

Proposed Rule Change by National Association of Securities Dealers  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

|  |                                       |  |   |   |   |
|--|---------------------------------------|--|---|---|---|
| Initial<br><input checked="" type="checkbox"/>                             | Amendment<br><input type="checkbox"/> | Withdrawal<br><input type="checkbox"/> | Section 19(b)(2)<br><input checked="" type="checkbox"/> | Section 19(b)(3)(A)<br><input type="checkbox"/> | Section 19(b)(3)(B)<br><input type="checkbox"/> |
| Pilot<br><input type="checkbox"/>  |                                       |  | Rule  |   |   |
| Extension of Time Period for Commission Action<br><input type="checkbox"/> |                                       | Date Expires<br><input type="text"/>   | <input type="checkbox"/> 19b-4(f)(1)                    | <input type="checkbox"/> 19b-4(f)(4)            | <input type="checkbox"/> 19b-4(f)(5)            |
|  |                                       |  | <input type="checkbox"/> 19b-4(f)(2)                    | <input type="checkbox"/> 19b-4(f)(6)            |   |
|  |                                       |  | <input type="checkbox"/> 19b-4(f)(3)                    |   |   |

|  |  |
|--|--|
| Exhibit 2 Sent As Paper Document<br><input type="checkbox"/> | Exhibit 3 Sent As Paper Document<br><input type="checkbox"/> |
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**Description**  
Provide a brief description of the proposed rule change (limit 250 characters).

Proposed Rule Change Relating to NASD's Direct Authority for the Activities Related to or in Support of Trading in Over-the-Counter Equity Securities

**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 | <input type="text" value="Andrea"/>                    | Last Name | <input type="text" value="Orr"/>            |
| Title      | <input type="text" value="Assistant General Counsel"/> |           |   |
| E-mail     | <input type="text" value="andrea.orr@nasd.com"/>       |           |   |
| Telephone  | <input type="text" value="(202) 728-8156"/>            | Fax       | <input type="text" value="(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.

|      |   |
|------|---|
| Date | <input type="text" value="07/19/2005"/>                                       |
| By   | <input type="text" value="Patrice Gliniecki"/>                                |
|      | (Name)  |
|      | <input type="text" value="Senior Vice President and Deputy 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.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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

**Form 19b-4 Information**

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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**

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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**

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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**

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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**

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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**

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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**

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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. Text of Proposed Rule Change**

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to NASD’s Plan of Allocation and Delegation of Functions by NASD to Subsidiaries (“Delegation Plan”) and certain NASD rules to reflect NASD’s direct authority for the activities related to or in support of trading in over-the-counter (“OTC”) equity securities,<sup>1</sup> including, but not limited to, the OTC Bulletin Board (“OTCBB”), rather than the current delegation of such authority to The Nasdaq Stock Market, Inc. (“Nasdaq”).

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

\* \* \* \* \*

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

**I. NASD, Inc.**

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

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

B. through E. No change.

## **II. NASD Regulation, Inc.**

### **A. Delegation of Functions and Authority:**

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

a. through s. No Change.

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

B. No Change.

### **C. Supplemental Delegation Regarding Committees**

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<sup>1</sup> The term "OTC equity securities" herein refers to OTC Equity Securities as defined in the Rule 6600 Series, including, but not limited to, OTC Bulletin Board securities.

1. No Change.

**2. [Operations] Uniform Practice Code Committee**

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

i. through iii. No Change.

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

**III. Nasdaq**

**A. Delegation of Functions and Authority**

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

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

b. and c. No change.

d. To develop and adopt rule changes (i) applicable to the collection, processing, and dissemination of quotation and transaction information for

securities traded on The Nasdaq Stock Market, on other markets operated by The Nasdaq Stock Market, and in the third market for securities listed on a registered exchange, [and in the over-the-counter market, ](ii) for Nasdaq-operated trading systems for these securities, and (iii) establishing trading practices with respect to these securities.

e. through o. No change.

