

ADDITIONAL INFORMATION OR COMMENTS: Copies of the form and supporting documents can be obtained from Chuck Mierzwa, the agency clearance officer (312-751-3363). Comments regarding the information collection should be addressed to Ronald J. Hodapp, Railroad Retirement Board, 844 North Rush Street, Chicago, Illinois 60611-2092 and the OMB reviewer, Laura Oliven (202-395-7316), Office of Management and Budget, Room 10230, New Executive Office Building, Washington, D.C. 20503.

Chuck Mierzwa,
Clearance Officer.
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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-35471; File No. SR-NASD-95-9]

Self-Regulatory Organizations; Notice of Proposed Rule Change by National Association of Securities Dealers, Inc., Relating to the Trading of Exchange-Listed Securities in the Over-the-Counter Market

March 10, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on March 6, 1995, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD.¹ 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

The NASD is proposing to make three significant changes to rules governing NASD members' over-the-counter ("OTC") trading in exchange-listed securities. First, the NASD proposes to require NASD members registered as Consolidated Quotations Service ("CQS") market makers to display certain customer limit orders in their quotes. Second, the NASD proposes to prohibit NASD members who are not

¹ The NASD originally submitted the proposed rule change on February 21, 1995. As a result of discussions on March 6, 1995, between the Commission staff and the NASD certain minor amendments to the filing were agreed upon. This notice reflects those amendments.

Intermarket Trading System/Computer Assisted Execution System Automated Interface ("ITS/CAES") market makers from effecting a transaction in any ITS/CAES-eligible security that "trades-through" (i.e., a purchase below the lowest bid or a sell above the highest offer) the best bid or offer displayed by any ITS/CAES market maker or any ITS Participant Exchange in that stock. Third, the NASD proposes to require all NASD members executing customer orders in ITS-eligible securities to afford such orders some opportunity for price improvement.

The full text of the proposed rule change is set forth below. (New language is italicized.)

Schedule D

PART VI
CONSOLIDATED QUOTATIONS SERVICE (CQS)

Sec. 2. Obligations of CQS Market Makers

- (a) No Change
- (b) No Change
- (c) A CQS market maker shall be required to process customer limit orders in securities eligible for inclusion on the ITS/CAES linkage in the following manner:
 - (i) if the limit order is for 500 shares or less, the CQS market maker either must execute the limit order immediately or display it in its quotation with a minimum size of 500 shares (unless the specified minimum for that security is less than 500 shares); or
 - (ii) if the limit order is for greater than 500 shares, the order's price must be reflected in the market maker's quotation, provided however, that if the size displayed with that updated quotation price is less than the limit order's size, the balance of the limit order must be executed at a price at least as favorable as the displayed price.

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Schedule G

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Sec. 1. Definitions

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(g) The terms "Participant Market," "ITS System," "ITS/CAES Market Maker," and "ITS Security" shall have the same meanings as set forth in section (a) of The Rules of Practice and Procedure for Intermarket Trading System/Computer Assisted Execution System Automated Interface.

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Sec. 4. Trading Practices

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(j) No member shall effect a trade in a security eligible for inclusion in the ITS/CAES Linkage, whether as principal or agent, at a price that is lower than the best bid or higher than the best offer currently displayed by an ITS/CAES Market maker or another Participant market (hereinafter referred to as a "trade-through") between 9:30 a.m. and 4:00 p.m. Eastern Standard Time (or such shorter period of time coinciding with the

time that the primary market for a particular ITS/CAES security is open) unless one of the following conditions exists: (1) the size of the bid or offer that is traded through is for 100 shares; (2) the transaction that constitutes the trade-through is not a "regular way" contract; (3) the bid or offer that is traded-through is being displayed from a Participant Market whose members are relieved of their obligations under paragraph (c)(2) of Securities Exchange Act Rule 11Ac1-1 with respect to such bid of offer; or (4) the bid or offer that is traded-through has caused a locked or crossed market in the affected ITS Security. The foregoing requirements shall not apply to trade-throughs effected by ITS/CAES Market Makers and governed by Sections (h)(1)(A)-(H) of the ITS/CAES Rules.

