

Proposed Rule Change by Financial Industry Regulatory Authority  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

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

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

Amend NASD Interpretive Material (IM) 2110-2 (Trading Ahead of Customer Limit Order) to provide an alternative method of calculating the current inside spread.

**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  Last Name   
 Title   
 E-mail   
 Telephone  Fax

**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   
 By  Vice President and Director of Capital Markets Policy  
 (Name) (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”),<sup>1</sup> Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend NASD Interpretive Material (IM) 2110-2 (Trading Ahead of Customer Limit Order) to provide that, for the purpose of determining the minimum price improvement obligation where there is no published current inside spread, members may calculate a current inside spread by contacting and obtaining priced quotations from at least two unaffiliated dealers.

The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

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

At its meeting on September 22, 2005, the FINRA Board of Governors authorized the filing of the proposed rule change with the SEC. No other action by FINRA is necessary for the filing of the proposed rule change.

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

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

(a) Purpose

NASD IM-2110-2 (commonly referred to as the “Manning Rule”) generally prohibits a member from trading for its own account at prices that would satisfy a customer’s limit order unless the member immediately thereafter executes the customer limit order at the price at which it traded for its own account or at a better price. The legal underpinnings for IM-2110-2 are a firm’s basic fiduciary obligations under agency law and the requirement that it must, in the conduct of its business, “observe high standards of commercial honor and just and equitable principles of trade.”

On September 12, 2008, the SEC approved amendments to the minimum price-improvement standards in IM-2110-2 to provide tiered standards that vary according to the price of the customer limit order.<sup>2</sup> The amendments became effective on November 11, 2008.<sup>3</sup> Revised NASD IM-2110-2 prescribes detailed minimum levels of price improvement that a member must provide in order to trade ahead of an unexecuted customer limit order without triggering the protection’s provided by the rule. In other words, the price-improvement standards in IM-2110-2 set forth the minimum amount by which a member must trade, in addition to the price of the customer buy limit order (or less than the price of a customer sell order), to avoid triggering the protections provided by IM-2110-2.

The minimum price improvement tiers are as follows:

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<sup>2</sup> See Securities Exchange Act Release No. 58532 (September 12, 2008), 73 FR 54649 (September 22, 2008) (order approving SR-NASD-2007-041).

<sup>3</sup> See Regulatory Notice 08-49 (September 2008).

- 1) For customer limit orders priced greater than or equal to \$1.00, 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, 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 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.

Therefore, if a firm is holding a customer limit order to buy priced at \$.75 and the applicable minimum price improvement standard is \$.01, the firm would be permitted to buy at \$.76 or higher without triggering the requirements of IM-2110-2.

The proposed rule change is being filed to provide members with an alternative method of calculating the minimum price improvement in cases where a member receives a limit order priced to sell an OTC equity security below \$1.00 and there is no quoted market. The minimum price-improvement standards are either a fixed amount or one-half ( $\frac{1}{2}$ ) of the current inside spread. However, where there is no current inside spread, the minimum price-improvement standard defaults to the fixed amount which, in certain circumstances, can equal the price of the customer limit order. For example, where a member receives a customer limit order priced at \$.01 and there is no current published inside spread, the minimum price-improvement standard would still be equal to \$.01, which would require the member to sell at 0 (\$.01 minus \$.01) to avoid triggering the customer limit order. Thus, under the current rule, the member is effectively prohibited from selling while the customer limit order is pending. FINRA believes that this result is overly restrictive.

Thus FINRA is proposing to amend IM-2110-2 to provide that, for the purpose of determining the minimum price improvement obligation where there is no published current inside spread, member firms may calculate a current inside spread by contacting

and obtaining priced quotations from at least two unaffiliated dealers. FINRA believes that obtaining priced quotations from a minimum of two unaffiliated dealers provides an adequate proxy for an inside spread typically displayed for an OTC equity security, but members are free to contact more than two unaffiliated dealers. Once the member has obtained bid and ask prices from at least two unaffiliated dealers, the highest bid and lowest offer obtained must be used as the basis for calculating the current inside spread for purposes of determining the member's minimum price improvement obligation.