2. No change.

B. and C. No Change.

#### **IV. and V. No Change.**

\* \* \* \* \*

#### **6545. Trading and Quotation Halt in OTCBB-Eligible Securities**

##### **(a) Authority for Initiating a Trading and Quotation Halt**

In circumstances in which it is necessary to protect investors and the public interest, [Nasdaq]NASD may direct members, pursuant to the procedures set forth in paragraph (b), to halt trading and quotations in the over-the-counter ("OTC") market of a security or an American Depositary Receipt ("ADR") that is included in the OTC Bulletin Board ("OTCBB") if:

(1) the OTCBB security or the security underlying the OTCBB ADR is listed on or registered with a foreign securities exchange or market, and the foreign securities exchange, market, or regulatory authority overseeing such issuer, exchange, or market, halts trading in such security for regulatory reasons because of public interest concerns ( "Foreign Regulatory Halt"); provided, however, that

[Nasdaq]NASD will not impose a trading and quotation halt if the Foreign Regulatory Halt was imposed solely for material news, a regulatory filing deficiency, or operational reasons; or

(2) through (3) No change.

**(b) Procedure for Initiating a Trading and Quotation Halt**

(1) When a halt is initiated under subparagraph (a)(1) of this rule, upon receipt of information from a foreign securities exchange or market on which the OTCBB security or the security underlying the OTCBB ADR is listed or registered, or from a regulatory authority overseeing such issuer, exchange, or market, [Nasdaq]NASD will promptly evaluate the information and determine whether a trading and quotation halt in the OTCBB security is appropriate.

(2) Should [Nasdaq]NASD determine that a basis exists under this rule for initiating a trading and quotation halt, the commencement of the trading and quotation halt will be effective simultaneous with the issuance of appropriate public notice.

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

(c) No change.

\* \* \* \* \*

**7010. System Services**

(a) through (o) No change.

**(p) Historical Research and Administrative Reports**

(1) and (2) No change.

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

A. No change

B. No change

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

D. No change

(4) No change.

\* \* \* \* \*

**11120. Definitions**

**(a) Committee**

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

(b) through (g) No Change.

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\* The Board of Governors has so designated the [Association's Operations] NASD's UPC Committee.

\* \* \* \* \*

**11890. Clearly Erroneous Transactions**

(a) No change

**(b) Procedures for Reviewing Transactions on NASD's or Nasdaq's Own**

**Motion**

(1) In the event of (i) a disruption or malfunction in the use or operation of any quotation, execution, communication, or trade reporting system owned or operated by Nasdaq and approved by the Commission, or (ii) extraordinary market conditions or other circumstances in which the nullification or modification of

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

(2) In the event of (i) a disruption or malfunction in the use or operation of any quotation, communication, or trade reporting system owned or operated by NASD or its subsidiaries and approved by the Commission, or (ii) extraordinary market conditions in which the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest, an Executive Vice President of NASD's Market

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

**(c) Review by the Market Operations Review Committee ("MORC") or the Uniform Practice Code ("UPC") Committee**

(1) A member, member of a UTP Exchange, or person associated with any such member may appeal a determination made under subsection (a) to the MORC. A member, member of a UTP Exchange, or person associated with any such member may appeal a determination made under subsection (b) (1) to the MORC, or a determination made under subsection (b)(2) to the UPC Committee, unless the officer making the determination also determines that the number of the affected transactions is such that immediate finality is necessary to maintain a fair and orderly market and to protect investors and the public interest. An appeal must be made in writing, and

must be received by Nasdaq or NASD, as applicable, within thirty (30) minutes after the person making the appeal is given the notification of the determination being appealed, except that if Nasdaq or NASD notifies the parties of action taken pursuant to paragraph (b) after 4:00 p.m., the appeal must be received by [Nasdaq by] 9:30 a.m. the next trading day. Once a written appeal has been received, the counterparty to the trade will be notified of the appeal and both parties shall be able to submit any additional supporting written information up until the time the appeal is considered by the appropriate Committee. Either party to a disputed trade may request the written information provided by the other party during the appeal process. An appeal [to the Committee] shall not operate as a stay of the determination being appealed. Once a party has appealed a determination to the appropriate Committee, the determination shall be reviewed and a decision rendered, unless both parties to the transaction agree to withdraw the appeal prior to the time a decision is rendered [by the Committee]. Upon consideration of the record, and after such hearings as it may in its discretion order, the MORC or the UPC Committee, pursuant to the standards set forth in this section, shall affirm, modify, reverse, or remand the determination.

