

**ACTION REQUESTED BY
APRIL 10, 2000**

Proposed Recordkeeping And Reporting Requirements Of Certain Quotations

NASD Regulation
Requests Comment On
Proposed Recordkeeping
And Reporting
Requirements For
Quotations On Certain
Automated, Inter-Dealer
Quotation Systems;
**Comment Period
Expires April 10, 2000**

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Legal & Compliance
- Operations
- Senior Management
- Technology
- Trading and Market Making

KEY TOPICS

- OTC Securities
- Recording And Reporting Quotation Data
- Market Making

Executive Summary

NASD Regulation, Inc. (NASD RegulationSM) requests comment from members, investors, and other interested parties on a rule proposal that would require members to record and maintain their proprietary quotations displayed in certain automated, inter-dealer quotation systems, such as the Electronic Pink Sheets (EPS), and to report such data to NASD Regulation upon request. Access to this quotation data is an integral part of NASD Regulation's efforts to surveil for member compliance with applicable rules and regulations. In addition, with respect to allegations of fraud or certain types of unusual trading activity, quotation data is necessary to reconstruct the market in order to obtain an accurate and complete representation of the cause of the potentially fraudulent or unusual activity.

The proposed rule would permit a member to use a reporting agent to provide the quotation data to NASD Regulation, with the member being ultimately responsible for provision of the data. NASD Regulation believes that most, if not all, members will use the services of a reporting agent, which will likely be the operator of the system, such as the National Quotation Bureau (NQB) with respect to the EPS. However, if a member knows or has reason to believe that it or its reporting agent is not complying with the requirements of the proposed rule, the member would be required immediately to withdraw its proprietary quotations until such time that the member is satisfied that the quotation data is being properly maintained and reported.

Included with this *Notice to Members* are Attachment A (the text of the proposed rule) and

Attachment B (specific questions that NASDR requests comments on from members and interested parties).

Request For Comment

NASD Regulation is seeking comment on a rule proposal relating to recordkeeping and reporting requirements of quotations on certain automated, inter-dealer quotation systems. NASD Regulation encourages all members, investors and interested parties to comment on the proposed rule. For your convenience, we have provided a checklist (see Attachment B) so that in a minimum amount of time you can provide NASD Regulation with your general comments. Comments must be received by **April 10, 2000**.

Members and interested parties can submit their comments using the following methods:

- 1) mailing in the checklist (Attachment B)
- 2) mailing in written comments
- 3) e-mailing written comments to: pubcom@nasd.com
- 4) submitting comments online at the NASDR Web Site (www.nasdr.com)

If you decide to send comments using both the checklist and one of the other methods listed above, please let us know. The checklist and/or written comments should be mailed to:

Joan C. Conley
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, NW
Washington, DC 20006-1500

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The only comments that will be considered are those submitted in writing, either via e-mail, regular mail, or the NASDR Web Site.

Before becoming effective, the NASD Regulation Board of Directors must adopt, and the Securities and Exchange Commission (SEC) must approve, any rule change. The NASD Board of Governors also may review the rule change.

Questions/Further Information

As noted, written comments should be submitted to Joan C. Conley. Questions concerning this *Notice to Members—Request for Comments* may be directed to the Legal Section, Market Regulation Department, at (301) 590-6410; or Stephanie M. Dumont, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8176.

Background

In September 1999, the EPS service, which is operated by the NQB, began displaying real-time, online stock quotations for approximately 5,000 securities. Some members may now enter quotations in the EPS, which are displayed over the Internet at the EPS Web Site on a real-time basis. Prior to the availability of EPS, the “pink sheets” consisted of weekly lists of quotes printed in hard copy by NQB. NQB updated these non-binding quotations by means of a daily facsimile to subscribers. Market participants could access intra-day quotations only by telephone or similar means of communication to Market Makers in the security.¹

