

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53017; File No. SR-NASD-2005-150)

December 22, 2005

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Modify Nasdaq's Minimum Pricing Increment Rules

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 December 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, II, and III below, which Items have been prepared by Nasdaq. Nasdaq filed this proposal pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ therefore making the proposed rule change effective immediately upon filing. Nasdaq intends for this rule change to become operative on January 31, 2006. 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 the Substance of the Proposed Rule Change

Nasdaq proposes to modify NASD Rules 4613, 4701, 4710, 4901, 4904, and 6330 to align Nasdaq's rules on minimum pricing increments with the corresponding provisions in the Commission's Regulation NMS.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

The text of the proposed rule change is below. Proposed new language is underlined; proposed deletions are in brackets.

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4613. Character of Quotations

(a) Quotation Requirements and Obligations

(1) Two-Sided Quote Obligation. For each security in which a member is registered as a market maker, the member shall be willing to buy and sell such security for its own account on a continuous basis and shall enter and maintain a two-sided quotation ("Principal Quote"), which is attributed to the market maker by a special maker participant identifier ("MPID") and is displayed in the Nasdaq Quotation Montage at all times, subject to the procedures for excused withdrawal set forth in Rule 4619.

(A) No change

(B) Minimum Price Variation [for Decimal-based Quotations] — The minimum quotation increment for Nasdaq National Market and Capital Market securities [authorized for decimal pricing] shall be \$0.01 for quotations priced at or above \$1.00 per share and \$0.0001 for quotations priced below \$1.00 per share; provided, however, that if the Securities and Exchange Commission ("SEC") permits, with respect to any security, the display, rank or acceptance of quotations priced at or above \$1.00 per share in an increment smaller than \$0.01, then the minimum quotation increment for such a security shall be the minimum permitted by the SEC or \$0.0001, whichever is greater. Quotations failing to meet this standard shall be rejected.

(2) and (3) No change

(b) through (e) No change

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4701. Definitions

Unless stated otherwise, the terms described below shall have the following meaning:

(a) through (ll) No change

(mm) The term "Pegged" shall mean, for priced limit orders so designated, that after entry into the Nasdaq Market Center, the price of the order is automatically adjusted by the Nasdaq Market Center in response to changes in either the Nasdaq Market Center inside bid or offer or the national best bid or offer, as appropriate. A Nasdaq Market Center Participant may enter either a Regular Pegged Order or a Reverse Pegged Order.

A Nasdaq Market Center Participant entering a Regular Pegged Order may specify that the price of the order will deviate from either the Nasdaq inside quote on the same side of the market or the national best bid or offer on the same side of the market by an offset amount of \$0 to \$0.99. A Nasdaq Market Center Participant entering a Reverse Pegged Order may specify that the price of the order will deviate from either the Nasdaq inside quote on the contra side of the market or the national best bid or offer on the contra side of the market by an offset amount of \$0.01 to \$0.99. The market participant entering a Pegged Order may (but is not required to) specify a cap price, to define a price at which pegging of the order will stop and the order will be permanently converted into an unpegged limit order. Pegged Orders shall not be available for ITS Securities. Pegged orders shall not be eligible for routing as set out in Rule 4714. Offset amounts for Pegged Orders are priced in \$0.01 increments. However, if at any time an offset amount specified by a Nasdaq Market Center Participant does not result in an offer or a bid that is fully compliant with the minimum price variation provisions of Rule 4613, then, for an offer, the applicable offset amount will be the smallest amount that results in a compliant order and is greater than the specified offset amount, and, for a bid, the applicable offset amount will be the largest amount that results in a compliant order and is smaller than the specified offset amount.

