

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52119; File No. SR-NASD-2005-089)

July 25, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to NASD's Direct Authority for the Activities Related to or in Support of Trading in Over-the-Counter 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 July 19, 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 the NASD. On July 22, 2005, the NASD filed 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

The NASD is proposing to amend NASD's Plan of Allocation and Delegation of Functions by the NASD to Subsidiaries ("Delegation Plan") and certain NASD rules to reflect the NASD's direct authority for the activities related to or in support of trading in over-the-counter ("OTC") equity securities,⁴ including, but not limited to, the OTC Bulletin Board ("OTCBB"), rather than the current delegation of such authority to The Nasdaq Stock Market,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1, which replaced the original filing in its entirety, proposed to revise NASD Rule 6620(f)(1) to reflect the changes proposed to NASD Rule 11890 and made other minor and technical changes to the filing.

⁴ The term "OTC equity securities" herein refers to OTC Equity Securities as defined in the Rule 6600 Series, including, but not limited to, OTC Bulletin Board securities.

Inc. (“Nasdaq”).

Below is the text of the proposed rule change, as amended. Proposed new language is in italics; proposed deletions are in brackets.

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**PLAN OF ALLOCATION AND DELEGATION OF FUNCTIONS BY NASD TO
SUBSIDIARIES**

I. NASD, Inc.

The NASD, Inc. (referenced as “NASD”), the Registered Section 15A Association, is the parent company of the [wholly-owned] Subsidiaries NASD Regulation, Inc. (referenced individually as “NASD Regulation”), The Nasdaq Stock Market, Inc. (referenced individually as “Nasdaq”), and NASD Dispute Resolution, Inc. (referenced individually as “NASD Dispute Resolution”) (referenced collectively as the “Subsidiaries”). The term “Association” shall refer to the NASD and the Subsidiaries collectively.

A. [Governors, Directors and Committee Members]Other Defined Terms - The terms “Industry Governors,” “Non-Industry Governors,” “Public Governors,” “Industry Directors,” “Non-Industry Directors,” “Public Directors,” “Industry committee members,” “Non-Industry committee members,” and “Public committee members,” as used herein, shall have the meanings set forth in the By-Laws of the NASD, NASD Regulation and Nasdaq, as applicable. For purposes of Section III herein, the term “other markets or systems” does not include markets or systems relating to the trading of OTC Equity Securities as defined in the Rule 6600 Series, including, but not limited to, OTC Bulletin Board securities.

B. through E. No change.

II. NASD Regulation, Inc.

A. Delegation of Functions and Authority:

1. Subject to Section I.B.11, the NASD hereby delegates to NASD Regulation and NASD Regulation assumes the following responsibilities and functions as a registered securities association:

a. through s. No change.

t. To develop and adopt rule changes to establish trading practices with respect to OTC Equity Securities, as defined in the Rule 6600 Series, including, but not limited to, OTC Bulletin Board securities.

B. No change.

C. Supplemental Delegation Regarding Committees

1. No change.

2. [Operations] Uniform Practice Code Committee

a. The [Operations] Uniform Practice Code Committee shall have the following functions:

i. through iii. No change.

b. The NASD Regulation Board shall appoint the [Operations] Uniform Practice Code Committee by resolution. The [Operations] Uniform Practice Code Committee shall have not more than 50 percent of its members directly engaged in market-making activity or employed by a member firm whose revenues from market-making activity exceed ten percent of its total revenues.

III. Nasdaq

A. Delegation of Functions and Authority

1. Subject to Section I.B.11., the NASD hereby delegates to Nasdaq and Nasdaq assumes the following responsibilities and functions as a registered securities association:

a. To operate The Nasdaq Stock Market, automated systems supporting The Nasdaq Stock Market, and other markets or systems[for non-Nasdaq securities].

b. and c. No change.

d. To develop and adopt rule changes (i) applicable to the collection, processing, and dissemination of quotation and transaction information for securities traded on The Nasdaq Stock Market, on other markets operated by The Nasdaq Stock Market, and in the third market for securities listed on a registered exchange, [and in the over-the-counter market,](ii) for Nasdaq-operated trading systems for these securities, and (iii) establishing trading practices with respect to these securities.

e. through o. No change.

2. No change.

B. and C. No change.

IV. and V. No change.

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6545. Trading and Quotation Halt in OTCBB-Eligible Securities

(a) Authority for Initiating a Trading and Quotation Halt

In circumstances in which it is necessary to protect investors and the public interest, [Nasdaq]NASD may direct members, pursuant to the procedures set forth in paragraph (b), to halt trading and quotations in 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 OTCBB security or the security underlying 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 [Nasdaq]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) through (3) No change.