(k) Between 9:30 a.m. and 4:00 p.m. Eastern Standard Time (or such shorter period of time coinciding with the time that the primary market for a particular ITS-eligible security is open), no member shall accept customer orders in securities eligible for inclusion in the ITS System for execution in the over-the-counter market, either as agent or principal, unless the member affords such orders some opportunity for price improvement over the best bid (in the case of a retail sell order) or best offer (in the case of a retail buy order) prevailing among the Participant Markets in the ITS System. A member can satisfy this requirement either by a manual procedure or an algorithm built into its internal order processing system. The specific parameters for granting price improvement at a member firm will be determined by competitive forces and the business judgment of the firm's management.

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

In its filing with the Commission, the NASD 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. The NASD 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

This proposal is intended to respond to specific recommendations contained in the SEC's Market 2000 Report for improving the efficiency and effectiveness of the OTC dealer markets in exchange-listed securities, including ITS/CAES eligible securities.² The

² Operation of ITS/CAES is governed by a national market system plan known as the "Plan for the Purpose of Creating and Operating an Intermarket Communications Linkage pursuant to

instant proposal would effect the following changes in selected NASD rules governing members' OTC trading in exchange-listed securities.

1. Display of Customer Limit Orders

Part VI of Schedule D to the NASD By-Laws establishes various regulations applicable to member firms that utilize the CQS to support their OTC market making in exchange-listed securities. Under the proposal, new Section 2(c) would specify the circumstances in which a CQS market maker in an ITS/CAES eligible security would be required to reflect customer limit orders in the firm's displayed CQS quotation. First, for customer limit orders of 500 shares or less, a CQS market maker would be required either to provide an immediate execution at the limit price or update its CQS quotation to reflect the customer's buy/sell interest at the limit price. The size associated with that quotation must be 500 shares unless the NASD has designated a lower minimum size for CQS quotations in that particular security.³ (This would be true even if, for example, the pending limit order were only for 200 shares.) Second, if a customer's limit order exceeds 500 shares, the market maker must update its CQS quotation to reflect the superior price of the customer limit order. If the market maker elects not to reflect the entire size of the pending limit order in the firm's updated quotation, the balance of the limit order must be executed at a price at least as favorable as the displayed price. In sum, this modification would result in the exposure of customer limit orders in ITS/CAES eligible securities to other CQS market makers as well as exchange specialists who would have the ability to interact with such orders through the ITS/CAES Linkage⁴ or CAES.⁵

Section 11A(a)(3)(B) of the Securities Exchange Act of 1934 ("Act") (hereinafter referred to as the "ITS Plan"). Under the ITS Plan, NASD members participating as ITS/CAES market makers must confine their market making to "Rule 19c-3 securities." This grouping consists of securities that were (1) not traded on a national securities exchange prior to April 26, 1979 or (2) traded on such an exchange on April 26, 1979, but thereafter ceased to be traded on an exchange for some period of time.

³At the present time, the NASD has not designated any CQS security as subject to a minimum quotation size of 200 shares.

⁴As discussed *infra* at note 6 and accompanying text, all CQS market makers in ITS/CAES-eligible securities must now be registered as ITS/CAES Market Makers.

⁵CAES is an automated system regulated by the NASD and operated by The Nasdaq Stock Market, Inc. that allows NASD members to direct agency orders (and principal orders with this rule change) in exchange-listed securities to CAES for automated execution in the third market. CAES market makers are CQS market makers who have registered as CAES market makers.

2. Trade-Through Prohibition

The proposal also contains two substantive changes to NASD trading practice regulations applicable to members effecting OTC trades in ITS/CAES securities. The first addresses the possibility of a member firm effecting an OTC trade in a ITS/CAES eligible security at a price inferior to a displayed market for that security in the ITS system. Currently, NASD regulations in this area only cover members that have registered as ITS/CAES market makers pursuant to the NASD Rules of Practice and Procedure for the Intermarket Trading System/Computer Assisted Execution System Automated Interface ("ITS/CAES Rules"). The proposed prohibition would apply to all member firms that effect trades in ITS/CAES eligible securities without being registered as ITS/CAES market makers in those securities, e.g., block positioning firms and order-entry firms. It would also apply to the remote circumstance where a registered ITS/CAES market maker effects a trade-through in an ITS/CAES eligible security in which the firm does not maintain a market making position.