(nn) The term "Discretionary" shall mean,

(1) for priced limit orders in Nasdaq listed securities so designated, an order that when entered into the Nasdaq Market Center has both a displayed bid or offer price, as well as a non-displayed discretionary price range in which the participant is also willing to buy or sell, if necessary. The displayed price may be fixed or may be pegged to deviate from the Nasdaq inside quote or the national best bid or offer on the same side of the market by an offset amount of \$0 to \$0.99. The pegging of the Discretionary Order may be capped in the same manner as that of a Pegged Order. The discretionary price range of a Discretionary Order that is pegged will be adjusted to follow the pegged displayed price. Discretionary price ranges (and offset amounts, if any) for Discretionary Orders are priced in \$0.01 increments. Compliance with the minimum price variation provisions of Rule 4613 in connection with range adjustments and pegging in Discretionary Orders will be ensured in the same manner as for Pegged Orders. Discretionary Orders for Nasdaq listed securities shall be eligible for routing as set out in Rule 4714.

(2) No change

(oo) through (vv) No change

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4710. Participant Obligations in the Nasdaq Market Center

(a) No change

(b) **Non-Directed Orders**

(1) through (4) No change

(5) If a Nasdaq Market Maker's Attributable Quote/Order is reduced to less than a round-lot amount on one side of the market due to Nasdaq Market Center executions, the Nasdaq Market Center will close the Market Maker's quote in the Nasdaq Market Center on that side of the market, and the Nasdaq Market Maker will be permitted a grace period of 30 seconds within which to take action to restore its Attributable Quote/Order, if the market maker has not authorized use of the AQR functionality or does not otherwise have an Attributable Quote/Order on both sides of the market in the system. A Nasdaq Market Maker that fails to transmit an Attributable Quote/Order in a security within the allotted time will have the exhausted side of its quotation restored by the system at a price \$0.01 inferior to the lowest displayed bid price or the highest displayed offer price in that security as appropriate. If all bids and/or offers are exhausted so that there are no longer any Quote/Orders displayed on the bid and/or offer side of the market, the system will refresh a market maker's exhausted bid or offer quote to a normal unit of trading priced \$0.01 inferior to the lesser of either: a) the last valid displayed inside bid/offer in the security before all such bids/offers were exhausted; or b) the market maker's last displayed bid/offer before exhaustion. If the resulting bid/offer quote would create a locked or crossed market, the Nasdaq Market Center will instead re-open the exhausted market maker's bid/offer quote at a price \$0.01 inferior to the unexhausted inside bid/offer in that security. If at any time an offer derived pursuant to this paragraph would not be fully compliant with the minimum price variation provisions of Rule 4613, then the system will create an offer that is priced higher than the non-compliant offer by the smallest amount necessary to make such an offer compliant with Rule 4613. If at any time this automatic quote restoration process would result in the creation of a bid/offer of less than \$0.01, the system will refresh that bid/offer to a price of \$0.01. Except as provided in subparagraph (b)(6) of this rule, a Nasdaq Market Maker that withdraws from a security may not re-register in the system as a market maker in that security for twenty (20) business days.

(6) through (8) No change

(c) through (e) No change

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4901. Definitions

Unless stated otherwise, the terms described below shall have the following meaning:

(a) through (q) No change

(r) The term "Pegged" shall mean, for priced limit orders so designated, that after entry into the System, the price of the order is automatically adjusted by the System in response to changes in the Nasdaq inside bid or offer (for Nasdaq-listed securities) or the national best bid or offer (for ITS securities), as appropriate. The Participant entering a

Pegged Order can specify that order's price will either equal the inside quote or improves the inside quote by an amount set by the entering party on the same side of the market (a "Regular Pegged Order") or offset the inside quote on the contra side of the market by an amount (the "Offset Amount") set by the Participant (e.g., \$0.01 less than the inside offer or \$0.02 more than the inside bid) (a "Reverse Pegged Order"). The Participant entering a Pegged Order may (but is not required to) specify a limit price, to define a price at which pegging of the order will stop and the order will be permanently converted into an unpegged limit order at limit price. This order type is available for Nasdaq-listed and Exchange-listed securities. Offset amounts for Pegged Orders are priced in \$0.01 increments. However, if at any time an offset amount specified by a Participant does not result in an offer or a bid that is fully compliant with the minimum price variation provisions of Rule 4904, then, for an offer, the applicable offset amount will be the smallest amount that results in a compliant order and is greater than the specified offset amount, and, for a bid, the applicable offset amount will be the largest amount that results in a compliant order and is smaller than the specified offset amount.

