OMB APPROVAL	
OMB Number:	3235-0045
Expires:	June 30, 2007
Estimated average burden hours per response...........38	

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2007 - 041
Amendment No.

Proposed Rule Change by National Association of Securities Dealers

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial	Amendment	Withdrawal	Section 19(b)(2)	Section 19(b)(3)(A)	Section 19(b)(3)(B)
☑	☐	☐	☑	☐	☐

Pilot ☐

Extension of Time Period for Commission Action ☐

Date Expires

Rule

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Proposed rule change to amend the minimum price-improvement standards set forth in NASD IM-2110-2, Trading Ahead of Customer Limit Order.

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name: Andrea
Last Name: Orr
Title: Assistant General Counsel
E-mail: andrea.orr@nasd.com
Telephone: (202) 728-8156
Fax: (202) 728-8264

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date: 06/27/2007

By: Stephanie Dumont
(Name)

Vice President and Associate General Counsel
(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Stephanie Dumont,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information Add Remove View	The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.
Exhibit 1 - Notice of Proposed Rule Change Add Remove View	The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)
Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications Add Remove View Exhibit Sent As Paper Document ☐	Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.
Exhibit 3 - Form, Report, or Questionnaire Add Remove View Exhibit Sent As Paper Document ☐	Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.
Exhibit 4 - Marked Copies Add Remove View	The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.
Exhibit 5 - Proposed Rule Text Add Remove View	The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.
Partial Amendment Add Remove View	If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. <u>Text of Proposed Rule Change</u>

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] the National Association of Securities Dealers, Inc. ("NASD") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to amend the minimum price-improvement standards set forth in NASD Interpretive Material (IM) 2110-2, Trading Ahead of Customer Limit Order.

Below is the text of the proposed rule change.[2] Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

IM-2110-2. Trading Ahead of Customer Limit Order

(a) General Application

To continue to ensure investor protection and enhance market quality, NASD's Board of Governors is issuing an interpretation to NASD Rules dealing with member firms' treatment of their customer limit orders in NMS stocks and OTC equity securities. This interpretation, which is applicable from 9:30 a.m. to 6:30 p.m. Eastern Time, will require members to handle their customer limit orders with all due care so that members do not "trade ahead" of those limit orders. Thus, members that handle customer limit orders, whether received from their own customers or from another member, are

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1 15 U.S.C. 78s(b)(1).

2 The text of IM-2110-2 is based on the rule changes approved in SR-NASD-2005-146, which become effective on the final implementation date of SR-NASD-2005-146, November 26, 2007. <u>See</u> Securities Exchange Act Release No. 55351 (February 26, 2007, 72 FR 9810 (March 5, 2007) (order approving SR-NASD-2005-146). <u>See</u> <u>also</u> NASD Notice to Members 07-19 (April 2007). <u>See</u> <u>also</u> File No. SR-NASD-2007-039, proposing to delay implementation of portions of SR-NASD-2005-146 until November 26, 2007.

prohibited from trading at prices equal or superior to that of the limit order without executing the limit order. In the interests of investor protection, NASD is eliminating the so-called disclosure "safe harbor" previously established for members that fully disclosed to their customers the practice of trading ahead of a customer limit order by a market-making firm.[1] For purposes of this interpretation, (1) "NMS stock" shall have the meaning set forth in SEC Rule 600(b)(47) of Regulation NMS and (2) "OTC equity security" shall have the meaning set forth in Rule 6610(d).

Rule 2110 states that:

A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

Rule 2320, the Best Execution Rule, states that:

In any transaction for or with a customer, a member and persons associated with a member shall use reasonable diligence to ascertain the best inter-dealer market for the subject security and buy or sell in such a market so that the resultant price to the customer is as favorable as possible to the customer under prevailing market conditions.

