

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-60515; File No. SR-FINRA-2009-054]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change To Extend Certain Regulation NMS Protections to Quoting and Trading in the Market for OTC Equity Securities

August 17, 2009.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 7, 2009, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by 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 adopt new FINRA Rules 6434 (Minimum Pricing Increment for OTC Equity Securities), 6437 (Prohibition from Locking or Crossing Quotations in OTC Equity Securities), 6450 (Restrictions on Access Fees) and 6460 (Display of Customer Limit Orders).

The text of the proposed rule change is available on FINRA’s Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

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

FINRA is proposing to adopt new rules to extend certain Regulation NMS protections to quoting and trading in over-the-counter equity securities (“OTC Equity Securities”).³ Specifically, FINRA is proposing rules to: (1) Restrict sub-penny quoting; (2) restrict locked and crossed markets; (3) implement a cap on access fees; and (4) require the display of customer limit orders.⁴

A. Background

On June 9, 2005, the SEC adopted Regulation NMS.⁵ Regulation NMS, in addition to re-designating the national market system rules previously adopted under Section 11A of the Act, also established new substantive rules to modernize and strengthen the regulatory structure of the U.S. equity markets.

Among other things, in adopting Regulation NMS, the SEC prohibited the imposition of access fees in excess of certain prescribed limitations; required SRO rules to address locked or crossed quotations; and prohibited the display of orders, quotations, and indications of interest in a pricing increment smaller than a penny (except where the security is priced at less than \$1.00 per share in which case certain restrictions apply). Regulation NMS also includes a pre-existing customer limit order display requirement, which renumbered Exchange Act Rule 11Ac1-4 as Rule 604 under the Regulation.

These provisions of Regulation NMS apply only to trading in NMS stocks as defined in Rule 600(b)(47) of Regulation NMS and do not apply to trading in OTC Equity Securities. FINRA previously filed with the SEC rule changes to apply aspects of Regulation NMS to quoting and trading in OTC Equity Securities. In particular, FINRA filed with the SEC a proposed rule change to impose sub-penny quoting prohibitions on OTC Equity Securities and a separate proposed rule change to impose restrictions on access fees.⁶

³ “OTC Equity Security” means any non-exchange-listed security and certain exchange-listed securities that do not otherwise qualify for real-time trade reporting. See FINRA Rule 6420(d).

⁴ The proposed rule also corrects certain cross-references to FINRA rules that have been adopted in the consolidated FINRA rulebook.

⁵ See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (“Regulation NMS Adopting Release”).

⁶ See Securities Exchange Act Release No. 52280 (August 17, 2005), 70 FR 49959 (August 25, 2005) (Proposed rule change to impose restrictions on the

In light of developments to date, FINRA has determined that extending certain NMS principles to the OTC equity market would be best if proposed together, rather than individually. Thus FINRA is now proposing to adopt rules to: (1) Restrict sub-penny quoting; (2) restrict locked and crossed markets; (3) implement a cap on access fees; and (4) require the display of customer limit orders. FINRA believes that these Regulation NMS principles, if applied to OTC Equity Securities, would enhance market quality and investor protections in this market.

B. Restrictions on Sub-penny Quoting

FINRA is proposing new FINRA Rule 6434 (Minimum Pricing Increment for OTC Equity Securities) to impose restrictions on the display of quotes and orders in sub-penny increments for OTC Equity Securities. Specifically, FINRA is proposing to prohibit members from displaying, ranking, or accepting from any person a bid or offer, order, or indication of interest in an OTC Equity Security in an increment smaller than \$0.01 if the bid or offer, order, or indication of interest is priced \$1.00 or greater per share, in an increment smaller than \$0.0001 if the bid or offer, order, or indication of interest is priced below \$1.00 and greater than \$0.01 per share, and in an increment smaller than \$0.000001 if the bid or offer, order or indication of interest is priced less than \$0.01 per share.

