

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁸ that the proposed rule change (File No. SR-CSE-95-04) be and hereby is approved, effective June 7, 1995.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁹

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34-35732; File No. SR-NASD-94-9]

**Self-Regulatory Organizations;
National Association of Securities
Dealers, Inc.; Order Approving
Proposed Rule Change to Provide
Non-member Viewing Access to
SelectNet and that the Transmission of
Broadcast Orders Through SelectNet
be Solely on an Anonymous Basis**

May 18, 1995.

I. Introduction

On January 30, 1995, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder.² The NASD seeks to amend SelectNet in two ways: (a) to provide real-time access to non-members to view all "broadcast" orders in SelectNet; and (b) to provide that the transmission of broadcast orders through SelectNet be solely on an anonymous basis.

Notice of the proposed rule change appeared in the **Federal Register** on April 28, 1994³ and March 7, 1995.⁴ The Commission received letters from four commenters in response to the NASD's proposal. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Background

Originally referred to as the Order Confirmation Transaction Service ("OCT") and approved by the Commission in January 1988,⁵ the

NASD developed SelectNet in response to the difficulties experienced in the Nasdaq market during the market break of October 1987. SelectNet is an electronic screen-based order routing system allowing market makers and order-entry firms (collectively referred to as "participants") to negotiate securities transactions in Nasdaq securities through computer communications rather than relying on the telephone.

To enter an order in SelectNet, a participant enters the normal trade information: security symbol, side (buy or sell), transaction size, and price. Participants may enter orders priced at, above or below the inside bid or ask and, thus, SelectNet offers the opportunity to negotiate for a price superior to the current inside quote. In addition, participants may provide that an order or counter-offer will be in effect for anywhere from 3 to 99 minutes, specify a day order, or indicate whether price or size are negotiable or whether a specific minimum quantity is acceptable. Participants may accept, counter, or decline a SelectNet order. In the event that a participant elects to counter an offer, the service allows negotiations to be conducted between the participants by exchanging counter-offers until an agreement is reached. Once agreement is reached, the execution is "locked-in" and reported to the tape.

Through SelectNet, participants may either direct an order to a particular market maker in the security, broadcast to all market makers in the security, or broadcast to all participants watching a particular security (a feature known as "all call"). The participants then may negotiate the terms of the order through counter-offers entered into the system. SelectNet's default setting provides anonymity for broadcast orders. However, a participant currently entering a broadcast order may elect to identify itself. After an anonymous broadcast order is executed, each participant to the transaction learns the identity of the other. In contrast, directed orders always display to the receiving participant the identity of the participant entering the order.

III. Description of the Rule Change

The NASD seeks to modify SelectNet in two ways. First, it proposes to permit

approving SelectNet, previously referred to as the Order Confirmation Transaction Service, on a temporary, accelerated basis). See also, Securities Exchange Act Release No. 25523 (Mar. 28, 1988), 53 FR 10965 (Apr. 4, 1988) (order extending temporary approval of SelectNet); Securities Exchange Act Release No. 25690 (May 11, 1988), 53 FR 17523 (May 17, 1988) (order granting permanent approval of SelectNet).

non-member viewing access to orders broadcast through SelectNet. Second, the NASD proposes to require that broadcast orders be entered on an anonymous basis only.

A. Non-member Viewing Access to Broadcast Orders

Under the NASD's proposal, non-members will be permitted to view on a real-time basis all orders broadcast through SelectNet. Specifically, non-members will be able to view all unexecuted broadcast SelectNet orders, including the security name, the side of the order (buy or sell), the quantity available, the order price, the original size of the order, the outstanding portion, and the duration of the order (from 3 to 99 minutes or all day). The NASD will provide this information via the Level 2 Nasdaq Workstation service, to which non-members may subscribe. In addition, the NASD will provide a data feed of the broadcast SelectNet information to data vendors who in turn may provide the information to non-members. Under either alternative, dissemination of SelectNet information will be provided on a real-time basis.

Non-members, however, will not be permitted to interact through SelectNet with the order or be provided access to orders directed from one participant to another. Moreover, because the NASD's proposal will restrict all broadcast orders to an anonymous basis, neither members nor non-members will be able to determine the identity of the participant entering a broadcast order.

B. All Broadcast Orders will be on an Anonymous Basis

As currently configured, SelectNet allows a participant broadcasting an order to elect either to identify itself or to send the order anonymously. Under this proposal, however, participants will be limited to entering broadcast orders on an anonymous basis.⁶ If two firms begin negotiating the terms of a broadcast order, however, the participant that entered the order may choose to identify itself to the contra side.