The NASD expects that instances of trade-throughs by its members should diminish with the recent implementation of an NASD requirement that all CQS market makers in ITS/CAES eligible securities become registered as ITS/CAES market makers pursuant to the ITS/CAES Rules.⁶ Nevertheless, it is still possible for an NASD member who is not a registered ITS/CAES market maker to effect a trade in an ITS/CAES eligible security at a price that constitutes a trade-through under the ITS/CAES Rules.⁷ Accordingly, the proposed rule would prohibit such conduct, unless the circumstances satisfied one of the four exceptions contained in the proposal: (1) the size of the market traded-through was 100 shares; (2) the transaction itself is not for regular-way settlement (e.g., a "cash" transaction settling the same day); (3) the bid/offer traded-through emanated from a market whose members are relieved of their obligations under the SEC's Firm Quote Rule;⁸ or (4) the bid/offer traded

⁶See Securities Exchange Act Release No. 34280 (June 29, 1994); 59 FR 34880 (July 7, 1994). This requirement took effect on October 31, 1994.

⁷In order to comply with the trade-through prohibition, a member firm would need to access a CQS display on its Nasdaq Workstation device or subscribe to a vendor service offering equivalent display capabilities. From a surveillance perspective, the NASD would develop an exception report capable of identifying trade-throughs that constituted violations of the proposed rule.

⁸See Securities Exchange Act Rule 11Ac1-1.

through had caused a locked/crossed market condition in the affected security. (These four exceptions also exist under the ITS/CAES Rules applicable to ITS/CAES market makers.) In addition, the proposed trade-through rule would apply only between 9:30 a.m. and 4:00 p.m. Eastern Standard Time ("E.S.T."), or such short period of time coinciding with time that the primary market for a particular ITS/CAES security is open.

Essentially, the proposed trade-through prohibition impacts only those NASD members that conduct business in Rule 19c-3 securities without being registered as ITS/CAES market makers in those issues. As such, these firms cannot avail themselves of the procedural mechanisms prescribed by the ITS/CAES rules for resolving intermarket complaints of trade-throughs by providing stock to another ITS participant. For this reason, the NASD will regard a violation of the proposed prohibition as a course of conduct warranting referral to the NASD's Market Surveillance Committee for possible disciplinary action. The NASD will not, however, compel the offending member to provide satisfaction to any ITS participant that was traded-through, even if the latter promptly complains and requests satisfaction. This result is appropriate because the NASD does not wish to compel members who periodically trade ITS/CAES eligible securities (whether as agent or principal) to assume the obligations of an ITS/CAES market maker as a condition of continuing to trade such securities. On the other hand, the trade-through prohibition is designed to ensure that non-ITS/CAES market makers will not ignore the superior bids or offers in Rule 19c-3 securities that may be displayed by ITS/CAES market makers or exchange participants in the ITS System.

3. Price Improvement

The second substantive change involving Section 4 of Schedule G relates to price improvement respecting retail orders executed OTC in securities eligible for inclusion in the ITS System.⁹ This initiative also responds to a recommendation contained in the SEC's *Market 2000 Report*. Basically, new Section 4(k) in Schedule G would require that members executing market orders from retail customers in ITS-eligible securities (either as principal or agent) afford such orders some opportunity for price improvement, *i.e.*,

⁹Accordingly, this price improvement requirement would cover all non Rule 19c-3 securities as well as all Rule 19c-3 securities.