(2) The decision of [the] a Committee pursuant to an appeal, or a determination by a Nasdaq or NASD officer that is not appealed, shall be final and binding upon all parties and shall constitute final [Association] action on the matter in issue. Any determination by a Nasdaq or NASD officer pursuant to paragraph (a) or (b) or any decision by [the] a Committee pursuant to paragraph (c)(1) shall be

rendered without prejudice as to the rights of the parties to the transaction to submit their dispute to arbitration.

**(d) Communications**

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

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

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

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

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

For purposes of Rule 11890 and other NASD rules that permit review of Nasdaq or NASD decisions by the MORC or the UPC Committee, respectively, a decision of the MORC or the UPC Committee may be rendered by a panel of three or more members of [the MORC] that Committee, provided that no more than 50 percent of the members of any panel are directly engaged in market making activity or employed by a member firm whose revenues from market making activity exceed ten percent of its total revenues.

\* \* \* \* \*

(b) Not applicable.

(c) Not applicable.

**2. Procedures of the Self-Regulatory Organization**

The proposed rule change was approved by the Board of Governors of NASD at its meeting on November 18, 2004, which authorized the filing of the rule change with the SEC. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the Board of Governors of NASD to adopt amendments to NASD Rules without recourse to the membership for approval.

The proposed rule change will be effective on September 1, 2005, assuming SEC approval prior to that date.

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

(a) Purpose

Pursuant to the Delegation Plan, activities related to or in support of the trading in OTC equity securities, including, but not limited to, operation of the OTCBB<sup>2</sup> (collectively referred to herein as “OTC equity operations”), have been delegated to Nasdaq. In this context, OTC equity operations includes services such as trade reporting, comparison, quote collection and dissemination, as applicable, and the related rulemaking functions in this area. NASD is proposing to assume direct authority for OTC equities operations rather than delegate it to Nasdaq and delegate to NASD Regulation rulemaking authority related to trading practices for OTC equity securities. NASD intends to contract with Nasdaq to have it continue to provide the OTCBB quotation and trade reporting platform and certain other services that it currently provides with respect to OTC equity operations. As a result, market makers and other users of such services will continue to access the OTCBB and other OTC equity services in the same way they do today.

In furtherance of this transition, NASD also is proposing to: (1) transfer trading and quotation halt authority for OTCBB-eligible securities from Nasdaq to NASD; (2) transfer the authority to set certain fees in this area from Nasdaq to NASD; and (3) transfer from Nasdaq to NASD the ability to nullify or modify a transaction in an OTC equity security due

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<sup>2</sup> The OTCBB provides an electronic quotation medium for subscribing members to enter, update, and display quotations in individual securities on a real-time basis. Such quotation entries may consist of a priced bid and/or offer; an unpriced indication of interest; or a bid/offer accompanied by a modifier to reflect unsolicited customer interest. The OTCBB is not an issuer listing service and therefore does not maintain a relationship with quoted issuers or impose quantitative listing standards as do Nasdaq and the exchanges. To be eligible for quotation on the OTCBB, issuers must be current in their filings with the SEC or applicable regulatory authority.

to a disruption or malfunction in the use or operation of any quotation, communication, or trade reporting system or other extraordinary market conditions.