Market participants currently quote in increments ranging from pennies to hundredths of pennies. As the SEC stated in the proposing release for Regulation NMS and in the Regulation NMS Adopting Release, potential harms associated with sub-penny quoting include an increase in the incidence of market participants stepping ahead of standing limit orders for an economically insignificant amount and added difficulty for broker-dealers to meet certain of their regulatory obligations by increasing the incidence of so-called “flickering” quotes.⁷ FINRA believes that essentially the same potential problems exist with respect to sub-penny quoting in OTC Equity Securities. Accordingly, FINRA is

display of quotes and orders in sub-penny increments for non-Nasdaq OTC equity securities; File No. SR-NASD-2005-095). See Securities Exchange Act Release No. 55717 (May 7, 2007), 72 FR 26856 (May 11, 2007) (Proposed amendment to exclude from the access fee display requirements any access fees below a specified level; File No. SR-NASD-2007-029).

⁷ See Securities Exchange Act Release No. 49325 (Feb. 26, 2004), 69 FR 11126 (Mar. 9, 2004). See also Securities Exchange Act Release No. 50870 (December 16, 2004), 69 FR 77423 (December 27, 2004).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

proposing a new rule that would adopt an approach to sub-penny quoting that is consistent with that implemented by the SEC in Regulation NMS.

FINRA believes that the proposed restrictions on sub-penny quoting will promote greater price transparency and consistency. As noted above, FINRA also believes that sub-penny restrictions limit the practice of “stepping ahead” of displayed limit orders by trivial amounts and, therefore, the proposed new rule should further encourage the display of limit orders and improve the depth and liquidity of the market.

C. Locked and Crossed Markets

FINRA rules do not currently prohibit locking or crossing quotations in OTC Equity Securities.⁸ As the SEC noted in the Regulation NMS Adopting Release, locked and crossed markets can cause confusion among investors concerning trading interest in a stock and, therefore, FINRA believes that restricting the practice of submitting locking or crossing quotations will enhance the usefulness of quotation information for OTC Equity Securities.

Rule 610(d) of Regulation NMS (Access to Quotations) requires that each national securities exchange and national securities association establish, maintain, and enforce written rules restricting locking and crossing activities. In furtherance of this requirement, FINRA adopted Rule 6240 (Prohibition from Locking or Crossing Quotations in NMS Stocks), which generally requires members to avoid displaying, or engaging in a pattern or practice of displaying, any quotations that lock or cross a protected quotation, and any manual quotations that lock or cross a quotation previously disseminated pursuant to an effective NMS Plan.

Consistent with the principles of Regulation NMS’s locking and crossing restrictions, FINRA is proposing to require that members implement policies and procedures that reasonably avoid the display of, or engaging in a pattern or practice of displaying, locking or crossing quotations in any OTC Equity Security within the same inter-dealer quotation system.⁹ FINRA

⁸ A “locking quotation” is the display of a bid (or offer) at a price that equals the displayed price of an offer (or bid) for a security in the same “inter-dealer quotation system” (as defined in proposed Rule 6437). A “crossing quotation” is the display of a bid (or offer) at a price that is higher than the displayed price of an offer (or bid) for a security in the same inter-dealer quotation system.

⁹ Because there currently is not a mandated consolidated quotation dissemination mechanism for OTC Equity Securities as exists with NMS stocks, the proposed rule only restricts locking and crossing quotations within inter-dealer quotation

believes that the proposed policies and procedures approach is appropriate for addressing locked and crossed quotations in this market in light of the differences inherent in the quoting and trading of OTC Equity Securities as compared to NMS stocks.

