange Act of 1934 ("Exchange Act").²

Under the Quote Rule, the National Association of Securities Dealers, Inc. ("NASD") must collect the best bid, best offer, and quotation sizes communicated otherwise than on an exchange by each NASD member acting in the capacity of an OTC market maker³ for:

- (1) Any exchange-traded security for which such member acts in the capacity of an OTC market maker, unless the executed volume of such member, during the most recent calendar quarter, comprised one percent or less of the aggregate trading volume for such security;⁴ and

¹ See Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006).

² 17 CFR 242.602.

³ "OTC market maker" means any dealer that holds itself out as being willing to buy from and sell to its customers, or others, in the United States, an NMS stock for its own account on a regular or continuous basis otherwise than on a national securities exchange in amounts of less than block size. 17 CFR 242.600(b)(52).

⁴ 17 CFR 242.602(a)(1)(ii); 17 CFR 242.600(b)(73)(ii)(A). Once Nasdaq begins operation as a national securities exchange, a security listed and registered on Nasdaq will be an "exchange-traded security." 17 CFR 242.600(b)(25).

- (2) Any other NMS security for which such member acts in the capacity of an OTC market maker and has in effect an election, pursuant to the Quote Rule, to communicate quotations to its association.⁵

The NASD must also collect the identity of the quoting member and then make all this information available to vendors at all times that last sale information is reported pursuant to an effective transaction reporting plan.⁶

To enable the NASD to fulfill this obligation, the Quote Rule also requires each of its members communicating bids and offers in a subject security to a broker-dealer or a customer, to promptly communicate its best bids, best offers, and quotation sizes to the NASD.⁷ Currently, an NASD member may comply with this obligation by communicating its best bids, best offers, and quotation sizes to Nasdaq, which today is a facility of the NASD.⁸

Once Nasdaq begins operations as a national securities exchange, the Quote Rule will require Nasdaq to collect the best bid, best offer, and aggregate quotation sizes communicated on the exchange by its members. Nasdaq will be required to make this information available to vendors at all times the exchange is open for trading. The Commission does not believe that transparency would be enhanced, or the goals of the national market system furthered, by the NASD and Nasdaq both collecting and disseminating the best quotations of a broker-dealer who is a member of both self-regulatory organizations ("SROs"). Accordingly, the Commission is exempting the NASD from the obligation under the Quote Rule to collect, process, and disseminate the best quotations of a member acting in the capacity of an OTC market maker if such OTC market maker promptly communicates such quotations to Nasdaq or another national securities exchange that operates an "automated trading center" disseminating "automated quotations," as defined in Rule 600(b)(3) and (4) of Regulation NMS.

The NASD's obligation under the Quote Rule is to disseminate to vendors the best quotation of *each* member acting in the capacity of an OTC market maker. An exchange on the other hand only needs to provide the best prices among all its members and the aggregate size at that price. The Commission continues to believe that information below the best available price furthers the goals of the national market system. Accordingly, the NASD's exemption is conditioned on the exchange to which an OTC market maker communicates its best quotations disseminating to vendors all such OTC market makers' best bids, best offers, and quotation sizes,

⁵ 17 CFR 242.602(a)(1)(ii); 17 CFR 242.600(b)(73)(ii)(B).

⁶ 17 CFR 242.602(a)(1)(ii). This obligation does not apply during any period when over-the-counter trading in the security has been suspended.

⁷ 17 CFR 242.602(b)(1); 600(b)(65) (definition of Responsible broker or dealer).

⁸ OTC market makers in Nasdaq securities may also comply with this obligation by communicating their quotes to the NASD's Alternative Display Facility.

even if they are not the exchange's best bid and offer.⁹ The Commission does not, however, believe it is necessary for such exchange to disseminate the identities of the OTC market makers.

The Commission is also exempting any OTC market maker that communicates its best bids, best offers, and quotation sizes in an exchange-traded security to a national securities exchange that operates an "automated trading center" disseminating "automated quotations," as defined in Rule 600(b)(3) and (4) of Regulation NMS, from the requirement to communicate the same bids and offers to the NASD, provided that the national securities exchange to which the OTC market maker communicates its quotations disseminates to vendors quotation information that includes at least the bids, offers, and aggregate quotation sizes of all such OTC market makers. The Commission believes that the goals of the national market system and, in particular, the availability to brokers, dealers, and investors of quotation information are satisfied by an OTC market maker who is a member of both the NASD and a national securities exchange communicating its best prices and sizes to one SRO.¹⁰

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For the reasons discussed above, pursuant to paragraph (d) of the Quote Rule, the Commission grants each OTC market maker an exemption from its obligation under Exchange Act Rule 602(b)(1) to communicate to a national securities association its best bids, best offers, and quotation sizes in exchange traded securities, provided that such OTC market maker promptly communicates such quotation information to a national securities exchange that: (1) operates an "automated trading center" disseminating "automated quotations," as defined in Rule 600(b)(3) and (4) of Regulation NMS; and (2) makes available to vendors the best bids, best offers, and quotation sizes communicated to it by any OTC market maker.

In addition, the Commission grants the NASD an exemption from its obligation under Exchange Act Rule 602(a)(1) to collect, process, and make available to vendors the best bid, best offer, and quotation sizes communicated otherwise than on an exchange by a member of such association acting in the capacity of an OTC market maker for a subject security and the identity of that member, provided that the same best bids, best offers, and quotation sizes of such OTC market maker are collected, processed, and made available by a national securities exchange that operates an "automated trading center" disseminating "automated quotations," as defined in Rule 600(b)(3) and (4) of Regulation NMS.

⁹ The Commission notes that an exchange could fulfill this condition by distributing its depth-of-book information.

¹⁰ This exemption would not relieve either an OTC market maker or the NASD of any obligation under the Quote Rule, if such an OTC market maker communicates a price otherwise than on an exchange that is better than the price it has communicated to a national securities exchange.

The Commission has determined that it is consistent with the public interest, the protection of investors and the removal of impediments to and perfection of the mechanism of a national market system to provide the exemption to OTC market makers and the NASD, as described above.

For the Commission, by the Division of Market
Regulation, pursuant to delegated authority,¹¹



Robert L.D. Colby
Acting Director

¹¹ 17 CFR 200.30-3(a)(28).