

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53920; File No. SR-NASD-2006-039)

June 1, 2006

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto to Amend NASD Rules to Modify and Expand NASD's Authority to Initiate Trading and Quotation Halts in OTC Equity Securities

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 22, 2006, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. On May 23, 2006, NASD filed with the Commission Amendment No. 1 to the proposed rule change.³ 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 (1) amend NASD rules to modify and expand NASD's authority to initiate trading and quotation halts in over-the-counter ("OTC") equity securities;⁴ and (2) adopt IM-6660-1 to identify certain factors that NASD may consider in determining, in its discretion, whether imposing a trading and quotation halt in an OTC equity security is appropriate. Below is the text of the proposed rule change, as amended. Proposed new language is in italics; proposed deletions are in brackets.⁵

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaced and superseded the original rule filing in its entirety.

⁴ See NASD Rule 6610.

⁵ The proposed rule text incorporates certain technical corrections that NASD will incorporate into

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[6545]6660. Trading and Quotation Halt in OTC[BB-Eligible] Equity Securities

(a) Authority for Initiating a Trading and Quotation Halt

In circumstances in which it is necessary to protect investors and the public interest, NASD may direct members, pursuant to the procedures set forth in paragraph (b), to halt trading and quotations in OTC Equity Securities (as such term is defined in Rule 6610)[the over-the-counter (“OTC”) market of a security or an American Depository Receipt (“ADR”), that is included in the OTC Bulletin Board (“OTCBB”)] if:

(1) the OTC[BB] Equity S[s]ecurity or the security underlying an American Depository Receipt (“ADR”) that is an OTC Equity Security (“OTC ADR”)[the OTCBB ADR] is listed on or registered with a foreign securities exchange or market, and the foreign securities exchange, market, or regulatory authority overseeing such issuer, exchange, or market, halts trading in such security for regulatory reasons because of public interest concerns (“Foreign Regulatory Halt”); provided, however, that NASD will not impose a trading and quotation halt if the Foreign Regulatory Halt was imposed solely for material news, a regulatory filing deficiency, or operational reasons; [or]

(2) the OTC[BB] Equity S[s]ecurity or the security underlying [the]an OTC[BB] ADR is a derivative or component of a security listed on or registered with a national securities exchange, The Nasdaq Stock Market, or foreign securities exchange or market (“listed security”) and the national securities exchange, The Nasdaq Stock Market, or foreign securities exchange or market, imposes a trading halt in the listed security[.]; or

an amendment that it will file with the Commission before approval of the proposed rule change. Telephone conversation between Kosha Dalal, Associate General Counsel, NASD and Tim Fox, Special Counsel, Commission on June 1, 2006.

(3) NASD determines that an extraordinary event has occurred or is ongoing that has had a material effect on the market for the OTC Equity Security or has caused or has the potential to cause major disruption to the marketplace and/or significant uncertainty in the settlement and clearance process. [the issuer of the OTCBB security or the security underlying the OTCBB ADR fails to comply with the requirements of SEC Rule 10b-17 regarding Untimely Announcements of Record Dates.]

(b) Procedure for Initiating a Trading and Quotation Halt

(1) When a halt is initiated under subparagraph (a)(1) of this rule, upon receipt of information from a foreign securities exchange or market on which the OTC[BB] Equity S[s]ecurity or the security underlying the OTC[BB] ADR is listed or registered, or from a regulatory authority overseeing such issuer, exchange, or market, NASD will promptly evaluate the information and determine whether a trading and quotation halt in the OTC[BB] Equity S[s]ecurity is appropriate.

(2) Should NASD determine that a basis exists under this rule for initiating a trading and quotation halt, the commencement of the trading and quotation halt will be effective simultaneous with the issuance of appropriate public notice.

(3) Trading and quotations in the OTC market may resume when NASD determines that the basis for the halt no longer exists, or when [five] ten business days have elapsed from the date NASD initiated the trading and quotation halt in the security, whichever occurs first. NASD shall disseminate appropriate public notice that the trading and quotation halt is no longer in effect.