IV. Comments

As noted above, the Commission received letters from four commenters in response to the proposal. Three of the commenters addressed the proposal to provide non-member viewing access, with one of these commenters supporting the proposal and the other two opposing it; the fourth commenter

⁶In contrast, directed orders will continue to identify the participant transmitting an order to another participant.

⁸ 15 U.S.C. 78s(b)(2) (1988).

⁹ 17 CFR 200.30(a)(12) (1994).

¹ 15 U.S.C. 78s(b)(1) (1988).

² 17 CFR 240.19b-4 (1994).

³ Securities Exchange Act Release No. 33938 (Apr. 20, 1994), 59 FR 22033 (Apr. 28, 1994) (notice of original proposal and Amendment No. 1).

⁴ Securities Exchange Act Release No. 35428 (Feb. 28, 1995), 60 FR 12583 (Mar. 7, 1995) (notice of Amendment No. 2).

⁵ Securities Exchange Act Release No. 25263 (Jan. 11, 1988), 53 FR 1430 (Jan. 19, 1988) (order

expressed opposition to the proposal to require anonymity for broadcast orders. The NASD responded to these comments in Amendment No. 2⁷ and by a letter dated April 8, 1995.⁸

Commenters responding to the NASD's original proposal criticized it because it would have limited non-member viewing access to Nasdaq WorkStation Level 2 subscribers.⁹ These commenters argued that the NASD should provide this access through a vendor data feed. In response, the NASD amended its filing to provide to vendors a separate data feed of broadcast orders.¹⁰

The NYSE and American Stock Exchange ("Amex") generally opposed the proposal because of their concerns about the broader policy issues surrounding SelectNet. Specifically, the NYSE and Amex argue that "orders" entered in SelectNet are actually quotations for purposes of the Quote Rule¹¹ and, therefore, the NASD should include them for dissemination in the calculation of the best bid and offer.¹² In response, the NASD argues that SelectNet orders lack the characteristics that trigger an obligation to include an order in the calculation of the best bid or offer in a Nasdaq security. Specifically, the NASD contends that unlike quotes, SelectNet orders are generally limited in duration¹³ and subject to price and size negotiation. The NASD concludes that classifying

SelectNet orders as "indications of interest" would be more appropriate than treating them as bids or offers.¹⁴ Moreover, the NASD argues that reassessing whether market maker orders broadcast through SelectNet should be reflected in the market maker's quote would necessarily include a similar assessment concerning market maker orders entered in Instinet.

One commenter opposed the NASD's proposal to modify the operation of SelectNet to provide that all broadcast orders be entered anonymously.¹⁵ This commenter argued that it identifies itself regularly with the hope that market makers will contact it to negotiate the order further. This commenter noted that it often wishes to be associated with certain buy or sell interest and that, paradoxically, the NASD's proposal to provide more information to non-members will result in less information to members.

In response, the NASD reiterated the two concerns set forth in its original filing as the basis for the proposal. First, the NASD believes that orders entered on an anonymous basis will act to maintain the incentives for dealers to continue to make markets that provide needed liquidity. The depth and liquidity of the Nasdaq market is dependent upon the presence of market makers who, among other duties, are required to maintain firm, continuous, two-sided quotations and participate in automated execution systems.¹⁶ The NASD is concerned about allowing order-entry firms to advertise buy and sell interest without having to satisfy these obligations. Specifically, the NASD believes that it would be inappropriate to allow a firm to pose as a dealer by posting identified positions in SelectNet without registering as a market maker. To allow this, the NASD argues, would reduce the incentive for firms to undertake market making responsibilities and consequently adversely affect market liquidity.

Second, the NASD is concerned that allowing a participant to identify itself provides the opportunity for the participant to condition or influence the market in one direction or another. For example, in the situation where a particular participant is considered a lead market maker or a major institutional block positioner in a

security, if it were interested in buying shares in the stock, it might broadcast a sell order in SelectNet and identify itself. The influence associated with the participant's name might trigger a decrease in the bid in reaction to the sell interest. This reaction would allow the participant to purchase the security at a lower price than would otherwise have been the case, simply because it was advertising its name, or conditioning the market.¹⁷

Finally, the NASD noted that once two firms begin negotiating an order, the firm entering the order may choose to identify itself to the contra side. Thus, two participants negotiating an order that find the need to continue negotiations over the telephone rather than through SelectNet may arrange to do so.