#### Delegation Plan Changes

NASD will be assuming direct responsibility for OTC equity operations and is therefore proposing to delete the delegation of authority to Nasdaq of these functions and also to delegate to NASD Regulation rulemaking authority related to trading practices for OTC equity securities. Nasdaq will continue to operate the Nasdaq Stock Market and other markets or systems, as appropriate, and will maintain its delegation of authority accordingly. In addition, NASD is proposing a technical change in the introductory language of Section I of the Delegation Plan, to delete the reference to “wholly-owned” subsidiaries given that Nasdaq is no longer a wholly-owned subsidiary of NASD.

#### OTCBB Trading and Quotation Halts

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

#### Charges and Fees

NASD will be responsible for determining fees associated with OTC equity operations. With one exception noted below, the fee provisions within Rule 7010 for

services related to OTC equity operations do not explicitly provide the authority to set such fees to Nasdaq, so no rule changes are necessary. The one exception is Rule 7010(p)(3), which governs the charges for historical research reports for OTCBB-eligible securities. As a result, NASD is proposing to amend Rule 7010(p)(3) to provide that NASD has authority set fees in this area. NASD is not proposing any changes to the current fee structure associated with OTC equity operations at this time.

Clearly Erroneous Authority

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

The proposed rule change will be effective on September 1, 2005, assuming SEC approval prior to that date.

(b) Statutory Basis

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

**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, as amended.

**5. 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.

**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.

**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**

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-2005-089)

**SELF-REGULATORY ORGANIZATIONS**

Proposed Rule Change by National Association of Securities Dealers, Inc.  
Relating to NASD's Direct Authority for the Activities Related to or in Support of Trading in  
Over-the-Counter Equity Securities

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> 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 NASD's Plan of Allocation and Delegation of Functions by NASD to Subsidiaries ("Delegation Plan") and certain NASD rules to reflect NASD's direct authority for the activities related to or in support of trading in over-the-counter ("OTC") equity securities,<sup>3</sup> including, but not limited to, the OTC Bulletin Board ("OTCBB"), rather than the current delegation of such authority to The Nasdaq Stock

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> The term "OTC equity securities" herein refers to OTC Equity Securities as defined in the Rule 6600 Series, including, but not limited to, OTC Bulletin Board securities.

Market, Inc. ("Nasdaq").

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

\* \* \* \* \*

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

### **I. NASD, Inc.**

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B. through E. No change.

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**A. Delegation of Functions and Authority:**

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

a. through s. No Change.

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

B. No Change.

**C. Supplemental Delegation Regarding Committees**

1. No Change.

**2. [Operations] Uniform Practice Code Committee**

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

i. through iii. No Change.

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

### **III. Nasdaq**

#### **A. Delegation of Functions and Authority**

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

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

b. and c. No change.

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

e. through o. No change.

2. No change.

B. and C. No Change.

### **IV. and V. No Change.**

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#### **6545. Trading and Quotation Halt in OTCBB-Eligible Securities**

##### **(a) Authority for Initiating a Trading and Quotation Halt**

In circumstances in which it is necessary to protect investors and the public interest, [Nasdaq]NASD may direct members, pursuant to the procedures set forth in paragraph (b), to halt trading and quotations in the over-the-counter ("OTC") market of a security or an American Depositary Receipt ("ADR") that is included in the OTC Bulletin Board ("OTCBB") if:

(1) the OTCBB security or the security underlying the OTCBB ADR is listed on or registered with a foreign securities exchange or market, and the foreign securities exchange, market, or regulatory authority overseeing such issuer, exchange, or market, halts trading in such security for regulatory reasons because of public interest concerns ( "Foreign Regulatory Halt"); provided, however, that [Nasdaq]NASD will not impose a trading and quotation halt if the Foreign Regulatory Halt was imposed solely for material news, a regulatory filing deficiency, or operational reasons; or

(2) through (3) No change.