(c) Violation of OTC[BB] Trading and Quotation Halt Rule

If a security is subject to a trading and quotation halt initiated pursuant to this rule, it shall be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110 for a member:

(1) to effect, directly or indirectly, a trade in such security; or

(2) to publish a quotation, a priced bid and/or offer, an unpriced indication of interest (including “bid wanted” and “offer wanted” indications), or a bid or offer accompanied by a modifier to reflect unsolicited customer interest, in any quotation medium. For purposes of this rule, “quotation medium” shall mean any: system of general circulation to brokers or dealers that regularly disseminates quotations of identified brokers or dealers; or publication, alternative trading system or other device that is used by brokers or dealers to disseminate quotations to others.

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IM-6660-1 Factors to be Considered When Initiating a Trading and Quotation

Halt

NASD may impose a trading and quotation halt in an OTC Equity Security pursuant to Rule 6660(a)(3) where NASD determines, in its discretion, based on the facts and circumstances of the particular event, that halting trading in the security is the appropriate mechanism to protect investors and ensure a fair and orderly marketplace. As a general matter, NASD does not favor imposing a trading and quotation halt in an OTC Equity Security and will exercise this authority in very limited circumstances. In determining whether to impose a trading halt under Rule 6660(a)(3), NASD will consider several factors in making its determination, including but not limited to: (1) the material nature of the event; (2) the material facts surrounding the event are

undisputed and not in conflict; (3) the event has caused widespread confusion in the trading of the security; (4) there has been a material negative effect on the market for the subject security; (5) the potential exists for a major disruption to the marketplace; (6) there is significant uncertainty in the settlement and clearance process for the security; and/or (7) such other factors as NASD deems relevant in making its determination. NASD may review all or some of these factors as it determines appropriate.

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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, as amended, 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

Effective October 1, 2005, NASD transferred ownership and operations of the OTC Bulletin Board (“OTCBB”) from The Nasdaq Stock Market, Inc. (“Nasdaq”) to NASD. Prompted in part by the transition of the OTCBB, NASD has been analyzing the regulatory framework in this sector of the marketplace to determine whether changes in this area are appropriate.⁶ As part of this ongoing effort, NASD is proposing several changes related to its

⁶ See, e.g., Securities Exchange Act Release No. 53224 (February 3, 2006), 71 FR 7101 (February 10, 2006) (SR-NASD-2005-112) (approving amendments to NASD Rule 3360 to expand the short interest reporting requirements to OTC equity securities).

current authority under NASD Rule 6545 to halt trading and quotations in the OTC market of a security or American Depository Receipt (“ADR”) that is included in the OTCBB.

Generally, national securities exchanges, such as the New York Stock Exchange LLC (“NYSE”) as well as Nasdaq, have the authority to halt trading and quotations in a security listed on such exchange.⁷ Issuers that have securities listed on a national securities exchange enter into a listing agreement with such exchange that provides, among other things, that such issuer will give timely notice of material news affecting the security or issuer. Such exchanges generally have the authority to halt trading and quotations in a security to allow a company to announce important news or where there is a significant order imbalance between buyers and sellers in a security.

NASD, however, does not have a listing agreement or similar relationship with issuers of OTC Equity Securities⁸ and cannot compel such issuers to disclose material information. As a result, NASD currently has limited trade halt authority with respect to these securities.

Specifically, NASD Rule 6545(a) currently provides NASD with authority to halt trading and quotations of OTCBB securities only where: (1) the OTCBB security (or security underlying an OTCBB ADR) is listed on or registered with a foreign market and the foreign regulatory authority or market halts trading in the security; (2) the OTCBB security (or the security underlying the OTCBB ADR) is a derivative or component of a security listed on or registered

⁷ See, e.g., NYSE Rule 80B (Circuit Breakers); Section 202.06 of the NYSE Listed Company Manual (Procedure for Public Release of Information); and NASD Rule 4120 (Trading Halts).

