

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52549; File No. SR-NASD-2005-115)

October 3, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend NASD Rule 11890

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 September 22, 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”) the proposed rule change as described in Items I and II below, which Items have been prepared by Nasdaq. Nasdaq filed the proposal as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act,<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

Nasdaq proposes to clarify the scope of a recent amendment to NASD Rule 11890. Nasdaq proposes to implement the proposed rule change on September 26, 2005. Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in [brackets].<sup>5</sup>

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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> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> The proposed rule change is marked to show changes from the rule as it appears in the electronic NASD Manual available at [www.nasd.com](http://www.nasd.com).

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11890. Clearly Erroneous Transactions

(a) Authority to Review Transactions Pursuant to Complaint of Market Participant

(1) No change.

(2) Procedures for Reviewing Transactions

(A) – (B) No change.

(C) Following the expiration of the period for submission of supporting material, a Nasdaq officer shall determine whether the complaint is eligible for review. A complaint shall not be eligible for review under paragraph (a) unless:

(i) the complainant has provided all of the supporting information required under paragraph (a)(2)(B), and

(ii) For trades executed between 9:30 a.m. and 4:00 p.m. Eastern Time, [T]the price of transaction to buy (sell) that is the subject of the complaint is greater than (less than) the best offer (best bid) by an amount that equals or exceeds the minimum threshold set forth below:

Inside Price	Minimum Threshold
\$0 - \$0.99	$\$0.02 + (0.10 \times \text{Inside Price})$
\$1.00 - \$4.99	$\$0.12 + (0.07 \times (\text{Inside Price} - \$1.00))$
\$5.00 - \$14.99	$\$0.40 + (0.06 \times (\text{Inside Price} - \$5.00))$
\$15 or more	\$1.00

For a transaction to buy (sell) a Nasdaq listed security, the inside price shall be the best offer (best bid) in Nasdaq at the time that the first share of the order that resulted in the disputed transaction was executed, and for a

transaction to buy (sell) an exchange-listed security, the inside price shall be the national best offer (best bid) at the time that the first share of the order that resulted in the disputed transaction was executed.

(D) – (G) No change.

(b) – (d) No change.

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II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq included statements concerning the purpose of and 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. Nasdaq 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

1. Purpose

NASD Rule 11890(a) allows designated officers of Nasdaq to declare transactions that arise out of the use or operation of Nasdaq execution or communications systems to be clearly erroneous and to nullify or modify the terms of such transactions. In SR-NASD-2004-009,<sup>6</sup> Nasdaq established a minimum price deviation threshold to provide a “bright line” rule standard for determining when transactions are considered eligible for review. A transaction price that meets these thresholds does not automatically trigger a clearly erroneous determination, but if the transaction price does not meet these thresholds the transaction will not be considered for clearly

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<sup>6</sup> Securities Exchange Act Release No. 52141 (July 27, 2005), 70 FR 44709 (August 3, 2005) (SR-NASD-2004-009).

erroneous review. Thus, there is now a conclusive presumption that a transaction to buy (sell) is not clearly erroneous unless its price is greater than (less than) the best offer (best bid) by an amount that equals or exceeds the minimum threshold set forth below:

<b><u>Inside Price</u></b>	<b><u>Minimum Threshold</u></b>
\$0 - \$0.99	$\$0.02 + (0.10 \times \text{Inside Price})$
\$1.00 - \$4.99	$\$0.12 + (0.07 \times (\text{Inside Price} - \$1.00))$
\$5.00 - \$14.99	$\$0.40 + (0.06 \times (\text{Inside Price} - \$5.00))$
\$15 or more	\$1.00

Nasdaq proposes an amendment to NASD Rule 11890 to clarify that the minimum price deviation thresholds are applicable only to transactions executed during regular market hours, i.e., between 9:30 a.m. and 4:00 p.m. According to Nasdaq, this amendment reflects the fact that the analysis conducted by Nasdaq to determine the appropriate levels for the thresholds was based on pricing during normal market hours, and that therefore application of the thresholds during other trading sessions is not consistent with the intent underlying the rule. Nasdaq believes that, during pre-market and post-market trading sessions, the inside price of many stocks may not fully reflect trading interest in the stock, since the range of market participants in these trading sessions is far more limited than during regular market hours. As a result, a trade that occurs at a price that deviates significantly from a stock's trading range during the most recent regular market session may nevertheless be sufficiently close to the pre-market or post-market inside price that it would not meet the minimum deviation threshold for the stock. Because the thresholds established by Nasdaq were based on analysis of trading patterns during regular market hours, Nasdaq believes that the rule should be clarified by limiting the thresholds' application to such hours. Nasdaq believes the change would result in a larger number of

transactions being eligible for review under NASD Rule 11890, since transactions occurring during pre-market and post-market sessions would always be eligible for adjudication under the rule unless the market participant seeking an adjudication failed to provide the information required under NASD Rule 11890(a)(2)(B) (i.e., the approximate time of transaction(s), security symbol, number of shares, price(s), contra broker(s) if the transactions are not anonymous, Nasdaq system used to execute the transactions, and the reason the review is being sought).

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,<sup>7</sup> in general and with Section 15A(b)(6) of the Act,<sup>8</sup> in particular, in that the proposal is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Nasdaq believes that the proposed rule change would ensure that NASD Rule 11890's minimum price deviation thresholds do not bar adjudication of clearly erroneous petitions in circumstances where the wider spreads prevailing in pre-market and post-market trading may make the application of such thresholds excessively restrictive.

### B. Self-Regulatory Organization's Statement on Burden on Competition

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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<sup>7</sup> 15 U.S.C. 78q-3.

<sup>8</sup> 15 U.S.C. 78q-3(b)(6).

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing proposed rule change is subject to Section 19(b)(3)(A)(iii) of the Act<sup>9</sup> and Rule 19b-4(f)(6) thereunder<sup>10</sup> because the proposal: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative prior to 30 days after the date of filing or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that the self-regulatory organization has given the Commission notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

Nasdaq has requested that the Commission waive the 30-day operative delay. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because such waiver would make immediately eligible for adjudication clearly erroneous petitions in circumstances where the wider spreads prevailing in pre-market and post-market trading otherwise may make the application of NASD Rule 11890's minimum price deviation thresholds overly restrictive. For these reasons, the Commission designates the proposal to be effective upon filing with the Commission.<sup>11</sup>

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<sup>9</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>10</sup> 17 CFR 240.19b-4(f)(6).

<sup>11</sup> For purposes only of waiving the operative delay for this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.<sup>12</sup>

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is 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-2005-115 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-2005-115. 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

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<sup>12</sup> See Section 19(b)(3)(C) of the Act, 15 U.S.C. 78s(b)(3)(C).

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 NASD. 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-2005-115 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

Jonathan G. Katz  
Secretary

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<sup>13</sup> 17 CFR 200.30-3(a)(12).