**(b) Procedure for Initiating a Trading and Quotation Halt**

(1) When a halt is initiated under subparagraph (a)(1) of this rule, upon receipt of information from a foreign securities exchange or market on which the OTCBB security or the security underlying the OTCBB ADR is listed or registered, or from a regulatory authority overseeing such issuer, exchange, or market, [Nasdaq]NASD will promptly evaluate the information and determine whether a trading and quotation halt in the OTCBB security is appropriate.

(2) Should [Nasdaq]NASD determine that a basis exists under this rule for initiating a trading and quotation halt, the commencement of the trading and

quotation halt will be effective simultaneous with the issuance of appropriate public notice.

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

(c) No change.

\* \* \* \* \*

#### **7010. System Services**

(a) through (o) No change.

#### **(p) Historical Research and Administrative Reports**

(1) and (2) No change.

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

A. No change

B. No change

C. [Nasdaq]NASD may, in its discretion, choose to make a report that purchasers wish to obtain every trading day available on a subscription

discount basis. In such cases, the price for a subscription to receive a report every trading day in a month shall be the applicable rate to receive the report for a day times 20; the price for a subscription to receive the report for every trading day in a quarter shall be the applicable rate to receive the report every day times 60; and the price for a subscription to receive a report every trading day in a year shall be the applicable rate to receive the report for a day times 240.

D. No change

(4) No change.

\* \* \* \* \*

#### **11120. Definitions**

##### **(a) Committee**

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

(b) through (g) No Change.

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\* The Board of Governors has so designated the [Association's Operations] NASD's UPC Committee.

\* \* \* \* \*

#### **11890. Clearly Erroneous Transactions**

(a) No change

**(b) Procedures for Reviewing Transactions on NASD's or Nasdaq's Own**

**Motion**

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

(2) In the event of (i) a disruption or malfunction in the use or operation of any

quotation, communication, or trade reporting system owned or operated by NASD or its subsidiaries and approved by the Commission, or (ii) extraordinary market conditions in which the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest, an Executive Vice President of NASD's Market Regulation Department or an Executive Vice President of NASD's Transparency Services Department may, on his or her own motion, review any transaction in an OTC equity security, as defined in Rule 6610, arising out of or reported through any such quotation, communication, or trade reporting system. An NASD officer acting pursuant to this subsection may declare any such transaction null and void or modify the terms of any such transaction if the officer determines that (i) the transaction is clearly erroneous, or (ii) such actions are necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest; provided, however, that, in the absence of extraordinary circumstances, the officer must take action pursuant to this subsection within thirty (30) minutes of detection of the transaction, but in no event later than 3:00 p.m., Eastern Time, on the next trading day following the date of the trade at issue.

**(c) Review by the Market Operations Review Committee ("MORC") or the Uniform Practice Code ("UPC") Committee**

(1) A member, member of a UTP Exchange, or person associated with any such member may appeal a determination made under subsection (a) to the MORC. A member, member of a UTP Exchange, or person associated with any such member may appeal a determination made under subsection (b) (1) to the MORC, or a

determination made under subsection (b)(2) to the UPC Committee, unless the officer making the determination also determines that the number of the affected transactions is such that immediate finality is necessary to maintain a fair and orderly market and to protect investors and the public interest. An appeal must be made in writing, and must be received by Nasdaq or NASD, as applicable, within thirty (30) minutes after the person making the appeal is given the notification of the determination being appealed, except that if Nasdaq or NASD notifies the parties of action taken pursuant to paragraph (b) after 4:00 p.m., the appeal must be received by [Nasdaq by] 9:30 a.m. the next trading day. Once a written appeal has been received, the counterparty to the trade will be notified of the appeal and both parties shall be able to submit any additional supporting written information up until the time the appeal is considered by the appropriate Committee. Either party to a disputed trade may request the written information provided by the other party during the appeal process. An appeal [to the Committee] shall not operate as a stay of the determination being appealed. Once a party has appealed a determination to the appropriate Committee, the determination shall be reviewed and a decision rendered, unless both parties to the transaction agree to withdraw the appeal prior to the time a decision is rendered[ by the Committee]. Upon consideration of the record, and after such hearings as it may in its discretion order, the MORC or the UPC Committee, pursuant to the standards set forth in this section, shall affirm, modify, reverse, or remand the determination.