(s) through (w) No change

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4904. Entry and Display of Orders

(a) No change

(b) Display of Orders — The System will display orders submitted to the System as follows:

(1) and (2) No change

(3) Minimum Price Variation — The minimum quotation increment for System Securities shall be \$0.01 for quotations priced at or above \$1.00 per share and \$0.0001 for quotations priced below \$1.00 per share; provided, however, that if the Securities and Exchange Commission ("SEC") permits, with respect to any security, the display, rank or acceptance of quotations priced at or above \$1.00 per share in an increment smaller than \$0.01, then the minimum quotation increment for such a security shall be the minimum permitted by the SEC or \$0.0001, whichever is greater. Quotations failing to meet this standard shall be rejected.

(4) Exceptions — The following exceptions shall apply to the display parameters set forth in paragraphs (1) and (2) above:

(A) No change

(B) [Minimum Increments and Rounding — The minimum trading increment for System quotations priced \$1.00 and above is \$.01. For quotations priced below \$1.00 the minimum increment is \$.0001.

(i) For System display purposes, quotations in sub-penny increments \$1.00 and above will be rounded down (for bids) or up (for offers) by the System to the nearest \$.01 increment. Orders so rounded shall have no superior execution priority compared to orders previously submitted at the relevant \$.01 increment.

(ii) For Nasdaq Market Center display purposes, any quotations in sub-penny increments shall be rounded down (for bids) and up (for offers) to the nearest \$.01 increment. Sub-penny quotations that are rounded for display purposes shall be executed at their actual price, rather than the rounded price at which they are displayed.

(C) Reserve Size — Reserve Size shall not be displayed in the System, but shall be accessible as described in Rule 4905.

[(D)] (C) Discretionary & Hunter Orders — Hunter Orders, and the discretionary portion of Discretionary Orders shall be available for execution only upon the appearance of contra-side marketable trading interest, and shall be executed pursuant to Rule 4905.

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6330. Obligations of CQS Market Makers

(a) through (c) No change

(d) Minimum Price Variation [for Decimal-based Quotations]

(1) The minimum quotation increment [for securities authorized for decimal pricing as part of the SEC-approved Decimals Implementation Plan for the Equities and Options Markets] shall be \$0.01 for quotations priced at or above \$1.00 per share and \$0.0001 for quotations priced below \$1.00 per share; provided, however, that if the Securities and Exchange Commission (“SEC”) permits, with respect to any security, the display, rank or acceptance of quotations priced at or above \$1.00 per share in an increment smaller than \$0.01, then the minimum quotation increment for such a security shall be the minimum permitted by the SEC or \$0.0001, whichever is greater. Quotations failing to meet this standard shall be rejected.

(2) When a quotation properly (not in violation of paragraph (1) above) priced in an increment of less than \$0.01 is routed for execution via the ITS System to a market that does not accept quotations in increments of less than \$0.01, such a quotation is rounded down (for bids) or up (for offers) to the nearest \$0.01 increment.

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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

The purpose of this change is to align Nasdaq's rules with Rule 612 of the Commission's Regulation NMS.⁵ Consistent with that rule, neither Nasdaq nor Nasdaq's Brut facility will accept sub-penny quotes⁶ priced at \$1.00 or above, except for sub-penny quotes in securities for which sub-penny quoting is authorized by the Commission at higher price levels. For quotes priced below \$1.00 (and for quotes in securities exempted by the Commission), Nasdaq and Brut⁷ will accept sub-penny quotes but only in increments of at least \$0.0001, as specified in Rule 612.

The proposed rule language also clarifies how Nasdaq will handle several special situations that will arise in implementing Rule 612. First, if a proper sub-penny quote submitted to Nasdaq is routed via the ITS System to a different market for execution, and such market does not accept sub-penny orders, then such quote will be rounded up (for offers) or down (for bids) to the nearest one cent increment. However, Nasdaq notes that any market routing an order to any facility of Nasdaq must be prepared to accept a sub-penny execution even if such market itself does not accept sub-penny orders. A proper execution priced in an increment of less than a cent would remain valid even if the

⁵ 17 CFR 242.612.