⁸ The term “OTC Equity Security” as used in proposed NASD Rule 6660 is defined in NASD Rule 6610(d), as may be amended from time to time. NASD Rule 6610(d) provides that the term means any equity security not classified as a “designated security,” for purposes of the NASD Rule 4630 and 4640 Series. This term also includes certain exchange-listed securities that do not otherwise qualify for real-time trade reporting because they are not “eligible securities” as defined in NASD Rule 6410(d). The term “OTC Equity Security” does not include “restricted securities,” as defined by Rule 144(a)(3) under the Securities Act of 1933, nor any securities designated in the PORTAL Market under the NASD Rule 5300 Series.

with Nasdaq, a national securities exchange or foreign exchange and the exchange or market halts trading in the underlying security; or (3) the OTCBB issuer fails to comply with the requirements of Rule 10b-17 under the Act,⁹ which generally requires the issuer of a class of securities that are publicly traded to give notice to NASD no later than 10 days prior to the record date of a dividend or distribution. Pursuant to NASD Rule 6545, NASD has authority to halt trading and quotations of OTCBB-eligible securities for up to five business days.

NASD is proposing four amendments to expand its current authority to halt trading and quotations:

First, NASD is proposing to expand the scope of its current trade halt authority to include authority to halt trading and quotations in all OTC Equity Securities, which includes ADRs that trade in the OTC market. NASD's existing trading halt authority is limited to OTCBB securities and therefore NASD does not have authority to impose trading or quotation halts in other OTC Equity Securities (e.g., securities quoted exclusively on the Pink Sheets). NASD believes that its trading and quotation halt authority should apply uniformly to all OTC Equity Securities and is therefore proposing to expand NASD's existing trading halt authority to all OTC Equity Securities.¹⁰ NASD believes that eliminating this disparity will further investor protections in this area of the securities market.

Second, NASD is proposing to modify and expand NASD's existing trading halt authority to provide more general trading and quotation halt authority beyond halts related to non-compliance with Rule 10b-17, while limiting such authority to only those extraordinary events that have a material effect on the market for the OTC Equity Security and that have the

⁹ 17 CFR 240.10b-17.

¹⁰ In addition, because the current NASD Rule 6500 Series relates solely to OTCBB securities, NASD is proposing to renumber the amended NASD Rule 6545 as NASD Rule 6660, which would be part of the NASD Rule 6600 Series (OTC Equity Securities).

potential to cause major disruption to the marketplace and/or cause significant uncertainty in the settlement and clearance process. Specifically, the proposed trading and quotation halt authority would provide NASD with the ability to impose a trading and quotation halt for material events, where NASD determines, in its discretion, based on the facts and circumstances of the particular event, that halting trading in the security is the appropriate mechanism to protect investors and ensure a fair and orderly marketplace.

Third, NASD is proposing to increase the maximum number of business days that it can impose a trading and quotation halt from up to five business days to ten business days. NASD believes that a period of up to ten business days is consistent with the maximum duration that the Commission is permitted to suspend trading in securities in accordance with Section 12(k) of the Act.¹¹ NASD believes increasing the maximum number of days from five to ten business days will allow more time for regulators to act and for the market of the subject security to stabilize.

Fourth, NASD is proposing to adopt IM-6660-1 to identify certain factors that NASD may consider in determining, in its discretion, whether halting trading in an OTC Equity Security under proposed NASD Rule 6660(a)(3) is appropriate. Proposed IM-6660-1 provides that as a general matter, NASD would not favor imposing a trading halt and thus would exercise this authority in very limited circumstances. It identifies factors that NASD would consider in determining whether to impose a trading halt under this expanded authority. Specifically, IM-6660-1 provides that NASD would consider several factors in making its determination, including but not limited to: (1) the material nature of the event; (2) whether the material facts surrounding the event are undisputed and not in conflict; (3) whether the event has caused widespread confusion in the trading of the security; (4) whether there has been a material

¹¹ 15 U.S.C. 781(k).

