

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-53024; File No. SR-NASD-2005-095)

December 27, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 2 Thereto Relating to Sub-Penny Restrictions for Non-Nasdaq Over-the-Counter Equity Securities

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 July 28, 2005, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. On August 16, 2005, NASD filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The proposed rule change, as amended, was published for comment in the Federal Register on August 25, 2005.<sup>4</sup> On December 22, 2005, NASD filed Amendment No. 2 to the proposed rule change.<sup>5</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

NASD is proposing to amend NASD Rule 6750 to impose restrictions on the display of quotes and orders in sub-penny increments for non-Nasdaq OTC equity securities.

Below is the text of the proposed rule change. Proposed new language is underlined; 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> In Amendment No. 1, the NASD made certain technical changes to the rule text.

<sup>4</sup> Securities Exchange Act Release No. 52280 (August 17, 2005), 70 FR 49959.

<sup>5</sup> In Amendment No. 2, the NASD altered the proposed rule text in response to a commenter, and made a technical change to the rule text.

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**6540. Requirements Applicable to Market Makers**

(a) No change.

(b) No change.

[(c) A participating ATS or ECN shall reflect non-subscriber access or post-transaction fees in the ATS's or ECN's posted quote in the OTC Bulletin Board montage.]

[(d)](c) OTCBB-eligible securities that meet the frequency-of-quotation requirement for the so called "piggyback" exception in SEC Rule 15c2-11(f)(3)(i) are identified in the Service as "active" securities. A member can commence market making in any active security by registering as a market maker through a Nasdaq Workstation at the firm. In all other instances, a member must follow the procedure contained in this Rule to become qualified as a market maker in a particular OTCBB-eligible security.<sup>1</sup>

**(1) Permissible Quotation Entries**

(A) No change.

(B) No change.

(C) No change.

(D) No change.

(E) The written notice required by subparagraphs [(d)](c)(1)(D)(i), (iii) and (iv) of this Rule may be submitted on the Underwriting Activity Report provided by the Market Regulation Department.

(F) For purposes of subparagraph [(d)](c)(1)(D), SEC Rules 100, 101, 103 and 104 are rules of the Commission adopted under Regulation M and the following terms shall have the meanings as defined in SEC Rule 100: "affiliated purchaser,"

"distribution," "distribution participant," "penalty bid," "reference security," "restricted period," "stabilizing," "subject security," and "syndicate covering transaction."

(2) No change.

(3) No change.

(4) No change.

(5) No change.

**[(e)](d) Compliance with Market Maker Requirements**

Failure of a member or a person associated with a member to comply with this Rule may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Rule 2110.

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<sup>1</sup> No change to footnote.

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**6750. [Minimum] Quotation [Size] Requirements for OTC Equity Securities**

(a) No change.

(b) No member shall display, rank, or accept a bid or offer, an order, or an indication of interest in any OTC Equity Security priced in an increment smaller than \$0.01 if that bid or offer, order or indication of interest is priced equal to or greater than \$1.00 per share.

(c) No member shall display, rank, or accept a bid or offer, an order, or an indication of interest in any OTC Equity Security priced in an increment smaller than \$0.0001 if that bid or offer, order or indication of interest is priced equal to or greater than \$0.01 per share and less than \$1.00 per share.

[(b)](d) 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 <sup>SM</sup>.

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\* The OTCBB can accept bids/offers expressed in fractions as small as ½ or in decimals up to four[six] places. In applying the price test for minimum quotation size, any increment beyond an upper limit in the right hand column will trigger application of the minimum quote size for the next tier. For example, a bid (or offer) of \$.505 must be firm for a size of 2,500 shares.

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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, NASD 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. 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

1. Purpose

Based on comments received in response to the publication of the proposed rule change and Amendment No. 1 thereto, NASD is filing this Amendment No. 2 to SR-NASD-2005-095 to respond to the comments received and to make a technical change as described herein.