Additionally, where there is a one-sided quote, the proposed rule change would permit a member to determine the current inside spread by using the best price obtained from at least two unaffiliated dealers on the other side of the quote. Members must document (1) the name of each dealer contacted and (2) the quotations received that were used as the basis for determining the current inside spread. The proposed rule change would apply solely to minimum price-improvement calculations under IM-2110-2 and would not implicate other rules or requirements (e.g., Three Quote Rule).

The proposed rule change would address the unintended effective prohibition on selling while certain customer limit orders are pending by providing members with an alternative means of determining the inside spread for use as the basis for calculating its minimum price-improvement obligation.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>4</sup> which requires, among other things, that FINRA 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. FINRA believes that the proposed rule change will address an unintended consequence of the minimum price-improvement standards set forth in IM-2110-2 while continuing to promote investor protection and improving the treatment of customer limit orders.

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

FINRA 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**

Written comments were neither solicited nor received.

**6. Extension of Time Period for Commission Action**

FINRA 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.<sup>5</sup>

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

Not applicable.

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<sup>4</sup> 15 U.S.C. 78o-3(b)(6).

<sup>5</sup> 15 U.S.C. 78s(b)(2).

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 5. Text of the proposed rule change.

**EXHIBIT 1**

**SECURITIES AND EXCHANGE COMMISSION**

(Release No. 34- ; File No. SR-FINRA-2008-064)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Proposed Rule Change to amend NASD Interpretive Material (IM) 2110-2 (Trading Ahead of Customer Limit Order)

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 , Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a 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 FINRA. 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**

FINRA is proposing to amend NASD Interpretive Material (IM) 2110-2 (Trading Ahead of Customer Limit Order) to provide that, for the purpose of determining the minimum price improvement obligation where there is no published current inside spread, members may calculate a current inside spread by contacting and obtaining priced quotations from at least two unaffiliated dealers.

The text of the proposed rule change is attached as Exhibit 5.

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

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

## **II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, FINRA 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. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

### **A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

#### **1. Purpose**

NASD IM-2110-2 (commonly referred to as the “Manning Rule”) generally prohibits a member from trading for its own account at prices that would satisfy a customer’s limit order unless the member immediately thereafter executes the customer limit order at the price at which it traded for its own account or at a better price. The legal underpinnings for IM-2110-2 are a firm’s basic fiduciary obligations under agency law and the requirement that it must, in the conduct of its business, “observe high standards of commercial honor and just and equitable principles of trade.”

On September 12, 2008, the SEC approved amendments to the minimum price-improvement standards in IM-2110-2 to provide tiered standards that vary according to the price of the customer limit order.<sup>3</sup> The amendments became effective on November 11, 2008.<sup>4</sup> Revised NASD IM-2110-2 prescribes detailed minimum levels of price

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<sup>3</sup> See Securities Exchange Act Release No. 58532 (September 12, 2008), 73 FR 54649 (September 22, 2008) (order approving SR-NASD-2007-041).

<sup>4</sup> See Regulatory Notice 08-49 (September 2008).

improvement that a member must provide in order to trade ahead of an unexecuted customer limit order without triggering the protection's provided by the rule. In other words, the price-improvement standards in IM-2110-2 set forth the minimum amount by which a member must trade, in addition to the price of the customer buy limit order (or less than the price of a customer sell order), to avoid triggering the protections provided by IM-2110-2.

The minimum price improvement tiers are as follows:

- 1) For customer limit orders priced greater than or equal to \$1.00, 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, 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 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.

Therefore, if a firm is holding a customer limit order to buy priced at \$.75 and the applicable minimum price improvement standard is \$.01, the firm would be permitted to buy at \$.76 or higher without triggering the requirements of IM-2110-2.

The proposed rule change is being filed to provide members with an alternative method of calculating the minimum price improvement in cases where a member receives a limit order priced to sell an OTC equity security below \$1.00 and there is no quoted market. The minimum price-improvement standards are either a fixed amount or one-half (1/2) of the current inside spread. However, where there is no current inside spread, the minimum price-improvement standard defaults to the fixed amount which, in certain circumstances, can equal the price of the customer limit order. For example, where a member receives a customer limit order priced at \$.01 and there is no current published inside spread, the minimum price-improvement standard would still be equal to \$.01,

which would require the member to sell at 0 (\$.01 minus \$.01) to avoid triggering the customer limit order. Thus, under the current rule, the member is effectively prohibited from selling while the customer limit order is pending. FINRA believes that this result is overly restrictive.

