

**Bills Committee on
Securities and Futures Bill and Banking (Amendment) Bill 2000**

**Securities and Futures Bill
NASDAQ and OTC Stocks**

Background

In response to a query from the Assistant Legal Adviser of the Legislative Council, we undertook, at the Bills Committee meeting on 28 September 2001, to provide Members with further information on the NASDAQ Stock Market in the US, in particular whether it is an over-the-counter (OTC) market. We have conducted some research with our industry contacts who are familiar with the US markets. The ensuing paragraphs set out a summary of the findings.

NASDAQ

2. The National Association of Securities Dealers Automated Quotation System (NASDAQ) covers the whole range of securities. About 4,000 large stocks qualify for listing on the NASDAQ Stock Market. Unlike the New York Stock Exchange (NYSE) and other exchanges, NASDAQ has no trading floor. It is a nationwide network of 500 plus market making firms linked together by a central computer system and phones. Where in a physical exchange a single specialist will make a market in a stock on one of the exchanges, the NASDAQ system allows multiple market makers for the same stock to compete for clients' trades. The best bid and offer of all competing market makers is known as the NASDAQ inside market (i.e. lowest Ask and highest Bid) or the national best bid and offer.

3. From 1975 onwards, NASDAQ has been regulated by the Securities and Exchange Commission (SEC). Markets that are not regulated by the SEC are usually referred to as OTC. So, in that sense, NASDAQ is not an OTC market.

Trading of OTC Stocks

4. Any stock that is not traded on an exchange regulated by the SEC is said to be traded OTC. The OTC market is a negotiated marketplace where stocks can be bought and sold from any number of competing market makers for a given stock.

5. Most active OTC stocks trade through NASDAQ computer and telephone networks that furnish subscribers with instant identification of market makers and their current quotations. Inactive OTC stocks are traded through a network of OTC dealers linked by telephone and telex machines. The rest of the OTC stocks either trade on the Over The Counter Bulletin Board or "on the pinks" (prices are listed on a set of pink sheets published daily). Some market makers have minimum share requirements for purchasing these securities.

Financial Services Bureau
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