V. Discussion

The Commission believes that the rule change is consistent with the requirements of Sections 11A and 15A of the Act and the rules and regulations thereunder applicable to the NASD and, therefore, has determined to approve the proposal.

Section 11A sets forth the Congressional goal of achieving more efficient and effective market operations and the economically efficient execution of transactions through new data processing and communications techniques.¹⁸ Section 11A also expresses the Congressional finding that the public interest, the protection of investors and the maintenance of fair and orderly markets are enhanced by assuring: (a) fair competition among brokers and dealers, and (b) the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities.¹⁹ Section 15A requires that the rules of the NASD, among other things, 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

⁷ Securities Exchange Act Release No. 35428 (Feb. 28, 1995), 60 FR 12583 (Mar. 7, 1995) (notice of Amendment No. 2).

⁸ Letter from Richard Ketchum, Executive Vice President & Chief Operating Officer, NASD, to Jonathan G. Katz, Secretary, SEC (Apr. 28, 1995).

⁹ Letters from James E. Buck, Senior Vice President and Secretary, NYSE (June 2, 1994), Daniel Parker Odell, Assistant Secretary, NYSE (Mar. 28, 1995), and Craig S. Tyle, Vice President & Senior Counsel, Investment Company Institute (May 19, 1994), to Jonathan G. Katz, Secretary, SEC.

¹⁰ Securities Exchange Act Release No. 35428 (Feb. 28, 1995), 60 FR 12583 (Mar. 7, 1995) (notice of Amendment No. 2). In response to this amendment, the Investment Company Institute submitted a second comment letter, expressing its support for the proposal. Letter from Craig S. Tyle, Vice President & Senior Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, SEC (Mar. 28, 1995).

¹¹ 17 CFR 240.11Ac1-1.

¹² The NYSE also notes in its comment letters that the SelectNet rules are contained in the *SelectNet User Guide*, but are not included in the *NASD Manual*. See *SelectNet User Guide* (Nov. 1990). The NASD has committed to submit to the Commission a package of SelectNet rules by the end of 1995. Letter from Richard Ketchum, Executive Vice President & Chief Operating Officer, NASD, to Jonathan G. Katz, Secretary, SEC (Apr. 28, 1995).

¹³ The NASD represents that SelectNet orders are usually either executed immediately or expire after three minutes. Thus, the NASD further argues, SelectNet orders fall within the exception that allows the NASD to exclude from the best bid or offer calculation an order which is executed immediately. 17 CFR 240.11Ac1-1(b)(1)(ii).

¹⁴ Under rules promulgated pursuant to the Act, "indications of interest" are not considered bids or offers. 17 CFR 240.11Ac1-1(a)(8).

¹⁵ Letter from John C. Helmer, President, Caldwell Securities Incorporated, to Jonathan G. Katz, Secretary, SEC (Mar. 15, 1994).

¹⁶ 17 CFR 240.11Ac1-1 and *NASD Manual*, Schedules to the By-Laws, Schedule D, Sec. 2(a) and (b), (CCH) ¶ 1819.

¹⁷ Indeed, the Commission and the NASD also have expressed concern that other types of market conditioning may violate just and equitable principles of trade. See, e.g., *NASD Manual*, Rules of Fair Practice, Art. III, Sec. 6, (CCH) ¶ 2156 (no member shall offer to buy or sell a security unless the member is prepared at the time to honor the offer).

¹⁸ 15 U.S.C. § 78k-1(a)(1)(B).

¹⁹ *Id.* 78k-1(a)(C)(ii) and (iii).

open market, and, in general, to protect investors and the public interest.²⁰

A. Non-member Viewing Access

In its *Market 2000* report,²¹ the Commission's Division of Market Regulation ("Division") expressed concern that the limited transparency of SelectNet orders often conceals from the broader market the best trading interest in a security and, in turn, impedes competition and price discovery.²² The Division, therefore, recommended that the NASD consider ways to enhance SelectNet transparency.²³ The Commission believes that this proposal is a positive response to the Division's recommendation in *Market 2000*.