Interpretation

The following interpretation of Rule 2110 has been approved by the Board:

A member firm that accepts and holds an unexecuted limit order from its customer (whether its own customer or a customer of another member) in an NMS stock or OTC equity security and that continues to trade the subject security for its own account at prices that would satisfy the customer's limit order, without executing that limit order, shall be deemed to have acted in a manner inconsistent with just and equitable principles of trade, in violation of Rule 2110, provided that a member firm may negotiate specific terms and conditions applicable to the acceptance of limit orders only with respect to limit orders that are: (a) for customer accounts that meet the definition of an "institutional account" as that term is defined in Rule 3110(c)(4); or (b) 10,000 shares or more, unless such orders are less than $100,000 in value. In the event that a member trades ahead of an unexecuted customer limit order at a price that is better than the unexecuted limit order, such member is required to execute the limit order at the price received by the member or better. Nothing in this interpretation, however, requires members to accept limit orders from any customer.

By rescinding the safe harbor position and adopting this interpretation, NASD wishes to emphasize that members may not trade ahead of their customer limit orders even if the member had in the past fully disclosed the practice to its customers prior to accepting limit orders. NASD believes that, pursuant to Rule 2110, members accepting and holding unexecuted customer limit orders owe certain duties to their customers and the customers of other member firms that may not be overcome or cured with disclosure of trading practices that include trading ahead of the customer's order. The terms and conditions under which institutional account or appropriately sized customer limit orders are accepted must be made clear to customers at the time the order is accepted by the firm so that trading ahead in the firm's market-making capacity does not occur.

The minimum amount of price improvement necessary [in order] for a member to execute an incoming order on a proprietary basis when holding an unexecuted limit order in that same security, and not be required to execute the held limit order is as follows:

1) For customer limit orders priced greater than or equal to $1.00 [that are at or inside the best inside], the minimum amount of price improvement required is $0.01 <u>for</u>

NMS stocks and the lesser of $0.01 or one-half (1/2) of the current inside spread for OTC equity securities;

2) For customer limit orders priced greater than or equal to $.01 and less than $1.00 [that are at or inside the best inside market], the minimum amount of price improvement required is the lesser of $0.01 or one-half (1/2) of the current inside spread;

3) [For customer limit orders priced outside the best inside market, the member must price improve the incoming order by executing the incoming order at a price at or inside the best inside market for the security; and]

[4) For customer limit orders in securities for which there is no published inside market, the minimum amount of price improvement required is $0.01.]

For customer limit orders priced less than $.01 but greater than or equal to $0.001, the minimum amount of price improvement required is the lesser of $0.001 or one-half (1/2) of the current inside spread;

4) For customer limit orders priced less than $.001 but greater than or equal to $0.0001, the minimum amount of price improvement required is the lesser of $0.0001 or one-half (1/2) of the current inside spread;

5) For customer limit orders priced less than $.0001 but greater than or equal to $0.00001, the minimum amount of price improvement required is the lesser of $0.00001 or one-half (1/2) of the current inside spread;

6) For customer limit orders priced less than $.00001, the minimum amount of price improvement required is the lesser of $0.000001 or one-half (1/2) of the current inside spread; and

7) For customer limit orders priced outside the best inside market, the minimum amount of price improvement required must either meet the requirements set forth above or the member must trade at a price at or inside the best inside market for the security.

NASD also wishes to emphasize that all members accepting customer limit orders owe those customers duties of "best execution" regardless of whether the orders are executed through the member or sent to another member for execution. As set out above, the Best Execution Rule requires members to use reasonable diligence to ascertain the best inter-dealer market for the security and buy or sell in such a market so that the price to the customer is as favorable as possible under prevailing market conditions. NASD emphasizes that order entry firms should continue to monitor routinely the handling of their customers' limit orders regarding the quality of the execution received.

(b) and (c) No Change.

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[1] No change to the footnote.

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(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on September 21, 2005, which authorized the filing of the rule change with the SEC. The Board of Governors of NASD had an opportunity to review the proposed rule change at its meeting on September 22, 2005. No other action by NASD is necessary for the filing of the proposed rule change. Sections 1(a)(ii) and

(1)(a)(iii) of Article VII of the NASD By-Laws permits the Board of Governors of NASD to adopt amendments to NASD Rules and interpretations without recourse to the membership for approval.