⁶ In this filing, "quote" or "quotation" is used to denote both quotations and orders.

⁷ This filing does not contain any changes to the rules of the INET System. If any such changes are necessary, they will be made in a separate filing at a later date.

sending market failed to meet its responsibilities in this regard (and the sending market would then have to assume full responsibility for any resulting losses and other harm).

Second, for pegged and discretionary orders, the new rule language clarifies that participants must continue to specify the offset amounts and the discretionary price ranges in whole cents. This will remain the case even when the stock can be properly priced in sub-penny increments.

Third, in the case of pegged or discretionary orders, when changes in the underlying price being “pegged” would result in a sub-penny order priced over \$1.00, the rule language provides that the “offset” amount be deemed slightly higher (for offers) or lower (for bids) than specified by the market participant, as necessary to create a compliant quote. For example, if the offset amount specified by a market participant for a pegged offer is \$0.01 and the national best offer is \$0.995, this would result in a pegged offer of \$1.005, which would violate Rule 612. The proposed rule states that in this situation Nasdaq should deem the offset amount to be higher than specified by the smallest amount necessary to produce a quote priced in whole cents. Therefore, in this example, under the proposed rule the offset amount would be deemed \$0.015, producing a pegged offer of \$1.01. In the case of discretionary orders, this same logic and approach will apply in determining the discretionary price range vis-à-vis the displayed price and in determining the offset amount if the displayed price is “pegged” to the national best bid or offer. In each case, the discretionary price range limit amount and the offset amount will be deemed higher (for offers) or lower (for bids) by the smallest amount necessary to produce a Rule 612-compliant quote.

Fourth, the same approach will be used when automatically refreshing the quotes of a market participant that has authorized the use of the Auto Quote Refresh (“AQR”) functionality. NASD Rule 4710(b)(5) describes the algorithm used to determine AQR pricing, and it could result in a sub-penny offer priced over \$1.00 (generally, if the stock is trading in sub-penny increments just below the \$1 threshold). In such a situation, the AQR-generated offer price will be adjusted upwards to the next whole penny.

Nasdaq notes that while it generally (subject to any security-specific exemptions the Commission may grant) will not accept sub-penny quotes priced above \$1.00, it will, consistent with Rule 612, still permit trade executions at such prices. For example, trades in sub-penny increments priced above \$1.00 could be produced in Nasdaq’s Opening Cross or Closing Cross. Nasdaq will permit such trades to proceed. At the same time, Nasdaq notes that, because of technological limitations, trades will never be executed in increments below \$0.0001, but will always be rounded up to the nearest \$0.0001 increment. Such a situation could arise, for example, in the Opening or Closing Cross if the bids and offers for a stock are priced below \$1.00 in \$0.0001 increments. Under such a scenario, the system would round the execution price up to the next \$0.0001 increment.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,⁸ in general and with Section 15A(b)(6) of the Act,⁹ in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market. Specifically, the

⁸ 15 U.S.C. 78o-3.

⁹ 15 U.S.C. 78o-3(b)(6).

proposal aligns Nasdaq's rules on sub-penny trading with the Commission's Regulation NMS.

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.

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

This proposal has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁰ and subparagraph (f)(6) of Rule 19b-4 thereunder¹¹ because the proposal: (1) does not significantly affect the protection of investors or the public interest, (2) does not impose any significant burden on competition, and (3) by its terms does not become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest.¹² Nasdaq intends for this rule change to become operative on January 31, 2006.

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 17 CFR 240.19b-4(f)(6).

¹² Pursuant to Rule 19b-4(f)(6)(iii) of the Act, a proposed rule change does not become operative for 30 days after the date of its 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 written 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 complied with the five day pre-filing requirement.

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.

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-2005-150 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-2005-150. 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-2005-150 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.¹³

Jonathan G. Katz
Secretary

¹³ 17 CFR 200.30-3(a)(12).