

for example, for compliance with NASD Rule 3320, *Offers at Stated Prices*, which requires that a member's quotation be "firm,"<sup>12</sup> and NASD Rule 6750, *Minimum Quotation Size Requirements for OTC Equity Securities*, which requires that every member firm that functions as a market maker in OTC equity securities on an inter-dealer quotation system that permits quotations to be updated on a real-time basis must honor those quotations for the minimum size applicable to the member firm's firm bid or ask price. NASD Regulation represents that although it has access to trade execution data through existing trade reporting requirements and systems, it does not otherwise have access to historical quotation activity at the time of trades.

As originally proposed, the rule change would not apply to quotations displayed on an inter-dealer quotation system that is qualified pursuant to section 17B of the Act.<sup>13</sup> In Amendment No. 2, the NASD proposed revising the rule text to state expressly that the exclusion applies to quotations on an inter-dealer quotation system that is operated by a registered securities association or national securities exchange. NASD Regulation observed that the registered securities association or national securities exchange operating such an inter-dealer quotation system would have access to quotation information displayed on that system. Therefore, the NASD would not require members to record and report information pertaining to quotations entered into inter-dealer quotation systems operated by a registered securities association or national securities exchange. NASD Regulation noted that, under this exclusion, members would not need to record and report quotation information for quotations on the OTC Bulletin Board, which is sponsored and regulated by the NASD.

The proposed rule change also would not apply to an inter-dealer quotation

system operated by a member of the NASD. The NASD indicated that if an NASD member were to operate an inter-dealer quotation system, the NASD would be able to receive the pertinent quotation data (or, in some cases, the display of limit orders) directly from the NASD member operating the system.

The proposed rule change would permit a member to use an agent to provide the quotation data to the NASD ("Reporting Agent").<sup>14</sup> The NASD believes that most or all members that would be required to provide quotation data under the proposed rule would use the services of a Reporting Agent, which likely would be the operator of the inter-dealer quotation system.

NASD Regulation anticipates that if a system operator agrees to be a member's Reporting Agent, the system operator would provide all relevant quotation data directly to NASD Regulation on a daily or ongoing basis. Notwithstanding a member's use of a Reporting Agent to furnish quotation information, the member would remain responsible for compliance with all requirements of the proposed rule. If a member knew or had reason to believe that it or its Reporting Agent was not in compliance with the proposed rule, the member would be required to withdraw its quotations or unpriced indications of interest from the inter-dealer quotation system until the member was satisfied that quotation data is being properly recorded and reported.<sup>15</sup> In this regard, NASD Regulation stated that it would expect members that use a Reporting Agent to periodically review or monitor its activities in order to ensure continued compliance with the proposed rule.

Under the NASD's original proposed rule change, if a member knew or had reason to believe that its Reporting Agent was not in compliance with the proposed rule, the member would be required to *immediately* withdraw its priced quotations and unpriced indications of interest. In response to concerns that problems with data systems could interfere with the ability of a member or its Reporting Agent to comply with the proposed rule, the NASD proposed removing the word "immediately" from the proposed rule's text.<sup>16</sup>

<sup>14</sup> NASD Rule 6630(e) would define "Reporting Agent" as "a third party that enters into any agreement with a member pursuant to which such third party agrees to fulfill such member's obligations under this Rule."

<sup>15</sup> See NASD Response to Comments and Amendment No. 1, *supra* note 5.

<sup>16</sup> NASD Response to Comments and Amendment No. 1. A literal reading of the original proposed rule text would have required a member to withdraw its quotations only if the member knew or had a reasonable belief that its Reporting Agent was not

To ensure that its members have adequate time to implement the proposed rule, the NASD represented that, if approved, it will announce the operative date of the proposed rule change in a Notice to Members to be published no later than 60 days following the date of Commission approval. The operative date will be 30 days following publication of the Notice to Members.

### III. Summary of Comments and NASD Response

The Commission received one comment letter in response to the proposed rule change. The letter, from Pink Sheets: (1) Expressed concern regarding the NASD's proposal to obtain quotation information based on regulation of NASD members rather than through the negotiation of a private contract between NASD Regulation and Pink Sheets; (2) stated that NASD Regulation must acknowledge Pink Sheets' private property rights in the data and provide assurances that this data will be protected, and not redistributed in competition with Pink Sheets; (3) stated that NASD members should not bear the entire responsibility for ensuring that the NASD receives the proper information; (4) stated that NASD members should not be required to withdraw quotations without time to address data systems problems when such problems are the cause of non-compliance; (5) asserted that the proposed rule should set forth the form in which required data must be provided; and (6) questioned the basis of the proposed rule's exclusion for systems operated by a registered securities association or national securities exchange.<sup>17</sup> Pink Sheets also noted its view that the proposed rule change is overly restrictive and should apply to bond quotation services and order routing and negotiation services in addition to electronic quotation services. These comments are discussed below, along with NASD Regulation's responses contained in NASD Response to Comments and Amendment No. 1.

#### A. Approach to Obtaining Quotation Data

Pink Sheets asserted that it has an intellectual property interest in the data that NASD members would be required to ensure was recorded, preserved, and provided to the NASD upon request. Pink Sheets posited that the negotiation

complying with the proposed rule. The NASD proposed a revision to the rule text clarifying that the member also must withdraw its quotes if the member itself is not complying with the proposed rule. *Id.*

<sup>17</sup> Pink Sheets Letter, *supra* note 4.

<sup>12</sup> NASD Rule 3320 states: "No member shall make an offer to buy from or sell to any person any security at a stated price unless such member is prepared to purchase or sell, as the case may be, at such price and under such conditions as are stated at the time of such offer to buy or sell." A member is expected to buy or sell at least a normal unit of trading in the quoted stock at its then prevailing quotations, unless the quotation is designated clearly as not firm or as firm for less than a normal unit of trading. NASD Firmness of Quotations Rule, IM-3320.

<sup>13</sup> 15 U.S.C. 78q-2. Section 17B states that "[t]he Commission shall facilitate the widespread dissemination of reliable and accurate last sale and quotation information with respect to penny stocks\* \* \* with a view toward establishing, at the earliest feasible time, one or more automated quotation systems that will collect and disseminate information regarding all penny stocks."