Thus FINRA is proposing to amend IM-2110-2 to provide that, for the purpose of determining the minimum price improvement obligation where there is no published current inside spread, member firms may calculate a current inside spread by contacting and obtaining priced quotations from at least two unaffiliated dealers. FINRA believes that obtaining priced quotations from a minimum of two unaffiliated dealers provides an adequate proxy for an inside spread typically displayed for an OTC equity security, but members are free to contact more than two unaffiliated dealers. Once the member has obtained bid and ask prices from at least two unaffiliated dealers, the highest bid and lowest offer obtained must be used as the basis for calculating the current inside spread for purposes of determining the member's minimum price improvement obligation.

Additionally, where there is a one-sided quote, the proposed rule change would permit a member to determine the current inside spread by using the best price obtained from at least two unaffiliated dealers on the other side of the quote. Members must document (1) the name of each dealer contacted and (2) the quotations received that were used as the basis for determining the current inside spread. The proposed rule change would apply solely to minimum price-improvement calculations under IM-2110-2 and would not implicate other rules or requirements (e.g., Three Quote Rule).

The proposed rule change would address the unintended effective prohibition on selling while certain customer limit orders are pending by providing members with an

alternative means of determining the inside spread for use as the basis for calculating its minimum price-improvement obligation.

2. **Statutory Basis**

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>5</sup> which requires, among other things, that FINRA 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. FINRA believes that the proposed rule change will address an unintended consequence of the minimum price-improvement standards set forth in IM-2110-2 while continuing to promote investor protection and improving the treatment of customer limit orders.

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

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the Federal Register or

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<sup>5</sup> 15 U.S.C. 78q-3(b)(6).

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-FINRA-2008-064 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Florence Harmon, Acting Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2008-064. 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, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA.

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-FINRA-2008-064 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.

Florence Harmon  
Acting Secretary

**EXHIBIT 5**

Below is the text of the proposed rule change. 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 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.<sup>1</sup> 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).

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<sup>1</sup> For purposes of the operation of certain transaction and quotation reporting systems and facilities during the period from 4 p.m. to 6:30 p.m. Eastern Time, members may generally limit the life of a customer limit order to the period of 9:30 a.m. to 4 p.m. Eastern Time. If a customer does not formally assent ("opt-in") to processing of the customer's limit order(s) during the extended hours

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

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period commencing after the normal close of the market, limit order protection

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 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, 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, the minimum amount of price improvement required is the lesser of \$0.01 or one-half (1/2) of the current inside spread;

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will not apply to that customer's order(s).

3) For customer limit orders priced less than \$.01 but greater than or equal to \$.0001, the minimum amount of price improvement required is the lesser of \$.0001 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 \$.00001, the minimum amount of price improvement required is the lesser of \$.00001 or one-half (1/2) of the current inside spread;

5) For customer limit orders priced less than \$.00001 but greater than or equal to \$.000001, the minimum amount of price improvement required is the lesser of \$.000001 or one-half (1/2) of the current inside spread;

6) For customer limit orders priced less than \$.000001, the minimum amount of price improvement required is the lesser of \$.0000001 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.

For purposes of determining the minimum price improvement standards for customer limit orders in OTC equity securities priced below \$1.00 where there is no published current inside spread, members may calculate a current inside spread by contacting and obtaining priced quotations from at least two unaffiliated dealers and using the highest bid and lowest offer obtained in calculating the current inside spread. Where there is only a one-sided quote in an OTC equity security priced below \$1.00, members may calculate the current inside spread by contacting and obtaining priced quotations from at least two unaffiliated dealers and using the best price obtained on the other side of the

quote. Members must document the name of each dealer contacted and the quotations received for purposes of determining the current inside spread. In addition, [I]f the minimum price improvement standards above would trigger the protection of a pending customer limit order, any better-priced customer limit order(s) must also be protected under this IM, even if those better-priced limit orders would not be directly triggered under the minimum price-improvement standards above.

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.