NASD proposes to implement the proposed rule change on the final implementation date of SR-NASD-2005-146, November 26, 2007.[3]

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

On February 26, 2007, the Commission approved SR-NASD-2005-146, which expanded the scope of IM-2110-2[4] to apply to over-the-counter (OTC) equity securities. The amendments relating to OTC equity securities are scheduled to become effective on November 26, 2007. Among other changes, SR-NASD-2005-146 amended the minimum level of price-improvement that a member must provide to trade ahead of an unexecuted customer limit order ("price-improvement standards") as follows. For customer limit orders priced greater than or equal to $1.00 that are at or inside the best inside market, the minimum amount of price improvement required is $0.01. For customer limit orders priced less than $1.00 that are at or inside the best inside market, the minimum amount of price improvement required is the lesser of $0.01 or one-half (1/2) of the current inside

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3 See Securities Exchange Act Release No. 55351 (February 26, 2007), 72 FR 9810 (March 5, 2007) (order approving SR-NASD-2005-146). See also File No. SR-NASD-2007-039, proposing to delay implementation of portions of SR-NASD-2005-146 until November 26, 2007.

4 Currently, IM-2110-2 generally prohibits a member from trading for its own account in an exchange-listed security at a price that is equal to or better than an unexecuted customer limit order in that security, unless the member immediately thereafter executes the customer limit order at the price at which it traded for its own account or better.

spread. For customer limit orders priced outside the best inside market, the member is required to execute the incoming order at a price at or inside the best inside market for the security. Lastly, for customer limit orders in securities for which there is no published inside market, the minimum amount of price improvement required is $0.01.

For example, if the best inside market for a security is $10 to $10.05 and a member is holding a customer limit order to buy priced at $10.01, the member would be permitted to buy at $10.02 or higher, without triggering the customer limit order. If the best inside market for a security is $.50 to $.51 and the member is holding a customer limit order to buy priced at $.50, the member would be permitted to buy at $.505 ($.50 + ½ ($.51-$.50)) or higher, without triggering the customer limit order.

NASD is proposing to revise the minimum price improvement standards to address three issues. First, because the minimum price improvement standard is determined based on the lesser of a specified amount ($.01) or ½ of the inside spread, the specified amount acts as an "upper limit" on the minimum price improvement requirement. NASD is concerned that the specified amount or upper limits on the minimum price improvement requirement (i.e., $.01) is disproportionately high for securities trading below $.01 and should vary proportionately with the amount of the limit order price. To address this inconsistency, NASD is proposing to add the following maximum upper limits for each price level: For customer limit orders priced less than $.01 but greater than or equal to $0.001, the minimum amount of price improvement required is the lesser of $0.001 or one-half (1/2) of the current inside spread. For customer limit orders priced less than $.001 but greater than or equal to $0.0001, the minimum amount of price improvement required is the lesser of $0.0001 or one-half (1/2) of the current inside spread. For customer limit orders priced less than $.0001 but greater than or equal to $0.00001, the minimum amount of price improvement required is the lesser of $0.00001 or one-half (1/2) of the current inside spread.[5] Lastly, for customer limit orders priced less than $.00001, the minimum amount of price improvement required is the lesser of $0.000001 or one-half (1/2) of the current inside spread.[6] NASD believes these proposed requirements are better aligned with the value of the limit order and continue to require an appropriate amount of minimum price improvement over a customer limit order before a member can trade for its own account.

Second, the current minimum price improvement standard for limit orders priced over $1.00 is $.01 and applies uniformly to NMS stocks and OTC equity securities. However, given that subpenny quoting and trading is permissible in OTC equity securities priced over $1.00 (and therefore subpenny spreads are possible), NASD believes that the minimum price improvement standard should be adjusted to also include

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5 The proposed minimum price-improvement provisions in this rule filing do not supersede, alter or otherwise affect any of the minimum pricing increment restrictions under Rule 612 of Regulation NMS. Rule 612 of Regulation NMS prohibits market participants from displaying, ranking, or accepting quotations, orders, or indications of interest in any NMS stock priced in an increment smaller than $0.01 if the quotation, order, or indication of interest is priced equal to or greater than $1.00 per share. If the quotation, order, or indication of interest in any NMS stock is priced less than $1.00 per share, the minimum pricing increment is $0.0001. See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR37496 (June 29, 2005).

