

important systems project.<sup>2</sup> The temporary fees were implemented on August 1, 1995, and applied to all filings received on or after that date. The fee increase was to be reduced for most types of filings made in calendar year 1997 and was to return to the pre-1995 levels in calendar year 1998.

NASD Regulation has added functionality to the new CRD system and improved the system's compatibility with various computer operating systems, such as Windows 95 and Windows NT. This has resulted in delays and cost increases in implementing the redesigned CRD. Accordingly, NASD Regulation is proposing to amend Schedule A, Section 2 to eliminate the scheduled fee rollbacks and to retain the current fee level indefinitely. This fee level will provide \$4 million in extra revenue each year over the revenue produced by the pre-1995 fee levels.

The NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(5) of the Act<sup>3</sup> which requires that the rules of the Association provide for the equitable allocation of reasonable dues, fees, and other charges in that the proposed rule provides a consistent basis for assessments among member firms and fairly assesses a charge to cover the costs incurred by the Association in the implementation of the redesigned CRD System.

## 2. Statutory Basis

The proposed rule change is consistent with Section 15A of the Act<sup>4</sup> in general and furthers the objectives of Section 15A(b) (5)<sup>5</sup> in particular in that it provides for the equitable allocation of reasonable dues, fees, and other charges among the NASD's members and other persons using its facilities.

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

The proposed rule change does not impose 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*

The NASD has neither solicited nor received written comments on the proposed rule change.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change constitutes or changes a due, fee, or other charge imposed by the NASD and, therefore, has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>6</sup> and subparagraph (e) of Rule 19b-4 thereunder.<sup>7</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file 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 at the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the National Association of Securities Dealers. All submissions should refer to File No. SR-NASD-96-53 and should be submitted by January 30, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

Jonathan G. Katz,

Secretary.

[FR Doc. 97-439 Filed 1-8-97; 8:45 am]

**BILLING CODE 8010-01-M**

[Release No. 34-38115; File No. SR-NASD-95-54]

## **Self-Regulatory Organizations; Order Approving Proposed Rule Change by National Association of Securities Dealers, Inc., Relating to a Modification of the Operation of the Small Order Execution System During Locked and Crossed Markets**

January 3, 1997.

On November 15, 1995,<sup>1</sup> the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("Commission" or "SEC") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>2</sup> and Rule 19b-4 thereunder.<sup>3</sup> The rule change amends NASD Rule 4730(b)(4)<sup>4</sup> to provide that during locked or crossed markets, SOES will execute orders in five-second intervals against a locked or crossed market maker at the best price, regardless of whether the market maker entered the quotation locking or crossing the market.

Notice of the proposed rule change, together with the substance of the proposal, was provided by issuance of a Commission release (Securities Exchange Act Release No. 37845, October 21, 1996) and by publication in the Federal Register (61 FR 55342, October 25, 1996). One comment letter was received.<sup>5</sup> This order approves the proposed rule change.

### I. Description of Rule Change

The rule change approved today modifies SOES to provide that during

<sup>1</sup> The NASD amended the proposed rule change four times subsequent to its initial filing. Amendment No. 4 filed October 16, 1996, changed the narrative in the proposed rule change. Amendment No. 3, filed October 2, 1996, replaced Amendment No. 2, which was filed September 23, 1996. Amendment No. 2, in turn, replaced Amendment No. 1, which was filed August 5, 1996.

The proposed rule change, as originally submitted, would have provided market makers with a 15-second grace period following their receipt of a Small Order Execution System ("SOES") execution report during locked and crossed markets in which to update their quotation in that security before being required to execute another SOES order in that security. The filing as amended would establish a 5 second grace period between SOES executions in locked and crossed markets. See letter from Robert E. Aber, Vice President and General Counsel, The Nasdaq Stock Market to Katherine England, Assistant Director, Division of Market Regulation, Commission (October 2, 1996).

<sup>2</sup> 15 U.S.C. § 78s(b)(1).

<sup>3</sup> 17 CFR 240.19b-4.

<sup>4</sup> NASD Manual, Marketplace Rules (CCH), Rule 4730.

<sup>5</sup> Letter from Edward J. Johnsen, Vice President & Counsel, Morgan Stanley & Co. Inc. ("Morgan Stanley"), to Jonathan G. Katz, Secretary, Commission, dated November 14, 1996.

<sup>2</sup> Securities Exchange Act Release No. 36025 (July 26, 1995), 60 FR 39200 (Aug. 1, 1995).

<sup>3</sup> 15 U.S.C. § 78o-3.

<sup>4</sup> 15 U.S.C. 78o-3.

<sup>5</sup> 15 U.S.C. 78o-3(b)(5).

<sup>6</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>7</sup> 17 CFR 240.19b-4.

