

quotations from any of the exempt systems if the member believes or has reason to believe that the data is not being properly maintained by the exempt system. Pink Sheets expressed concern that the NASD could force market makers on the OTCBB that also quote in the EQS to abandon their use of the EQS. In addition, Pink Sheets inquired why the proposed rule would not apply to electronic bond quotation services.

With regard to the original proposal to exclude systems qualified under section 17B of the Act, NASD Regulation stated that, because those systems are sponsored and regulated by either a national securities association or national securities exchange, the association or exchange would be able to obtain quotation data directly from those systems. Regarding electronic bond quotation services, NASD Regulation stated that it does not currently require historical quotation information for regulation of the OTC component of the bond market. NASD Regulation represented, however, that it will continue to monitor bond market activity to determine whether it is necessary to impose, in that area, requirements similar to those described in the proposed rule change.

IV. Discussion

The Commission has carefully considered the proposed rule change and amendments thereto, along with the comment letter from Pink Sheets, as well as the response letter from NASD Regulation and the NASD Letter. The Commission finds that the NASD proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association. In particular, the Commission finds that the proposed rule change is consistent with section 15A(b)(6) of the Act,²⁴ which requires the rules of a national securities association to 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. In addition, the Commission finds that the proposed rule change is consistent with section 15A(b)(2) of the Act,²⁵ which requires that a national securities association be organized and have the capacity to be able to carry out the purposes of the Act and to comply, and enforce compliance by its members and persons associated with its members, with the Act and rules and regulations

thereunder and the rules of the association.

The Commission finds that the proposed rule change is designed to ensure that the NASD receives quotation information that is necessary to adequately surveil member activity in OTC equity securities quoted on inter-dealer quotation systems that permit quotation updates on a real-time basis and that are not operated by a registered national securities association, a registered national securities exchange, or an NASD member. The required quotation information must be recorded and reported by the member itself or, on the member's behalf, though a Reporting Agent. The Commission believes that this quotation information is necessary for the NASD, through NASD Regulation, to adequately surveil member compliance with applicable rules and regulations in a trading environment where quotations for OTC equity securities are displayed on a real-time basis in those inter-dealer quotation systems for which the NASD does not otherwise have access to quotation data. Because these OTC equity securities often are microcap securities that can be the subject of fraud and manipulation, the Commission believes that it is vital for the NASD to have access to quotation information for these securities so that the NASD can properly carry out its regulatory responsibilities with respect to this market sector.

In considering this proposed rule change, the Commission observes that the NASD has amended the proposed rule change to address, and has clarified a number of points in response to, issues raised in the Pink Sheets Letter. Specifically, in response to comments made in the Pink Sheets Letter, the NASD revised the proposal with respect to the circumstances under which a member would be required to withdraw its quotes from the inter-dealer quotation system in the event of non-compliance with the rule's provisions. The Commission believes that the NASD's revisions address the Pink Sheets' concerns that an NASD member would be required to immediately withdraw its quotes where non-compliance is the result of a temporary data systems problem. The NASD also responded to the Pink Sheets' concern about the specificity of the standards in which the NASD would require data to be submitted by indicating that it would publish information regarding the prescribed form for recording and reporting the quotation information in a Notice to Members. Finally, the NASD responded to the Pink Sheets' objection that the proposed rule did not cover

electronic bond quote services by indicating that it would monitor activities to determine whether NASD Rule 6630 should in the future cover a broader range of securities. The Commission does not believe that the NASD's obligations as a self-regulatory organization ("SRO") to enforce compliance by its members with the Act requires it to apply the same rules to all the varied activities of its members. Instead, the Commission believes that, in many cases, it is appropriate for an SRO to tailor its rules to aid it in fulfilling its responsibilities with respect to a particular market segment. The Commission believes that this proposal is appropriately tailored to surveil a market segment that historically has experienced repeated instances of fraud and manipulation.

There are two issues raised by Pink Sheets that the Commission wishes to address further. First, Pink Sheets claimed that NASD Rule 6630 is anti-competitive because it excludes systems that are sponsored and regulated by a registered securities association or national securities exchange, and is unfairly targeted at EQS and its users. The Commission finds that the proposed rule's exclusion of quotations displayed in inter-dealer quotation systems operated by a registered national securities association or national securities exchange is consistent with the Act. To qualify for the exclusion, the system must be operated by an SRO registered with, and regulated by, the Commission. These SROs have responsibilities under the Act to surveil systems they operate. Accordingly, it is unnecessary, and would be needless and redundant, for the NASD to require its members to record and report information regarding quotations on such systems. On the other hand, the Commission believes that it is necessary for the NASD, as the principal regulator of the OTC equity market, to have the requisite information regarding quotations displayed by members in covered quotation systems to enable it to carry out its functions as an SRO. The Commission also believes that the NASD appropriately places the burden to provide the quotation information on its members, because it is these members over which the NASD is obligated to enforce compliance with the Act's provisions.²⁶ To reduce the costs and burdens on its members, however, the NASD will permit members to enter into an agreement

²⁴ 15 U.S.C. 78o-3(b)(6).

²⁵ 15 U.S.C. 78o-3(b)(2).

²⁶ 15 U.S.C. 78o-3(b)(2).