6 For customer limit orders in securities for which there is no published inside market, the minimum amount of price improvement required would default to the same tiered minimum price improvement standards described herein. NASD believes that the minimum price improvement requirement of $.01 for customer limit orders in securities for which there is no published inside market is disproportionately high for lower-priced securities and, therefore, the proposed tiered requirements are more appropriate.

a measure based on the inside spread, consistent with the standards below $1.00. Accordingly, NASD is proposing that for customer limit orders for OTC equity securities priced greater than or equal to $1.00, the minimum amount of price improvement required is the lesser of $0.01 or one-half (1/2) of the current inside spread.[7]

Finally, NASD is proposing to change the minimum price improvement standard for limit orders priced outside the inside market. Although typically trades occur at or inside the best inside market, firms may trade proprietarily outside the best inside market for a variety of reasons, such as where there is little or no depth at the inside market or the inside market is manual or not easily accessible. Under the current requirements, such trades would trigger all limit orders priced outside the inside market, no matter how far outside the inside market the limit order is priced. For example, the best inside market for a security is $.50 to $.51. The member is displaying a quote to buy at $.49 and also is holding a customer limit order to buy priced at $.45. The member's quotation is accessed by another broker-dealer and the member buys at $.49. Under the current requirements, the member would be required to fill the customer's purchase order at $.45 because it had not purchased at the inside market of $.50.

NASD does not believe this is an appropriate result, and is therefore proposing that, where the limit order is priced outside the inside market for the security, the minimum amount of price improvement required must either meet the same tiered minimum price improvement standards set forth above or the member must trade at a price at or inside the best inside market for the security. NASD believes this will

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7 Other than the proposed distinction to address permissible subpenny quoting and trading in OTC equity securities priced over $1.00, the proposed price-

continue to require an appropriate amount of price improvement for a member to trade ahead of a customer limit order, irrespective of whether the limit order is priced inside or outside the best inside market.

As noted above, NASD proposes to implement the proposed rule change on the final implementation date of SR-NASD-2005-146, November 26, 2007.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[8] 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 better reflects trading in low-priced securities and the application of IM-2110-2.

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

NASD 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.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The original filing, SR-NASD-2005-146, which proposed the recently approved price-improvement standards, was subject to notice and comment.[9] No comments were

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improvement standards will apply uniformly to NMS stocks and OTC equity securities. See supra note 5.

8 15 U.S.C. 78o–3(b)(6).

9 See Securities Exchange Act Release No. 54705 (November 3, 2006), 71 FR 65863 (November 9, 2006) (notice of filing of SR-NASD-2005-146 and Amendment Nos. 1 and 2 thereto).

received in response to the Federal Register publication of that filing. However, following SEC approval, several broker-dealers raised concerns regarding the application of the amended price-improvement standards, in particular for securities trading below $.01 and those trading outside the best inside market. One broker-dealer indicated that the inside market may not be a good reflection of trading in certain OTC equity securities. With respect to these low-priced OTC equity securities, the broker-dealer indicated that the amended price-improvements standards could result in a minimum price improvement that is significantly greater than the value of the security. Additionally, certain broker-dealers indicated that, under the amended minimum price improvement standards, firms that trade proprietarily outside the best inside market would trigger all customer limit orders outside the best inside market. These broker-dealers recommended that NASD revisit the amended price-improvement standards to better address trading in low-priced securities and trading outside the best inside market.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.[10]

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

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[10] 15 U.S.C. 78s(b)(2).

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2007-041)

Self-Regulatory Organizations: National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change Relating to Amendments to the Minimum Price-Improvement Standards in IM-2110-2 (Trading Ahead of Customer Limit Order)

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 , 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. 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 the minimum price-improvement standards set forth in NASD Interpretive Material (IM) 2110-2, Trading Ahead of Customer Limit Order.

Below is the text of the proposed rule change.[3] Proposed new language is in italics; proposed deletions are in brackets.

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[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b-4.

[3] The text of IM-2110-2 is based on the rule changes approved in SR-NASD-2005-146, which would become effective on the final implementation date of SR-NASD-2005-146, November 26, 2007. See Securities Exchange Act Release No. 55351 (February 26, 2007, 72 FR 9810 (March 5, 2007) (order approving SR-NASD-2005-146). See also NASD Notice to Members 07-19 (April 2007). See also File No. SR-NASD-2007-039, proposing to delay implementation of portions of SR-NASD-2005-146 until November 26, 2007.