(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 OTCBB security or the security underlying the OTCBB ADR is listed or registered, or from a regulatory authority overseeing such issuer, exchange, or market, [Nasdaq]NASD will promptly evaluate the information and determine whether a trading and quotation halt in the OTCBB security is appropriate.

(2) Should [Nasdaq]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 [Nasdaq]NASD determines that the basis for the halt no longer exists, or when five business days have elapsed from the date [Nasdaq]NASD initiated the trading and quotation halt in the security, whichever occurs first. [Nasdaq]NASD shall disseminate appropriate public notice that the trading and quotation halt is no longer in effect.

(c) No change.

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6620. Transaction Reporting

(a) through (e) No change.

(f) Reporting Cancelled Trades

(1) Obligation and Party Responsible for Reporting Cancelled Trades

With the exception of trades cancelled [by Nasdaq staff] in accordance with Rule 11890, members shall report to the Nasdaq Market Center the cancellation of any trade previously submitted to the Nasdaq Market Center. The member responsible under Rule 6620 for submitting the original trade report shall submit the cancellation report in accordance with the procedures set forth in paragraph (f)(2). For trades executed through a Nasdaq system that automatically reports trades to the Nasdaq Market Center, the member that would have been required by Rule 6620 to report the trade (but for the trade

being reported automatically by the Nasdaq system) shall submit the cancellation report in accordance with the procedures set forth in paragraph (f)(2).

(2) No change.

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7010. System Services

(a) through (o) No change.

(p) Historical Research and Administrative Reports

(1) and (2) No change.

(3) The charge to be paid by the purchaser of an Historical Research Report regarding an OTC Bulletin Board security or other OTC security through the OTCBB.com website shall be determined in accordance with the following schedule:

A. No change.

B. No change.

C. [Nasdaq]NASD may, in its discretion, choose to make a report that purchasers wish to obtain every trading day available on a subscription discount basis. In such cases, the price for a subscription to receive a report every trading day in a month shall be the applicable rate to receive the report for a day times 20; the price for a subscription to receive the report for every trading day in a quarter shall be the applicable rate to receive the report every day times 60; and the price for a subscription to receive a report every trading day in a year shall be the applicable rate to receive the report for a day times 240.

D. No change

(4) No change.

(q) through (v) No change.

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11120. Definitions

(a) Committee

The term “Committee” as used in this Code, unless the context otherwise requires, shall mean the Committee delegated the authority to administer this Code by the Board of Governors.*

(b) through (g) No change.

* The Board of Governors has so designated the [Association’s Operations] NASD’s Uniform Practice Code Committee.

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11890. Clearly Erroneous Transactions

(a) No change.

(b) Procedures for Reviewing Transactions on NASD’s or Nasdaq’s Own Motion

(1) In the event of (i) a disruption or malfunction in the use or operation of any quotation, execution, communication, or trade reporting system owned or operated by Nasdaq and approved by the Commission, or (ii) extraordinary market conditions or other circumstances in which the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors and the

public interest, the President of Nasdaq or any Executive Vice President designated by the President may, on his or her own motion, review any transaction in Nasdaq or exchange-listed securities arising out of or reported through any such quotation, execution, communication, or trade reporting system, including transactions entered into by a member of a UTP Exchange through the use or operation of such a system, but excluding transactions that are entered into through, or reported to, a UTP Exchange. A Nasdaq officer acting pursuant to this subsection may declare any such transaction null and void or modify the terms of any such transaction if the officer determines that (i) the transaction is clearly erroneous, or (ii) such actions are necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest; provided, however, that, in the absence of extraordinary circumstances, the officer must take action pursuant to this subsection within thirty (30) minutes of detection of the transaction, but in no event later than 3:00 p.m., Eastern Time, on the next trading day following the date of the trade at issue.

(2) In the event of (i) a disruption or malfunction in the use or operation of any quotation, communication, or trade reporting system owned or operated by NASD or its subsidiaries and approved by the Commission, or (ii) extraordinary market conditions in which the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest, an Executive Vice President of NASD's Market Regulation Department or an Executive Vice President of NASD's Transparency Services Department may, on his or her own motion, review any transaction in an OTC equity security, as defined in Rule

6610, arising out of or reported through any such quotation, communication, or trade reporting system. An NASD officer acting pursuant to this subsection may declare any such transaction null and void or modify the terms of any such transaction if the officer determines that (i) the transaction is clearly erroneous, or (ii) such actions are necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest; provided, however, that, in the absence of extraordinary circumstances, the officer must take action pursuant to this subsection within thirty (30) minutes of detection of the transaction, but in no event later than 3:00 p.m., Eastern Time, on the next trading day following the date of the trade at issue.