an execution at a price superior to the best bid or offer currently reflected in the ITS System. It is the NASD's understanding that most firms trading exchange-listed securities in the OTC market already provide some form of price improvement opportunity, depending on factors such as order size and the trading characteristics of the particular security, and that there is no uniform way to achieve price improvement. This is to be expected as affording customers price improvement opportunities is driven by competitive considerations to attract and retain order flow from order entry firms. Thus, in light of the varied means by which firms offer price improvement and the competitive nature of price improvement, the NASD has concluded that it would be too limiting and restrictive for the NASD to mandate and articulate specific parameters for granting price improvement to individual orders in ITS-eligible securities. Rather, the NASD believes that it is sufficient to adopt a more generalized provision specifying that members must afford some opportunity for price improvement in executing customer orders in exchange-listed securities. Accordingly, under the proposal, price improvement, at a minimum, would have to involve either exposing customer orders to an algorithm incorporated into the firms' in-house execution system or manually reviewing incoming orders prior to their execution. The NASD believes that this flexible approach to mandating price improvement is appropriate and that firms should be encouraged to experiment with the specific parameters for granting price improvement. In addition, the proposed price improvement requirement would apply only between 9:30 a.m. and 4:00 p.m. E.S.T., or such shorter period of time coinciding with the time that the primary market for a particular ITS-eligible security is open.

The NASD believes that this proposed rule change is consistent with the requirements of Sections 11A(a)(1) and 15A(b)(6) of the Act. Section 11A(a)(1) specifies the Congressional findings and objectives for a national market system. These include the fostering of economically efficient execution of securities transactions; the promotion of fair competition among brokers and dealers, and between exchange markets and over-the-counter securities markets; and facilitating the best execution of customers' orders. Section 15A(b)(6) requires, among other things, that the NASD's rules be designed to promote just and equitable principles of trade;

foster cooperation and coordination with persons engaged in regulating and facilitating securities transactions; remove impediments to and perfect the mechanisms of the national market system; and in general to protect investors and the public interest. The NASD submits that its proposal will advance these objectives by facilitating the prompt execution of customer limit orders in ITS/CAES eligible securities in circumstances where the limit price is superior to the best bid/offer reflected in the ITS System; by curbing instances of trade-throughs in such securities by broker-dealers that are NASD members, but are not registered as ITS/CAES market makers in the affected securities; and by mandating all firms that accept and execute customer orders in securities eligible for inclusion in the ITS System provide some opportunity for price improvement in the execution of such orders. Collectively, these changes will enhance the protections afforded investors trading exchange-listed securities in the OTC market and promote the integrity, fairness and price discovery process of the OTC market for exchange-listed securities. These rule changes also will facilitate the execution of investors' orders in exchange-listed securities in the OTC market at the best available price; regardless of whether that price emanates from an exchange participant in ITS or an ITS/CAES market maker. Moreover, the new trade-through prohibition will diminish the confusion that occasionally results when the Consolidated Tape reflects a trade-through by an NASD member firm which is not registered as an ITS/CAES market maker.

Furthermore, because the NASD believes these proposals are responsive to specific recommendations made in the SEC's *Market 2000 Report* and because the NASD has addressed or responded to all of the other recommendations in the Report concerning trading in the third market, the NASD believes the SEC should take prompt action to expand the ITS/CAES Linkage to include non-Rule 19c-3 securities. Requiring NASD members to adhere to these new rules without expanding the ITS/CAES linkage would be particularly burdensome and unfair given that NASD members will be obligated to comply with these new rules and automated access to the primary markets for non-19c-3 securities through ITS will facilitate compliance with these rules by NASD members. If the ITS/CAES linkage were expanded to include all ITS-eligible securities, the NASD would correspondingly propose to expand the

scope of the proposed trade-through rule and the limit order display rule to apply to all ITS-eligible securities.

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

The NASD believes that the proposed rule change will not 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

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 NASD 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. Persons making written submissions should fix six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by April 6, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 95-6504 Filed 3-15-95; 8:45 am]

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[Release No. 34-35467; File No. SR-MSRB-95-1]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to an Extension of the CDI Pilot System from April 6, 1995 Through December 31, 1995

March 10, 1995.