negative effect on the market for the subject security; (5) whether the potential exists for a major disruption to the marketplace; (6) whether there is significant uncertainty in the settlement and clearance process for the security; and/or (7) such other factors as NASD deems relevant in making its determination. NASD may review all or some of these factors as it determines appropriate. NASD staff would weigh the relevant information and make a determination whether halting trading in the security is appropriate and may consult with NASD's Uniform Practice Code ("UPC") Committee (or any successor thereto) as it deems necessary or appropriate.¹²

NASD is proposing to expand its trading and quotation halt authority in the OTC market at this time in large part due to several recent events, for which NASD believes that having this type of authority would have been beneficial to investors and the marketplace. For example, in 2005, an issuer announced that 3 million shares of its common stock, an OTC Equity Security, were issued improperly prior to the impending payment of a 3 million for 1 share dividend (i.e., a forward split) in the security. As a result, significant questions arose regarding the accuracy of publicly disseminated information concerning the issuer, including the total shares outstanding, the availability of non-restricted shares for trading and delivery, the issuer's shareholders, and rights with respect to shares of the issuer. The impact of this event was far-reaching, including

¹² The UPC Committee is a standing committee of NASD, currently consisting of six professionals in the securities industry. The UPC Committee has authority to advise NASD on issues of interest and concern to the securities industry, including specifically interpretations with respect to the UPC. NASD staff may present matters relating to possible trading halts to the UPC Committee from time to time. However, the role of the UPC Committee in this regard is advisory only. NASD staff will retain full power and authority to make all determinations under proposed NASD Rule 6660 and IM-6660-1.

widespread investor confusion and the potential for several large clearing firms to be forced to recognize substantial net capital charges on their short positions and open fails.¹³

Based on NASD's experience to date, each event presents a unique set of facts and circumstances. As a result, NASD would exercise significant discretion in determining whether a particular event affecting a security warranted a trading and quotation halt. The authority would not be used to correct informational imbalances resulting from corporate news about the issuer (e.g., financial results, release of new product, or pending regulatory investigation) because NASD has no listing or other agreement with the issuer of an OTC Equity Security and therefore cannot compel such issuers to disclose material information.

It is important to note that for OTC Equity Securities, quoting may not automatically resume when a trading halt ends. Rule 15c2-11 under the Act¹⁴ and NASD Rule 6740 require a broker-dealer to review information about the issuer and have a reasonable basis under the circumstances to believe that the information on the issuer is accurate in all material respects and the sources of such information are reliable unless an exception to Rule 15c2-11 is available. If a trading or quotation halt is in effect for more than four consecutive business days, the "piggyback" exception of Rule 15c2-11(f)(3)¹⁵ would not be available. As a result, broker-dealers would be required to comply with the requirements of Rule 15c2-11 and NASD Rule 6740 before resuming publication of quotations for the subject security.

NASD believes that the proposed amendments will further the goal of investor protection in this sector of the marketplace and enhance the quality of the OTC market. NASD will

¹³ See SEC Order of Suspension of Trading, In the Matter of Gluv Corporation (File No. 500-1; May 27, 2005). See also NASD Notice to Members 05-41 (June 2005).

¹⁴ 17 CFR 240.15c2-11.

¹⁵ 17 CFR 240.15c2-11(f)(3).

announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

2. Statutory Basis

NASD believes that the proposed rule change, as amended, is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁶ 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. NASD believes that the proposed rule change, as amended, will further investor protection and the operation of a fair and orderly markets by expanding NASD's current authority to halt trading and quotation in OTCBB securities to (1) all OTC Equity Securities and (2) extraordinary events that have the potential to cause major market disruption.

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

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

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 by NASD.

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

¹⁶ 15 U.S.C. 78q-3(b)(6).

the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, as amended, or

(B) institute proceedings to determine whether the proposed rule change, as amended, should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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. Please include File Number SR-NASD-2006-039 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 20549-1090.

All submissions should refer to File Number SR-NASD-2006-039. 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 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-2006-039 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.¹⁷

Nancy M. Morris
Secretary

¹⁷ 17 CFR 200.30-3(a)(12).