## Proposal

As described in the original filing and Amendment No. 1, NASD is proposing amendments to NASD Rule 6750 that would prohibit members from displaying, ranking, or accepting a bid or offer, an order, or an indication of interest in any non-Nasdaq OTC equity securities in any quotation medium priced in an increment smaller than \$0.01 if such bid or offer, order, or indication of interest is priced equal to or greater than \$1.00 per share. In addition, members also would be prohibited from displaying, ranking, or accepting a bid, offer, an order, or an indication of interest in any non-Nasdaq OTC Equity Security priced in an increment smaller than \$0.0001 if such bid or offer, order, or indication of interest is priced equal to or greater than \$0.01 per share and less than \$1.00 per share.

## Comments to the Proposed Rule Change

The Commission received two comment letters in response to the publication of the proposed rule change.<sup>6</sup> The first commenter supports the proposal, but states the proposed sub-penny requirements conflict with Rule 6540(c), which requires alternative trading systems (“ATSs”) and electronic communications networks (“ECNs”) to reflect non-subscriber access or post-transaction fees in their posted quote in the over-the-counter Bulletin Board (“OTCBB”) montage. Specifically, the commenter states that, because ATS access fees generally are in sub-penny amounts, ATSs would not be able to reflect those access fees in their quotes if sub-penny quoting were prohibited. In addition, the commenter contends that there is no legitimate policy

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<sup>6</sup> See Letter to Jonathan G. Katz, Secretary, Commission, from Phylis M. Esposito, Executive Vice President, Chief Strategy Officer, Ameritrade, Inc., dated October 31, 2005; Letter to Jonathan G. Katz, Secretary, Commission, from Kevin J.P. O’Hara, Chief Administrative Officer and General Counsel, Archipelago Trading Services, Inc., dated September 23, 2005.

rationale for keeping Rule 6540(c) for the OTCBB, particularly in light of the Commission's recent adoption of Regulation NMS, which permits ECNs and ATS to charge access fees in national market system securities.

NASD agrees with the commenter that, absent eliminating the access fee display requirement Rule 6540(c), it would conflict with the proposed amendments to Rule 6750. Accordingly, NASD is proposing to delete the text of Rule 6540(c).

The second commenter also supports the proposal, but argues that further rulemaking related to the OTC market is required. Specifically, the commenter suggests that NASD impose limit order display requirements for OTC equity securities, together with or prior to the implementation of this proposal. The commenter indicates that, unlike Rule 612 under Regulation NMS,<sup>7</sup> which was preceded by the Commission's Order Handling Rules, including the Limit Order Display Rule,<sup>8</sup> no similar requirements currently exist in the OTC market.

Because the changes recommended by the commenter are outside the scope of the proposed changes that are part of this rule filing, NASD is not responding to these recommendations specifically herein. NASD will review and analyze these recommendations 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 these recommendations is appropriate.

#### Technical Change

NASD also is proposing to make a technical change to the footnote in Rule 6750 relating to OTCBB system technology. Specifically, the footnote in Rule 6750 provides, among other

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<sup>7</sup> 17 CFR 242.612.

<sup>8</sup> 17 CFR 242.604.

things, that the OTCBB can accept bids/offers expressed in decimals up to six decimal places. The footnote text does not reflect the current OTCBB technology. Therefore, NASD is proposing to amend the text of the footnote in Rule 6750 to reflect that the OTCBB can accept bids/offers expressed in decimals up to four decimal places.

2. Statutory Basis

NASD believes that the proposed rule change, as amended, is consistent with the provisions of Section 15A of the Act,<sup>9</sup> in general, and with Section 15A(b)(6) of the Act,<sup>10</sup> in particular, in that it is 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. NASD believes that the proposed rule change would reduce the potential harms associated with sub-penny quoting in non-Nasdaq OTC equity securities.

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

NASD does not believe that the proposed rule change, as amended, would 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>9</sup> 15 U.S.C. 78o-3.

<sup>10</sup> 15 U.S.C. 78o-3(b)(6).

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 and Amendment No. 1 thereto were solicited by the Commission in response to the publication of the proposed rule change and Amendment No. 1 thereto. The Commission received two comment letters.<sup>11</sup> The comments are summarized above.

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 self-regulatory organization 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.

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<sup>11</sup> See supra note 6.



#### 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-2005-095 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-2001.

All submissions should refer to File Number SR-NASD-2005-095. 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, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of 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 the File Number SR-NASD-2005-095 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>12</sup>

Nancy M. Morris  
Secretary

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