Because the EPS now displays quotations on a real-time basis, NASD Regulation staff requires access to this quotation data to

surveil adequately for member compliance with applicable rules and regulations and, when necessary, to reconstruct market activity. For example, member activities in the EPS are subject to NASD Rule 3320, “Offers at Stated Prices,” which requires that a member’s quotations be “firm,” *i.e.*, the member is expected to buy or sell at least a normal unit of trading in the quoted stock at its then prevailing quotations, unless clearly designated otherwise. In addition, NASD Rule 6750 provides that every member firm that functions as a Market Maker in over-the-counter (OTC) equity securities on an inter-dealer quotation system that permits quotation updates on a real-time basis must honor those quotations for the minimum size applicable to the Market Maker’s firm bid or ask. Although complete trade report data would be available through existing trade reporting requirements and systems, NASD Regulation staff does not otherwise have access to historical quotation activity at the time of trades.²

Therefore, NASD Regulation is proposing that members that participate in automated quotation systems such as the EPS be required to record and maintain their proprietary quotation data.

Proposed Rule

Under the proposal, members that publish quotations on the EPS (or any similar automated quotation system) would be required to record and maintain proprietary quotation data on a daily basis and to report such quotation data to NASD Regulation upon its request. The proposed rule would require that members record their quotation activity by the end of each business day and preserve such records in accordance with Rule 17a-4(a) under the Securities Exchange Act of 1934 (Exchange Act).

Specifically, under Rule 17a-4, members would be required to preserve these records for a period of not less than six years, the first two years in an accessible place.

The proposed rule would not apply to quotations provided on an inter-dealer quotation system that is qualified pursuant to Section 17B of the Exchange Act, because by definition, such a system would be sponsored and regulated by a registered securities association or national securities exchange, and quotation information would be available from the system directly. This includes, for example, the OTC Bulletin Board[®], which is sponsored and regulated by the NASD. In addition, the proposed rule would not apply to an inter-dealer quotation system that is operated by a member of the NASD because the NASD would obtain quotation data (or in many cases, the display of limit orders) directly from the member that operates the system.

The proposed rule would permit a member to use a reporting agent to provide the quotation data to NASD Regulation. NASD Regulation believes that most, if not all, firms would use the services of a reporting agent, which would likely be the operator of the system, such as NQB. In this regard, we anticipate that the operator of the system will provide NASD Regulation all relevant quotation data directly on a daily or ongoing basis. The member, however, would remain ultimately responsible for complying with all requirements of the proposed rule, notwithstanding the use of a reporting agent. If a member knows or has reason to believe that it or its reporting agent is not complying with the requirements of the rule, the member would be required immediately to withdraw its

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proprietary quotations until such time that the member is satisfied that the quotation data is being properly maintained and reported. In this regard, the NASD would expect a member to periodically review or monitor the reporting agent's activities to ensure continued compliance.

The proposed rule would require members to record and report the time of the quotation displayed, the bid and bid quotation size, the offer and offer quotation size, and the prevailing inside bid and offer at the time of the quotation. The member would need to record this information for all updates in quotations or quotation size.

Endnotes

¹NASD Rule 2320(g) requires that a member executing a customer order in these securities obtain quotations from at least three dealers (or all dealers if three or less) to determine the best inter-dealer market prior to executing a trade.

²While quotation data generally is provided directly by the exchange or system on which it is displayed, in this instance, the operator of the system, NQB, is not a registered broker/dealer, a member of the NASD, or a national securities exchange.

ATTACHMENT A

Text Of Proposed Rule

Rule 6630. Recording of Quotation Information

(a) Quotation Recording Requirements

(1) Subject to the terms and conditions contained herein, each member that displays in an automated quotation medium proprietary quotations or indications of interest in OTC Equity Securities shall record each item of information described in paragraph (b) of this Rule. This quote activity record must reflect all changes in an OTC Market Maker's proprietary quotation or quotation size displayed, and the time each such change was made.

(2) Members shall, by the end of each business day, record each item of information required to be recorded under this Rule in such form as is prescribed by the Association from time to time.