(2) The decision of [the] a Committee pursuant to an appeal, or a determination by a Nasdaq or NASD officer that is not appealed, shall be final and binding upon all parties and shall constitute final [Association] action on the matter in

issue. Any determination by a Nasdaq or NASD officer pursuant to paragraph (a) or (b) or any decision by [the] a Committee pursuant to paragraph (c)(1) shall be rendered without prejudice as to the rights of the parties to the transaction to submit their dispute to arbitration.

**(d) Communications**

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

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

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

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

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

For purposes of Rule 11890 and other NASD rules that permit review of Nasdaq or NASD decisions by the MORC or the UPC Committee, respectively, a decision of the MORC or the UPC Committee may be rendered by a panel of three or more members of [the MORC] that Committee, provided that no more than 50 percent of the members of any panel are directly engaged in market making activity or employed by a member firm whose revenues from market making activity exceed ten percent of its total revenues.

\* \* \* \* \*

**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

Pursuant to the Delegation Plan, activities related to or in support of the trading in OTC equity securities, including, but not limited to, operation of the OTCBB<sup>4</sup> (collectively referred to herein as “OTC equity operations”), have been delegated to Nasdaq. In this context, OTC equity operations includes services such as trade reporting, comparison, quote collection and dissemination, as applicable, and the related rulemaking functions in this area. NASD is proposing to assume direct authority for OTC equities operations rather than delegate it to Nasdaq and delegate to NASD Regulation rulemaking authority related to trading practices for OTC equity securities. NASD intends to contract with Nasdaq to have it continue to provide the OTCBB quotation and trade reporting platform and certain other services that it currently provides with respect to OTC equity operations. As a result, market makers and other users of such services will continue to access the OTCBB and other OTC equity services in the same way they do today.

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

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<sup>4</sup> The OTCBB provides an electronic quotation medium for subscribing members to enter, update, and display quotations in individual securities on a real-time basis. Such quotation entries may consist of a priced bid and/or offer; an unpriced indication of interest; or a bid/offer accompanied by a modifier to reflect unsolicited customer interest. The OTCBB is not an issuer listing service and therefore does not maintain a relationship with quoted issuers or impose quantitative listing standards as do Nasdaq and the exchanges. To be eligible for quotation on the OTCBB, issuers must be current in their filings with the SEC or applicable regulatory authority.

### Delegation Plan Changes

NASD will be assuming direct responsibility for OTC equity operations and is therefore proposing to delete the delegation of authority to Nasdaq of these functions and also to delegate to NASD Regulation rulemaking authority related to trading practices for OTC equity securities. Nasdaq will continue to operate the Nasdaq Stock Market and other markets or systems, as appropriate, and will maintain its delegation of authority accordingly. In addition, NASD is proposing a technical change in the introductory language of Section I of the Delegation Plan, to delete the reference to “wholly-owned” subsidiaries given that Nasdaq is no longer a wholly-owned subsidiary of NASD.

### OTCBB Trading and Quotation Halts

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

### Charges and Fees

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

a result, NASD is proposing to amend Rule 7010(p)(3) to provide that NASD has authority set fees in this area. NASD is not proposing any changes to the current fee structure associated with OTC equity operations at this time.

#### Clearly Erroneous Authority

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

The proposed rule change will be effective on September 1, 2005, assuming SEC approval prior to that date.

#### 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of

Section 15A(b)(6) of the Act, 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 changes will clarify the NASD Delegation Plan and rules to reflect NASD's direct responsibility for OTC equity operations.

**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, as amended.

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

Written comments were neither solicited nor received.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, 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](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2005-089 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-2001.

All submissions should refer to File Number SR-NASD-2005-089. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549-2001. 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-2005-089 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

Secretary

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<sup>5</sup> 17 CFR 200.30-3(a)(12).