As the SEC noted in the Regulation NMS Adopting Release with respect to the adoption of Rule 610(d), FINRA also recognizes that a member’s quotations may, on occasion, accidentally lock or cross another member’s quotations. Thus, similar to Rule 6240, FINRA would expect that members’ policies and procedures would require the quoting participant to make “reasonable efforts” to first contact or route an order to execute against the full displayed size of any quotation before locking and crossing that quotation. For example, a member firm may also include so-called “ship and post” procedures that require such firm to attempt to execute against a relevant displayed quotation while posting a quotation that could lock or cross such a quotation. In addition, members’ policies and procedures must be reasonably designed to enable the reconciliation of locked or crossed quotations, including requiring the member to take reasonable action to resolve the locked or crossed market when such member is responsible for displaying the locking or crossing quotation. FINRA believes that implementation of policies and procedures to avoid locking and crossing quotations, in conjunction with members’ existing obligation to honor posted quotations pursuant to NASD Rule 3320 (Offers at Stated Prices) and NASD IM-3320 (Firmness of Quotations), will facilitate more fair and orderly markets and support market efficiency.

D. Access Fee Cap

FINRA is proposing a new rule to prohibit members from imposing non-subscriber access or post-transaction fees against published quotations in any OTC Equity Security that exceed or accumulate to more than specified amounts.

Currently, FINRA Rule 6540(c) requires that an ATS or ECN reflect non-subscriber access or post-transaction fees in the ATS’s or ECN’s posted quote in the OTC Bulletin Board montage. There are no restrictions on ATS or ECN access fees displayed in other inter-dealer quotation systems, such as the Pink Sheets. FINRA is proposing to eliminate the requirement that members reflect access fees in OTCBB posted

systems, but not across inter-dealer quotation systems.

quotations, and to replace that requirement with a uniform access fee cap, consistent with Rule 610(c) of Regulation NMS. The proposed fee cap, as set forth in proposed Rule 6450, would restrict access fees in all OTC Equity Securities that exceed or accumulate to more than the following limits:

a. If the price of the quotation is \$1.00 or more, the fee or fees cannot exceed or accumulate to more than \$0.003 per share; or

b. If the price of the quotation is less than \$1.00, the fee or fees cannot exceed or accumulate to more than 0.3% of the quotation price per share.¹⁰

Also consistent with Regulation NMS, the proposal would codify that market makers, as well as ATSS, are permitted to charge access fees within the framework of the proposed access fee cap.

Consistent with the SEC’s conclusions in adopting Regulation NMS, FINRA believes that capping access fees is the most effective approach of the available alternatives, as well as the least disruptive to current market practice (other alternatives include an access fee display requirement and an outright prohibition on access fees). As the SEC stated in the Regulation NMS Adopting Release, a single, uniform fee limitation of \$0.003 per share is the fairest and most appropriate resolution of the access fee issue. First, it will not seriously interfere with current business practices because trading centers have very few fees on their books of more than \$0.003 per share and do not earn substantial revenues from such fees. In addition, a uniform fee limitation promotes equal regulation of different types of trading centers, where previously some had been permitted to charge fees and some had not. The SEC also noted that if wide disparities in access fees were permitted, the prices of quotations would be less useful and accurate. Therefore, a limitation on the level of access fees addresses the potential distortions caused by substantial, disparate fees.

E. Limit Order Display

Rule 604 of Regulation NMS requires the immediate display of customer limit orders. Specifically, Regulation NMS requires the display of (1) the price and

¹⁰ These standards are substantially similar to the access fee restrictions in Regulation NMS. See Regulation NMS Adopting Release. Note, however, that the restrictions under Rule 610(c) of Regulation NMS are limited to “protected quotations,” for which there is no comparable designation in the OTC equity market. Instead, the proposal would apply the restrictions uniformly to all quotations displayed in the OTC equity market.

the full size of each customer limit order that is at a price that would improve the bid or offer of the specialist or OTC market maker in such security; and (2) the full size of each customer limit order held by the specialist or OTC market maker that: Is priced equal to the bid or offer of such specialist or OTC market maker for such security; is priced equal to the national best bid or national best offer; and represents more than a *de minimis* change in relation to the size associated with the specialist or OTC market maker's bid or offer.