(3) Maintaining and Preserving Records

(A) Each member shall maintain and preserve records of the information required to be recorded under this Rule for the period of time and accessibility specified in SEC Rule 17a-4(a).

(B) The records required to be maintained and preserved under this Rule may be immediately produced or reproduced on "micrographic media" as defined in SEC Rule 17a-4(f)(1)(i) or by means of

"electronic storage media" as defined in SEC Rule 17a-4(f)(1)(ii) that meet the conditions set forth in SEC Rule 17a-4(f) and be maintained and preserved for the required time in that form.

(b) Information to be Recorded

The quote activity record required pursuant to paragraph (a) of this Rule shall contain, at a minimum, the following information for every proprietary quotation displayed throughout the trading day:

- (1) Submitting Firm;
- (2) Inter-dealer quotation medium;
- (3) Trade Date;
- (4) Time Quotation Displayed (expressed in hours, minutes and seconds);
- (5) Security Name and Symbol;
- (6) Bid and Bid Quotation Size;
- (7) Offer and Offer Quotation Size;
- (8) Prevailing Inside Bid; and
- (9) Prevailing Inside Offer

If no updates were entered to an OTC Market Maker's proprietary quotation or quotation size for any given trading day, the member must record the information in subparagraphs (b)(1) through (7).

(c) Quotations Not Required To Be Recorded

The recording requirements contained in paragraphs (a) and (b)

of this Rule shall not apply to quotations of OTC Equity Securities that are displayed on an inter-dealer quotation system that is:

- (1) qualified pursuant to Section 17B of the Act; or
- (2) operated by a member of the Association.

(d) Reporting Requirements

(1) General Requirement

Members shall report information required to be recorded under this Rule to the Association upon its request.

(2) Method of Transmitting Data

Members shall transmit this information in the form prescribed by the Association.

(e) Reporting Agent Agreements

(1) "Reporting Agent" shall mean a third party that enters into any agreement with a member pursuant to which such third party agrees to fulfill such member's obligations under this Rule.

(2) Any member may enter into an agreement with a Reporting Agent pursuant to which the Reporting Agent agrees to fulfill the obligations of such member under this Rule. Any such agreement shall be evidenced in writing, which shall specify the respective functions and responsibilities of each party to the agreement that are required to effect full compliance with the requirements of this Rule.

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(3) All written documents evidencing an agreement described in paragraph (e)(2) shall be maintained by each party to the agreement.

(4) Each member remains responsible for compliance with the requirements of this Rule, notwithstanding the existence of an agreement described in this

paragraph. If a member knows or has reason to believe that its Reporting Agent is not complying with the requirements of this Rule, the member must immediately withdraw its proprietary quotations until such time that the member is satisfied that the quotation data is being properly maintained and reported.

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ATTACHMENT B

Request For Comment Checklist—Questions For Members And Other Interested Parties

The following list of questions provides a quick and easy means to comment on some of the provisions contained in the proposal. This list of questions does not cover all of the changes contained in the proposal; therefore, we encourage members and other interested parties to review the entire proposal and to comment separately on all aspects of the proposal.

Instructions

Comments must be received by **April 10, 2000**. Members and interested parties can submit their comments using the following methods:

- mailing in this checklist
- e-mailing written comments to *pubcom@nasd.com*
- mailing in written comments
- submitting comments online at the NASDR Web Site (*www.nasdr.com*)

The checklist and/or written comments and should be mailed to:

Joan C. Conley
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1. Do you support the proposed rule described in the *Notice*?

Yes No See my attached written comments

2. Is the specific information that would be required to be recorded and reported under the proposed rule appropriate?

Yes No See my attached written comments

3. Are the use of "Reporting Agent" agreements appropriate for compliance with the proposed requirements?

Yes No See my attached written comments

Contact Information

Name: _____

Firm: _____

Address: _____

City/State/Zip: _____

Phone: _____

E-Mail: _____

Are you:

An NASD Member

An Investor

A Registered Representative

Other: _____