(c) Review by the Market Operations Review Committee (“MORC”) or the Uniform Practice Code (“UPC”) Committee

(1) A member, member of a UTP Exchange, or person associated with any such member may appeal a determination made under subsection (a) to the MORC. A member, member of a UTP Exchange, or person associated with any such member may appeal a determination made under subsection (b) (1) to the MORC, or a determination made under subsection (b)(2) to the UPC Committee, unless the officer making the determination also determines that the number of the affected transactions is such that immediate finality is necessary to maintain a fair and orderly market and to protect investors and the public interest. An appeal must be made in writing, and must be received by Nasdaq or NASD, as applicable, within thirty (30) minutes after the person making the appeal is given the notification of the determination being appealed, except that if Nasdaq or NASD notifies the parties of action taken pursuant to paragraph (b) after

4:00 p.m., the appeal must be received by [Nasdaq by] 9:30 a.m. the next trading day.

Once a written appeal has been received, the counterparty to the trade will be notified of the appeal and both parties shall be able to submit any additional supporting written information up until the time the appeal is considered by the appropriate Committee.

Either party to a disputed trade may request the written information provided by the other party during the appeal process. An appeal [to the Committee] shall not operate as a stay of the determination being appealed. Once a party has appealed a determination to the appropriate Committee, the determination shall be reviewed and a decision rendered, unless both parties to the transaction agree to withdraw the appeal prior to the time a decision is rendered[by the Committee]. Upon consideration of the record, and after such hearings as it may in its discretion order, the MORC or the UPC Committee, pursuant to the standards set forth in this section, shall affirm, modify, reverse, or remand the determination.

(2) The decision of [the] a Committee pursuant to an appeal, or a determination by a Nasdaq or NASD officer that is not appealed, shall be final and binding upon all parties and shall constitute final [Association] action on the matter in issue. Any determination by a Nasdaq or NASD officer pursuant to paragraph (a) or (b) or any decision by [the] a Committee pursuant to paragraph (c)(1) shall be rendered without prejudice as to the rights of the parties to the transaction to submit their dispute to arbitration.

(d) Communications

(1) All materials submitted [to Nasdaq or the MORC]pursuant to this Rule shall be submitted via facsimile machine and within the time parameters specified herein; provided, however, that if requested, Nasdaq or NASD staff may authorize submission of material via electronic mail on a case-by-case basis. Materials shall be deemed received at the time indicated by the equipment (i.e., facsimile machine or computer) receiving the materials. Nasdaq and NASD, in [its]their sole and absolute discretion, reserve[s] the right to reject or accept any material that is not received within the time parameters specified herein.

(2) Nasdaq or NASD shall provide affected parties with prompt notice of determinations under this Rule via facsimile machine, electronic mail, or telephone (including voicemail); provided, however, that if an officer nullifies or modifies a large number of transactions pursuant to subsection (b), Nasdaq or NASD may instead provide notice to parties via the Nasdaq Workstation II Service, a press release, or any other method reasonably expected to provide rapid notice to many market participants.

IM-11890-1. Refusal to Abide by Rulings [of a Nasdaq Officer or the MORC]

It shall be considered conduct inconsistent with just and equitable principles of trade for any member to refuse to take any action that is necessary to effectuate a final decision of a Nasdaq or NASD officer or the MORC or the UPC Committee under Rule 11890.

IM-11890-2. Review by Panels of the MORC or the UPC Committee

For purposes of Rule 11890 and other NASD rules that permit review of Nasdaq or NASD decisions by the MORC or the UPC Committee, respectively, a decision of the MORC or

the UPC Committee may be rendered by a panel of three or more members of [the MORC] that Committee, provided that no more than 50 percent of the members of any panel are directly engaged in market making activity or employed by a member firm whose revenues from market making activity exceed ten percent of its total revenues.

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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, the 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, as amended. The text of these statements may be examined at the places specified in Item IV below. The 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

Pursuant to the Delegation Plan, activities related to or in support of the trading in OTC equity securities, including, but not limited to, operation of the OTCBB⁵ (collectively referred to herein as “OTC equity operations”), have been delegated to Nasdaq. In this context, OTC equity operations includes services such as trade reporting, comparison, quote collection and

⁵ The OTCBB provides an electronic quotation medium for subscribing members to enter, update, and display quotations in individual securities on a real-time basis. Such quotation entries may consist of a priced bid and/or offer; an unpriced indication of interest; or a bid/offer accompanied by a modifier to reflect unsolicited customer interest. The OTCBB is not an issuer listing service and therefore does not maintain a relationship with quoted issuers or impose quantitative listing standards as do Nasdaq and the exchanges. To be eligible for quotation on the OTCBB, issuers must be current in their filings with the Commission or applicable regulatory authority.

dissemination, as applicable, and the related rulemaking functions in this area. The NASD is proposing to assume direct authority for OTC equities operations rather than delegate it to Nasdaq and delegate to NASD Regulation rulemaking authority related to trading practices for OTC equity securities. The NASD intends to contract with Nasdaq to have it continue to provide the OTCBB quotation and trade reporting platform and certain other services that it currently provides with respect to OTC equity operations. As a result, market makers and other users of such services will continue to access the OTCBB and other OTC equity services in the same way they do today.