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IM-2110-2. Trading Ahead of Customer Limit Order

(a) General Application

To continue to ensure investor protection and enhance market quality, NASD's Board of Governors is issuing an interpretation to NASD Rules dealing with member firms' treatment of their customer limit orders in NMS stocks and OTC equity securities. This interpretation, which is applicable from 9:30 a.m. to 6:30 p.m. Eastern Time, will require members to handle their customer limit orders with all due care so that members do not "trade ahead" of those limit orders. Thus, members that handle customer limit orders, whether received from their own customers or from another member, are prohibited from trading at prices equal or superior to that of the limit order without executing the limit order. In the interests of investor protection, NASD is eliminating the so-called disclosure "safe harbor" previously established for members that fully disclosed to their customers the practice of trading ahead of a customer limit order by a market-making firm.[1] For purposes of this interpretation, (1) "NMS stock" shall have the meaning set forth in SEC Rule 600(b)(47) of Regulation NMS and (2) "OTC equity security" shall have the meaning set forth in Rule 6610(d).

Rule 2110 states that:

A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

Rule 2320, the Best Execution Rule, states that:

In any transaction for or with a customer, a member and persons associated with a member shall use reasonable diligence to ascertain the best inter-dealer market for the subject security and buy or sell in such a market so that the resultant price to the customer is as favorable as possible to the customer under prevailing market conditions.

Interpretation

The following interpretation of Rule 2110 has been approved by the Board:

A member firm that accepts and holds an unexecuted limit order from its customer (whether its own customer or a customer of another member) in an NMS stock or OTC equity security and that continues to trade the subject security for its own account at prices that would satisfy the customer's limit order, without executing that limit order, shall be deemed to have acted in a manner inconsistent with just and equitable principles of trade, in violation of Rule 2110, provided that a member firm may negotiate specific terms and conditions applicable to the acceptance of limit orders only with respect to limit orders that are: (a) for customer accounts that meet the definition of an "institutional account" as that term is defined in Rule 3110(c)(4); or (b) 10,000 shares or more, unless such orders are less than $100,000 in value. In the event that a member trades ahead of an unexecuted customer limit order at a price that is better than the unexecuted limit order, such member is required to execute the limit order at the price received by the member or better. Nothing in this interpretation, however, requires members to accept limit orders from any customer.

By rescinding the safe harbor position and adopting this interpretation, NASD wishes to emphasize that members may not trade ahead of their customer limit orders even if the member had in the past fully disclosed the practice to its customers prior to accepting limit orders. NASD believes that, pursuant to Rule 2110, members accepting and holding unexecuted customer limit orders owe certain duties to their customers and the customers of other member firms that may not be overcome or cured with disclosure of trading practices that include trading ahead of the customer’s order. The terms and conditions under which institutional account or appropriately sized customer limit orders are accepted must be made clear to customers at the time the order is accepted by the firm so that trading ahead in the firm’s market-making capacity does not occur.

The minimum amount of price improvement necessary [in order] for a member to execute an incoming order on a proprietary basis when holding an unexecuted limit order in that same security, and not be required to execute the held limit order is as follows:

1) For customer limit orders priced greater than or equal to $1.00 [that are at or inside the best inside], the minimum amount of price improvement required is $0.01 for NMS stocks and the lesser of $0.01 or one-half (1/2) of the current inside spread for OTC equity securities;

2) For customer limit orders priced greater than or equal to $.01 and less than $1.00 [that are at or inside the best inside market], the minimum amount of price improvement required is the lesser of $0.01 or one-half (1/2) of the current inside spread;

3) [For customer limit orders priced outside the best inside market, the member must price improve the incoming order by executing the incoming order at a price at or inside the best inside market for the security; and]

[4) For customer limit orders in securities for which there is no published inside market, the minimum amount of price improvement required is $0.01.]

For customer limit orders priced less than $.01 but greater than or equal to $0.001, the minimum amount of price improvement required is the lesser of $0.001 or one-half (1/2) of the current inside spread;

4) For customer limit orders priced less than $.001 but greater than or equal to $0.0001, the minimum amount of price improvement required is the lesser of $0.0001 or one-half (1/2) of the current inside spread;

5) For customer limit orders priced less than $.0001 but greater than or equal to $0.00001, the minimum amount of price improvement required is the lesser of $0.00001 or one-half (1/2) of the current inside spread;

6) For customer limit orders priced less than $.00001, the minimum amount of price improvement required is the lesser of $0.000001 or one-half (1/2) of the current inside spread; and

7) For customer limit orders priced outside the best inside market, the minimum amount of price improvement required must either meet the requirements set forth above or the member must trade at a price at or inside the best inside market for the security.