On March 7, 1995, the Municipal Securities Rulemaking Board ("Board" or "MSRB") filed with the Securities and Exchange Commission ("Commission" or "SEC") a proposed rule change (File No. SR-MSRB-95-1), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), and Rule 19b-4 thereunder. The proposed rule change is described in Items I, II, and III below, which Items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rule change from interested people. The Board has requested accelerated approval of the proposed rule change in order to permit the Pilot system to continue to operate without interruption.

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

The Board is filing herewith a proposed rule change to request an extension, from April 6, 1995, through December 31, 1995, of its Continuing Disclosure Information ("CDI") Pilot system of the Municipal Securities Information Library (MSIL) system.¹

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

In its filing with the Commission, the Board 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. The Board 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

(a) On April 6, 1992, the SEC approved the CDI Pilot system for an 18-month period.² The CDI Pilot system began operating on January 23, 1993, and functions as part of the Board's MSIL system. The CDI Pilot system accepts and disseminates voluntary submissions of official disclosure notices relating to outstanding issues of municipal securities, *i.e.*, continuing disclosure information. During its first phase of operation, the system accepted disclosure notices only from trustees. On May 17, 1993, the Pilot system also began accepting notices from issuers.³ On September 1, 1993, the Commission approved an 18-month extension of the Pilot system, which extension will expire on April 6, 1995.⁴

On November 10, 1994, the Commission approved amendments to its Rule 15c2-12 which prohibit a dealer from underwriting a new issue of municipal securities unless the issuer commits, among other things, to provide material events notices to the Board's CDI Pilot system or to all Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs") and to the applicable state information depository.⁵ In addition, the Rule prohibits a dealer from recommending the purchase or sale of a municipal security unless the dealer has in place procedures that provide reasonable assurance that it will receive prompt notice of material events.⁶ The Board is considering certain changes to the CDI Pilot system consistent with the new Commission requirements, including reconsideration of certain issuer and

trustee enrollment procedures and page limits on submissions.

The Board believes that an extension of the operation of the CDI Pilot system will give it sufficient time to determine the system changes needed, in consultation with the Commission as well as potential users of the system, including NRMSIRs. We anticipate filing system changes well before the December 31, 1995, extension date. At that time, the Board also plans to ask the Commission for permanent approval of the revised CDI system.

(b) The Board believes the proposed rule change is consistent with Section 15B(b)(2)(C) of the Act, which provides that the Board's rules shall:

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 municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.

The MSIL system is designed to increase the integrity and efficiency of the municipal securities market by, among other things, helping to ensure that the price charged for an issue in the secondary market reflects all available official information about that issue. The Board will continue to operate the output of the CDI Pilot system to ensure that the information is available to any party who wishes to subscribe to the service. As with all MSIL system services, this service is available, on equal terms, to any party requesting the service.

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

The Board does not believe that the proposed rule change will impose any burden on competition 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

The Board has requested that the Commission find good cause, pursuant to Section 19(b)(2) of the Act, for approving the proposed rule change prior to the thirtieth day after

² Securities Exchange Act Release No. 30556 (April 6, 1992), 57 FR 12534. A complete description of the CDI system is contained in File No. SR-MSRB-90-4, Amendment No. 1.

³ On May 17, 1993, the Board reported to the Commission on the initial phase of operation of the CDI system regarding technical, policy and cost issues and proposed enhancements to the system.

⁴ Securities Exchange Act Release No. 32825 (September 1, 1993), 58 FR 47306.

⁵ Securities Exchange Act Release No. 34961 (November 10, 1994), 59 FR 59590. This provision of the Rule will become effective on July 3, 1995.

⁶ The effective date of this provision of the Rule is January 1, 1996.

¹⁰ 17 CFR 200.30-3(a)(12).

¹ The MUNICIPAL SECURITIES INFORMATION LIBRARY system and the MSIL system are trademarks of the Board. The MSIL system, which was approved in Securities Exchange Act Release No. 29298 (June 13, 1991) 56 FR 28194, is a central facility through which information about municipal securities is collected, stored and disseminated.