

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52280; File No. SR-NASD-2005-095)

August 17, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of a Proposed Rule Change and Amendment No. 1 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”)¹ and Rule 19b-4 thereunder,² 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, which Items have been prepared by NASD. On August 16, 2005, NASD submitted Amendment No. 1 to the proposed rule change.³ 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

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 in italics; proposed deletions are in brackets.

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, NASD made minor clarification to the proposed rule text, corrected typographical errors, and changed the proposed compliance date for the rule change.

(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 SM.

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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

NASD is proposing a rule change that would prohibit the accepting, ranking, or displaying of quotes, orders, or indications of interest in sub-penny increments for all non-Nasdaq OTC equity securities in any quotation medium,⁴ except for quotes, orders, and indications of interest priced at less than \$1.00 per share. NASD believes that the existing quotation environment, in which market participants use quotation increments ranging from pennies to hundredths of pennies, can harm investors by creating a two-tiered market, one for ordinary investors and another for professionals, undermining important Commission and self-regulatory organization policy objectives. The potential harm associated with sub-penny quoting in national market stocks is described in the Commission's Proposing Release and Adopting Release for Regulation NMS,⁵ and, in NASD's view, essentially the same potential problems

⁴ "Quotation medium" is defined in NASD Rule 6710(f) and includes, among others, the Over-the-Counter Bulletin Board and the Electronic Pink Sheets.

⁵ See Securities Exchange Act Release No. 49325 (February 26, 2004), 69 FR 11126 (March 9, 2004) (Proposing Release); Securities Exchange Act Release No. 50870 (December 16, 2004), 69 FR 77423 (December 27, 2004) (Reproposing Release); Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (Adopting Release). Regulation NMS, among other things, prohibits market participants from accepting, ranking, or displaying orders, quotes, or indications of interest in NMS stocks in a pricing increment finer than a penny, except for orders, quotations, or indications or interest that are priced at less than \$1.00 per share. In Regulation NMS, the Commission indicated that other potential harms associated with sub-penny quoting include a decrease in market depth, an increase in the incidence of market participants stepping ahead of standing limit orders for an economically insignificant amount, and added difficulty for broker-dealers to meet certain of their regulatory obligations by increasing the incidence of so-called "flickering" quotes. Further, the Commission expressed concern that sub-penny quotes could impair broker-dealers' efforts to meet their best execution obligations and interfere with investors' understanding of securities prices.

exist with respect to OTC equity securities.

Accordingly, NASD is proposing a rule change that would prohibit members from displaying, ranking, or accepting a bid, offer, order, or indication of interest in any non-Nasdaq OTC equity security in any quotation medium priced in an increment smaller than \$0.01 if such bid, 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, order, or indication of interest in any non-Nasdaq OTC Equity Security priced in an increment smaller than \$0.0001 if such bid, offer, order, or indication of interest is priced equal to or greater than \$0.01 per share and less than \$1.00 per share. This is consistent with the sub-penny requirements in Regulation NMS. However, unlike Regulation NMS, members would not be prohibited from displaying, ranking, or accepting a bid, offer, order, or indication of interest in any non-Nasdaq OTC equity security priced in an increment smaller than \$0.0001 if such bid, offer, order, or indication of interest is priced less than \$0.01 per share. This reflects the fact that it is not uncommon for non-Nasdaq OTC equity securities to trade at prices below \$0.01, and the proposal is not intended to restrict quoting or trading of such securities.

If the Commission approves this proposed rule change, NASD would 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 compliance date of the proposed rule change will coincide with the compliance date of Rule 612 (“the Sub-Penny Rule”) under Regulation NMS,⁶ assuming Commission approval of the proposed rule change prior to that date. NASD will

⁶ Currently, the compliance date of the Sub-Penny Rule under Regulation NMS is January 31, 2006. See Securities Exchange Act Release No. 52196 (Aug. 2, 2005), 70 FR 45529 (Aug. 8, 2005).

announce the compliance date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁷ which requires, among other things, that NASD rules 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 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 would 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.

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

⁷ 15 U.S.C. 78o-3(b)(6).

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-2005-095 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-2005-095. 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. 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.⁸

Jill M. Peterson
Assistant Secretary

⁸ 17 CFR 200.30-3(a)(12).