NASD also wishes to emphasize that all members accepting customer limit orders owe those customers duties of "best execution" regardless of whether the orders are executed through the member or sent to another member for execution. As set out above, the Best Execution Rule requires members to use reasonable diligence to ascertain the best inter-dealer market for the security and buy or sell in such a market so that the price to the customer is as favorable as possible under prevailing market conditions. NASD emphasizes that order entry firms should continue to monitor routinely the handling of their customers' limit orders regarding the quality of the execution received.

(b) and (c) No Change.

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[1] No change to the footnote.

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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

On February 26, 2007, the Commission approved SR-NASD-2005-146, which expanded the scope of IM-2110-2[4] to apply to over-the-counter (OTC) equity securities. The amendments relating to OTC equity securities are scheduled to become effective on November 26, 2007. Among other changes, SR-NASD-2005-146 amended the minimum level of price-improvement that a member must provide to trade ahead of an unexecuted customer limit order ("price-improvement standards") as follows. For customer limit orders priced greater than or equal to $1.00 that are at or inside the best inside market, the minimum amount of price improvement required is $0.01. For customer limit orders priced less than $1.00 that are at or inside the best inside market, the minimum amount of price improvement required is the lesser of $0.01 or one-half (1/2) of the current inside

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4 Currently, IM-2110-2 generally prohibits a member from trading for its own account in an exchange-listed security at a price that is equal to or better than an unexecuted customer limit order in that security, unless the member immediately thereafter executes the customer limit order at the price at which it traded for its own account or better.

spread. For customer limit orders priced outside the best inside market, the member is required to execute the incoming order at a price at or inside the best inside market for the security. Lastly, for customer limit orders in securities for which there is no published inside market, the minimum amount of price improvement required is $0.01.

For example, if the best inside market for a security is $10 to $10.05 and a member is holding a customer limit order to buy priced at $10.01, the member would be permitted to buy at $10.02 or higher, without triggering the customer limit order. If the best inside market for a security is $.50 to $.51 and the member is holding a customer limit order to buy priced at $.50, the member would be permitted to buy at $.505 ($.50 + ½ ($.51-$.50)) or higher, without triggering the customer limit order.

NASD is proposing to revise the minimum price improvement standards to address three issues. First, because the minimum price improvement standard is determined based on the lesser of a specified amount ($.01) or ½ of the inside spread, the specified amount acts as an "upper limit" on the minimum price improvement requirement. NASD is concerned that the specified amount or upper limits on the minimum price improvement requirement (i.e., $.01) is disproportionately high for securities trading below $.01 and should vary proportionately with the amount of the limit order price. To address this inconsistency, NASD is proposing to add the following maximum upper limits for each price level: For customer limit orders priced less than $.01 but greater than or equal to $0.001, the minimum amount of price improvement required is the lesser of $0.001 or one-half (1/2) of the current inside spread. For customer limit orders priced less than $.001 but greater than or equal to $0.0001, the minimum amount of price improvement required is the lesser of $0.0001 or one-half (1/2) of the current inside spread. For customer limit orders priced less than $.0001 but greater than or equal to $0.00001, the minimum amount of price improvement required is the lesser of $0.00001 or one-half (1/2) of the current inside spread.[5] Lastly, for customer limit orders priced less than $.00001, the minimum amount of price improvement required is the lesser of $0.000001 or one-half (1/2) of the current inside spread.[6] NASD believes these proposed requirements are better aligned with the value of the limit order and continue to require an appropriate amount of minimum price improvement over a customer limit order before a member can trade for its own account.

Second, the current minimum price improvement standard for limit orders priced over $1.00 is $.01 and applies uniformly to NMS stocks and OTC equity securities. However, given that subpenny quoting and trading is permissible in OTC equity securities priced over $1.00 (and therefore subpenny spreads are possible), NASD believes that the minimum price improvement standard should be adjusted to also include a measure based on the inside spread, consistent with the standards below $1.00.