The NASD's proposal to provide non-members viewing access to orders broadcast through SelectNet will help achieve more efficient and effective market operations by increasing transparency of market information. Increased transparency, in turn, will facilitate more efficient price discovery and enhance price competition among all market participants. This change to SelectNet will allow non-members to obtain with relative ease and low cost important pricing information about Nasdaq securities. Moreover, investors will be better able to assess the overall supply and demand for a particular Nasdaq security and, thus, effect transactions in a more cost-effective manner. They will now be able to view, although not participate directly in, an important system for trading Nasdaq securities.²⁴

In response to the NASD's proposal, the NYSE and Amex raised broad policy concerns about the operation of SelectNet in the context of the Quote Rule. The NYSE and Amex argued that orders broadcast through SelectNet constitute quotations for purposes of the Quote Rule and, therefore, should be reflected in market maker quotations.

The Commission believes that this issue reaches beyond the broadcast of SelectNet orders to non-members. For example, it raises question about whether the widespread dissemination of orders through broker-dealer trading systems, such as Instinet, constitute quotations for purposes of the Quote Rule. Thus, the Commission believes

that this issue is beyond the scope of this proposal and that the policy issue raised by the NYSE and Amex deserve continued examination. Moreover, the Commission believes that this proposal is a meaningful advance in the effort to enhance transparency in the Nasdaq market and, therefore, should not await further debate of this issue.

B. The Anonymous Display of All Broadcast Orders

As noted above, the NASD will not identify the origin of SelectNet orders when pricing information is made available through Nasdaq or vendor facilities. One commenter opposed this feature for the reasons described above.

The Commission currently believes the NASD's proposal incorporating anonymity in the display of orders broadcast through SelectNet is consistent with the goals of the Act. The Commission believes requiring anonymity will promote just and equitable principles of trade by removing a mechanism for a participant to induce market movement simply by associating its name with a particular order.

In addition, the Commission finds that the rule change does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. While the imposition of the anonymity requirement may alter certain existing trading practices, the Commission believes that the proposal furthers the purposes of the Act by enhancing SelectNet transparency for non-members. The Commission believes that expanded dissemination of SelectNet information will better inform public investors regarding the prices at which investors and dealers are willing to transact business in a particular security.

VI. Conclusion

For the reasons stated above, the Commission finds that the proposed rule change is consistent with the requirements of the Act.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change SR-NASD-94-9 be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁵

Margaret H. McFarland,
Deputy Secretary.

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²⁵ 17 CFR 200.30-3(a)(12).

[Investment Company Act Release No. 21081; 811-0407]

SBM Company; Notice of Application

May 17, 1995.

AGENCY: Securities and Exchange Commission ("SEC").

ACTION: Notice of application for deregistration under the Investment Company Act of 1940 ("Act").

APPLICANT: SBM Company.

RELEVANT ACT SECTION: Section 8(f).

SUMMARY OF APPLICATION: Applicant requests an amended order eliminating prior conditions, thus permitting applicant to sell substantially all of its assets, including a subsidiary that is a registered investment company, to another company.

FILING DATE: The application was filed on April 5, 1995.

HEARING OR NOTIFICATION OF HEARING: An order granting the application will be issued unless the SEC orders a hearing. Interested persons may request a hearing by writing to the SEC's Secretary and serving applicant with a copy of the request, personally or by mail. Hearing requests should be received by the SEC by 5:30 p.m. on June 12, 1995, and should be accompanied by proof of service on applicant, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request such notification by writing to the SEC's Secretary.

ADDRESSES: Secretary, SEC, 450 Fifth Street, N.W., Washington, D.C. 20549. Applicant, 8400 Normandale Lake Boulevard, Suite 1150, Minneapolis, Minnesota 55437.

FOR FURTHER INFORMATION CONTACT: James J. Dwyer, Staff Attorney, at (202) 942-0581, or Robert A. Robertson, Branch Chief, at (202) 942-0564 (Division of Investment Management, Office of Investment Company Regulation).

SUPPLEMENTARY INFORMATION: The following is a summary of the application. The complete application may be obtained for a fee from the SEC's Public Reference Branch.

Applicant's Representations

1. Applicant, a Minnesota corporation, is a financial holding company that also acts as investment adviser, transfer agent, and dividend disbursing agent for certain mutual funds. Applicant's wholly-owned subsidiaries are State Bond and

²⁰ *Id.* 780-3(b)(6).

²¹ *Market 2000: An Examination of Current Equity Market Developments*, Division of Market Regulation, United States Securities and Exchange Commission (Jan. 1994).

²² *Id.* at IV-7.

²³ *Id.* at 19 and IV-7.

²⁴ The NASD has represented that SelectNet usage has grown from a daily average of 3,000 transactions and 6 million shares in the first half of 1991 to over 10,550 transactions and more than 12.6 million shares in the first quarter of 1995.