In furtherance of this transition, the NASD also is proposing to: (1) transfer trading and quotation halt authority for OTCBB-eligible securities from Nasdaq to the NASD; (2) conform the language governing reporting cancelled trades to reflect the proposed changes in NASD Rule 11890 relating to the NASD's ability to nullify or modify transactions in OTC equity securities; (3) transfer the authority to set certain fees in this area from Nasdaq to the NASD; and (4) transfer from Nasdaq to the NASD the ability to nullify or modify a transaction in an OTC equity security due to a disruption or malfunction in the use or operation of any quotation, communication, or trade reporting system or other extraordinary market conditions.

Delegation Plan Changes

The NASD will be assuming direct responsibility for OTC equity operations and is therefore proposing to delete the delegation of authority to Nasdaq of these functions and also to delegate to NASD Regulation rulemaking authority related to trading practices for OTC equity securities. Nasdaq will continue to operate the Nasdaq Stock Market and other markets or systems, as appropriate, and will maintain its delegation of authority accordingly. In addition,

the NASD is proposing a technical change in the introductory language of Section I of the Delegation Plan, to delete the reference to “wholly-owned” subsidiaries given that Nasdaq is no longer a wholly-owned subsidiary of the NASD.

OTCBB Trading and Quotation Halts

The NASD is proposing to amend NASD Rule 6545, which governs the trading and quotation halt authority for OTCBB-eligible securities, to provide that NASD has direct responsibility for this function. NASD Rule 6545 currently provides Nasdaq with authority to impose trading and quotation halts in OTCBB-eligible securities in certain circumstances. Instead, the NASD proposes to amend NASD Rule 6545 to provide that the NASD has the authority to determine the basis for a trading and quotation halt and to resume trading after a trading and quotation halt has been initiated under the rule.

Cancelled Trades

The NASD is proposing to amend NASD Rule 6620(f), which governs the reporting of cancelled trades for OTC Equity Securities, to reflect the proposed transfer of authority to the NASD to nullify or modify transactions in OTC equity securities pursuant to NASD Rule 11890 as discussed below. Accordingly, the NASD proposes to amend Rule NASD 6620(f) to conform the language in that rule to the proposed language in NASD Rule 11890.

Charges and Fees

The NASD will be responsible for determining fees associated with OTC equity operations. With one exception noted below, the fee provisions within NASD Rule 7010 for services related to OTC equity operations do not explicitly provide the authority to set such fees to Nasdaq, so no rule changes are necessary. The one exception is NASD Rule 7010(p)(3),

which governs the charges for historical research reports for OTCBB-eligible securities. As a result, the NASD is proposing to amend NASD Rule 7010(p)(3) to provide that the NASD has authority to set fees in this area. The NASD is not proposing any changes to the current fee structure associated with OTC equity operations at this time.

Clearly Erroneous Authority

The NASD is proposing to amend NASD Rule 11890 to transfer the authority to the NASD to nullify or modify transactions in OTC equity securities as may be necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest. Specifically, the proposed rule change, as amended, will permit an Executive Vice President of NASD's Market Regulation Department or an Executive Vice President of NASD's Transparency Services Department to review, on his or her own motion, any transaction in an OTC equity security, as defined in NASD Rule 6610, arising out of or reported through any quotation, communication, or trade reporting system owned or operated by the NASD or its subsidiaries and approved by the Commission in the event of a disruption or malfunction in the use or operation of any such system or extraordinary market conditions. The proposed rule change, as amended, also provides for a process by which a determination under this provision may be appealed to the Uniform Practice Code (UPC) Committee, unless the officer making the determination also determines that the number of the affected transactions is such that immediate finality is necessary to maintain a fair and orderly market and to protect investors and the public interest.

The NASD intends for the proposed rule change, as amended, to become effective on September 1, 2005, assuming Commission approval prior to that date.

2. Statutory Basis

The NASD believes that the proposed rule change, as amended, is consistent with the provisions of Section 15A(b)(6) of the Act,⁶ 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. The NASD believes that the proposed rule change, as amended, will clarify the NASD Delegation Plan and rules to reflect the NASD's direct responsibility for OTC equity operations.

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

The 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, as amended.

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

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, as amended, or

⁶ 15 U.S.C. 78o-3(b)(6).

- 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-2005-089 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2005-089. 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 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-2005-089 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.⁷

Margaret H. McFarland
Deputy Secretary

⁷ 17 CFR 200.30-3(a)(12).