FINRA is proposing to impose a similar requirement on customer limit orders in OTC Equity Securities, specifically, a market maker displaying a priced quote would be required to immediately¹¹ display customer limit orders that it receives that (1) improve the price of the bid or offer displayed by the market maker, or (2) improve the size of its bid or offer by more than a *de minimis* amount where it is the best bid or offer in the inter-dealer quotation system where the market maker is quoting.¹² Regulation NMS includes several exceptions from its limit order display requirements, which also would apply to the proposed limit order display rule for OTC Equity Securities. Thus the proposed rule would except any customer limit order:

- a. That is executed upon receipt of the order.
- b. That is placed by a customer who expressly requests that the order not be displayed.
- c. That is an odd-lot order.¹³

¹¹ Under Rule 604 of Regulation NMS, the requirement to "publish immediately" a customer limit order requires the display (or execution or re-routing) of customer limit orders as soon as is practicable after receipt which, under normal market conditions, would require display no later than 30 seconds after receipt. See Securities Exchange Act Release No. 37619A, 61 FR 48290 (September 12, 1996). FINRA proposes to adopt this same interpretation with respect to the timing of display of customer limit orders in OTC Equity Securities.

¹² Under Rule 604 of Regulation NMS, a customer limit order should be considered *de minimis* if it is less than or equal to 10% of the displayed size associated with a specialist's or OTC market maker's bid or offer and FINRA proposes to adopt this same interpretation with respect to the proposed rule. See Exchange Act Release No. 37619A, 61 FR 48290 (September 12, 1996).

¹³ As discussed in *Trade Reporting Notice 3/18/08*, with respect to OTC Equity Securities trading at \$175 or more per share, FINRA has designated the "unit of trade" as one share rather than 100 shares for purposes of public dissemination. As such, trades in these securities for fewer than 100 shares are not considered "odd-lot transactions" and are disseminated by FINRA. However, for all other purposes, including the amendments proposed herein, transactions and orders of fewer than 100 shares are considered "odd lots," unless otherwise specifically determined by FINRA.

d. That is a block size order, unless a customer placing such order requests that the order be displayed.¹⁴

e. That is delivered immediately upon receipt to a national securities exchange or an electronic communications network that widely disseminates such order and immediately provides to an inter-dealer quotation system the prices and sizes of the orders at the highest buy price and the lowest sell price for such security.¹⁵

f. That is delivered immediately upon receipt to another OTC market maker that complies with the proposed limit order display requirements with respect to that order.

g. That is an all-or-none order.

In adopting the limit order display requirements for NMS stocks, the SEC stated that the display of limit orders is designed, among other objectives, to publicize accurate market interest and increase quote competition. While the SEC recognized that the rule may lead to reduced spreads and a diminution in market maker profits per trade, the SEC also noted that narrower spreads could result in increased customer orders and volume over time and thus, ultimately improve liquidity. FINRA believes that extending limit order display requirements to OTC Equity Securities will improve transparency in the OTC equity market. In addition, as has been stated by the SEC, the display of customer limit orders advances the goal of the public availability of quotation information, as well as fair competition, market efficiency, best execution and disintermediation.

Because the proposed new rules provide for significant regulatory changes, FINRA plans to implement the requirements in two phases to minimize the impact on firms. Phase one would implement sub-penny quoting restrictions, an access fee cap and

¹⁴ Under Regulation NMS, a "block size" with respect to an order means it is: (i) of at least 10,000 shares or (ii) for a quantity of stock having a market value of at least \$200,000. Because of the lower average trade prices (and corresponding higher average total share amount) of orders in OTC Equity Securities, FINRA believes that a 10,000 share standard alone would exclude customer limit orders that should otherwise be displayed. Therefore, FINRA is proposing that the definition of "block size" under the rule for OTC Equity Securities be an order that is: (i) Of at least 10,000 shares and (ii) has a market value of at least \$100,000. This is consistent with the large order size exception under IM-2110-2 (Trading Ahead of Customer Limit Order).