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5 The proposed minimum price-improvement provisions in this rule filing do not supersede, alter or otherwise affect any of the minimum pricing increment restrictions under Rule 612 of Regulation NMS. Rule 612 of Regulation NMS prohibits market participants from displaying, ranking, or accepting quotations, orders, or indications of interest in any NMS stock priced in an increment smaller than $0.01 if the quotation, order, or indication of interest is priced equal to or greater than $1.00 per share. If the quotation, order, or indication of interest in any NMS stock is priced less than $1.00 per share, the minimum pricing increment is $0.0001. See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR37496 (June 29, 2005).

6 For customer limit orders in securities for which there is no published inside market, the minimum amount of price improvement required would default to the same tiered minimum price improvement standards described herein. NASD believes that the minimum price improvement requirement of $.01 for customer limit orders in securities for which there is no published inside market is disproportionately high for lower-priced securities and, therefore, the proposed tiered requirements are more appropriate.

Accordingly, NASD is proposing that for customer limit orders for OTC equity securities priced greater than or equal to $1.00, the minimum amount of price improvement required is the lesser of $0.01 or one-half (1/2) of the current inside spread.[7]

Finally, NASD is proposing to change the minimum price improvement standard for limit orders priced outside the inside market. Although typically trades occur at or inside the best inside market, firms may trade proprietarily outside the best inside market for a variety of reasons, such as where there is little or no depth at the inside market or the inside market is manual or not easily accessible. Under the current requirements, such trades would trigger all limit orders priced outside the inside market, no matter how far outside the inside market the limit order is priced. For example, the best inside market for a security is $.50 to $.51. The member is displaying a quote to buy at $.49 and also is holding a customer limit order to buy priced at $.45. The member's quotation is accessed by another broker-dealer and the member buys at $.49. Under the current requirements, the member would be required to fill the customer's purchase order at $.45 because it had not purchased at the inside market of $.50.

NASD does not believe this is an appropriate result, and is therefore proposing that, where the limit order is priced outside the inside market for the security, the minimum amount of price improvement required must either meet the same tiered minimum price improvement standards set forth above or the member must trade at a price at or inside the best inside market for the security. NASD believes this will continue to require an appropriate amount of price improvement for a member to trade

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[7] Other than the proposed distinction to address permissible subpenny quoting and trading in OTC equity securities priced over $1.00, the proposed price-improvement standards will apply uniformly to NMS stocks and OTC equity securities. See supra note 5.

ahead of a customer limit order, irrespective of whether the limit order is priced inside or outside the best inside market.

As noted above, NASD proposes to implement the proposed rule change on the final implementation date of SR-NASD-2005-146, November 26, 2007.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[8] 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 better reflects trading in low-priced securities and the application of IM-2110-2.

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

NASD 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

The original filing, SR-NASD-2005-146, which proposed the recently approved price-improvement standards, was subject to notice and comment.[9] No comments were received in response to the Federal Register publication of that filing. However, following SEC approval, several broker-dealers raised concerns regarding the application

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8 15 U.S.C. 78o–3(b)(6).

9 See Securities Exchange Act Release No. 54705 (November 3, 2006), 71 FR 65863 (November 9, 2006) (notice of filing of SR-NASD-2005-146 and Amendment Nos. 1 and 2 thereto).

of the amended price-improvement standards, in particular for securities trading below $.01 and those trading outside the best inside market. One broker-dealer indicated that the inside market may not be a good reflection of trading in certain OTC equity securities. With respect to these low-priced OTC equity securities, the broker-dealer indicated that the amended price-improvements standards could result in a minimum price improvement that is significantly greater than the value of the security. Additionally, certain broker-dealers indicated that, under the amended minimum price improvement standards, firms that trade proprietarily outside the best inside market would trigger all customer limit orders outside the best inside market. These broker-dealers recommended that NASD revisit the amended price-improvement standards to better address trading in low-priced securities and trading outside the best inside market.

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.

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. Please include File Number SR-NASD-2007-041 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-2007-041. 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-2007-041 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.[10]

Nancy M. Morris

Secretary

10 17 CFR 200.30-3(a)(12).