¹⁵ FINRA also is proposing to exclude from Rule 2320(g)(2) those priced quotations that represent a customer limit order displayed on an electronic communications network in conformance with this proposed exception. Rule 2320(g)(2) requires that members display the same priced quotation in a non-exchange-listed security when quoting in two or more quotation mediums.

restrictions on locked and crossed markets. Phase two would implement customer limit order display requirements. FINRA will announce the implementation dates for the proposed rule change in a *Regulatory Notice* to be published no later than 90 days following Commission approval. The implementation date of Phase one will be at least 120 days but no more than 365 days from the date of Commission approval and Phase two will be at least 90 days following the implementation of Phase one, but no more than 365 days from the date of Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁶ which requires that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

FINRA further believes that the proposed rule change is consistent with the provisions of 15A(b)(11) of the Act,¹⁷ which requires, among other things, that FINRA rules must govern the form and content of quotations relating to securities sold otherwise than on a national securities exchange and require that such rules relating to quotations shall be designed to produce fair and informative quotations, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing, and publishing quotations.

FINRA is proposing to: (1) Restrict subpenny quoting; (2) restrict locked and crossed markets; (3) implement a cap on access fees; and (4) require the display of customer limit orders. FINRA believes that the proposed restrictions on sub-penny quoting will promote greater price transparency and consistency, reduce the potential harms associated with sub-penny quoting in OTC equity securities and improve the depth and liquidity of this market.

FINRA believes that locked and crossed markets can cause confusion among investors concerning trading interest in a stock and that restricting the practice of submitting locking or

¹⁶ 15 U.S.C. 78o-3(b)(6).

¹⁷ 15 U.S.C. 78o-3(b)(11).

crossing quotations will enhance the usefulness of quotation information in the over-the-counter market, facilitate more fair and orderly markets and support market efficiency.

Where wide disparities in access fees are permitted, the prices of quotations are less useful and accurate. Therefore, FINRA believes that a cap on access fees would improve the usefulness and accuracy of quotations and address the potential distortions caused by substantial, disparate fees. Finally, FINRA believes that applying limit order display requirements to OTC Equity Securities would improve transparency in the OTC equity market and advance the goal of the public availability of quotation information, as well as fair competition, market efficiency, best execution and disintermediation.

FINRA believes that the proposed extension of the specified Regulation NMS protections to quoting and trading in OTC Equity Securities will prevent fraudulent and manipulative acts and practices in this market, promote just and equitable principles of trade, and protect investors and the public interest.

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

(A) By order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing,

including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2009-054 on the subject line.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549-1090. All submissions should refer to File Number SR-FINRA-2009-054. 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 publicly available. All submissions should refer to File Number SR-FINRA-2009-054 and should be submitted on or before September 16, 2009.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁸

Florence E. Harmon,

Deputy Secretary.

[FR Doc. E9-20532 Filed 8-25-09; 8:45 am]

BILLING CODE 8010-01-P

¹⁸ 17 CFR 200.30-3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-60521; File No. SR-NASDAQ-2009-076]

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Modify Processing of Orders on the NASDAQ Options Market

August 18, 2009.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 13, 2009, The NASDAQ Stock Market LLC ("Nasdaq") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by Nasdaq. Nasdaq has designated the proposed rule change as effecting a change described under Rule 19b-4(f)(6) under the Act,³ which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of the Substance of the Proposed Rule Change

The text of the proposed rule change is below. Proposed new language is in *italics*; proposed deletions are in [brackets].⁴

* * * * *

Chapter VI Trading Systems

Sec. 1 Definitions

The following definitions apply to Chapter VI for the trading of options listed on NOM.

(a)-(d) No change.

(e) The term "Order Type" shall mean the unique processing prescribed for designated orders that are eligible for entry into the System, and shall include:

(1)-(7) No Change.

[(8) "Additional Exposure Orders" are orders that are priced at the National Best Offer, for buys, and the National Best Bid, for sells. The order is exposed on the System Book Feed for a time determined by the Exchange, not to exceed one second. At the end of the exposure period, if still unexecuted, the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

⁴ Changes are marked to the rules of The NASDAQ Stock Market LLC found at <http://nasdaqomx.cchwallstreet.com>.