<sup>8</sup> 17 CFR 200.30-3(a)(12).

locked or crossed markets, SOES will execute orders in five-second intervals against a market maker whose quotation is locked or crossed at the best price, regardless of whether the market maker entered the quotation locking or crossing the market. Currently, when markets are not locked or crossed, SOES provides market makers with a 15-second period of time following their receipt of a SOES execution report to update their quotation before being required to execute another order in that security through SOES. The NASD represented in its filing that when the market for a Nasdaq National Market security is locked or crossed,<sup>6</sup> however, SOES is currently designed so that the market maker whose quotation is locked or crossed and the market maker who has entered a locking or crossing quotation will have SOES orders representing shares equal to the SOES minimum exposure limit<sup>7</sup> or the firm's exposure limit, whichever is greater, executed by SOES against the market maker's account without any delay between SOES executions ("locked and crossed market rule").<sup>8</sup> Thus, in such instances, unlike the operation of SOES during non-locked or crossed markets, the market maker's account will receive SOES executions without any delay between executions until its exposure limit is exhausted. In addition, during locked or crossed markets, SOES orders are executed against market makers whose quotations are locked or crossed irrespective of any preference indicated by the SOES order entry firm.

The locked and crossed market rule was intended to increase the accuracy of displayed quotations in NNM securities

<sup>6</sup> Quotations are "locked" when the bid price quoted by one market maker in a security equals the ask price quoted by another market maker in the same security. Quotations are "crossed" when the bid price quoted by one market maker in a security is greater than the ask price quoted by another market maker in the same security.

<sup>7</sup> The minimum exposure limit for SOES is currently twice the maximum SOES order size for a given security. Thus, the minimum exposure limit for a Nasdaq/National Market security in the 1,000-share tier size is 2,000 shares. The NASD has filed a proposed rule change that would, among other things, eliminate minimum exposure limits in SOES. See Securities Exchange Act Release No. 38008 (December 2, 1996), 61 FR 64550 (December 5, 1996) (publishing notice of filing of SR-NASD-96-43).

<sup>8</sup> See Rule 4730(b)(4). The Commission notes that Rule 4730(b)(4) currently provides that "a Market Maker with a quotation for that security in the Nasdaq System that is causing the locked or crossed market may have orders representing shares equal to the minimum exposure limit or the firm's exposure limit, whichever is greater, executed by SOES for that Market Maker's account at its quoted price if that price is the best price." Rule 4730(b)(4) by its terms does not apply to market makers whose quotations have been locked or crossed. The proposed rule would change this distinction and both types of firms to the Rule.

by providing an incentive for market makers to reduce the frequency and duration of locked and crossed markets.<sup>9</sup>

The NASD stated in its filing that the magnitude of SOES orders received and executed during locked and crossed markets is such that market makers execute significant volume through SOES before they are able to rectify locked and crossed markets. The NASD further stated the rule change was intended to continue to provide market makers an incentive to update their quotations in locked and crossed markets while enhancing market makers' ability to react to SOES transactions in locked and crossed markets.<sup>10</sup>

## II. Comments

Morgan Stanley opposes the proposed rule change. It states that the interval proposed is too short for it to react to a locked or crossed market. It recommends a 15 second interval at a minimum, but argues that a SOES market maker whose quotation has been locked or crossed should not be subject to SOES executions for: (i) 90 seconds after its quotation has been locked or crossed; or (ii) whatever period of time is needed for the locking or crossing market maker to notify the NASD, and for the NASD, in turn, to notify the market maker that its quotation has been locked or crossed. It also recommends that NASD provide a market maker whose quotation has been locked or crossed with a warning window on its screen.

## III. Discussion

The Commission finds that the rule change is consistent with the provisions of Sections 15A(b)(6), 15A(b)(9), 15A(b)(11) and 11A(a)(1)(C) of the Act and Rule 11Ac1-1 ("Quote Rule") thereunder.<sup>11</sup> Among other things,

<sup>9</sup> See Securities Exchange Act Release No. 25791 (June 9, 1988), 53 FR 22594 (order approving SR-NASD-88-1). The NASD stated in its filing that prior to the approval of SR-NASD-88-1, SOES would not execute orders in locked and crossed markets.

<sup>10</sup> The NASD indicated that many locked and crossed markets occur after trading halts are lifted or when market makers are adjusting their quotations in response to material news disclosed concerning the issuer of the security.

<sup>11</sup> Section 15A(b)(9) provides that the rules of the NASD must not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Section 15A(b)(11) directs the NASD to adopt rules designed to produce fair and informative quotations, prevent fictitious and misleading quotations, and promote orderly procedures for collecting and distributing quotations. Section 11A(a)(1)(C) of the Act states that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure, among other

things, (i) economically efficient execution of securities transactions; (ii) fair competition among brokers and dealers; and (iii) the practicality of brokers executing investor orders in the best market.

Section 15A(b)(6) requires that the rules of a national securities association 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 open market and a national market system and in general to protect investors and the public interest. The Commission believes that the rule change will remove impediments to and perfect the mechanism of a free and open market and a national market system by providing Nasdaq market makers with a brief period to update their quotations during locked and crossed markets before being subject to a SOES execution. The Commission recognizes that a locked or crossed market can occur during unusual market conditions. Consequently, it is not unreasonable to provide market makers with a very brief period to update their quotes. At the same time, market makers should have an incentive to fix a locked or crossed market as quickly as possible in order to correct the quotation anomaly. Thus, the quote update period for locked and crossed markets should be as short as possible. The Commission believes that the rule strikes this balance by encouraging market makers to remedy quickly locked and crossed markets that occur, given that market makers will continue to face executions at intervals that are less than one-third of the length of intervals between unpreferred SOES executions during times when markets are not locked or crossed.

The Commission does not believe that the alternatives recommended by Morgan Stanley provide market makers with a sufficient incentive to remedy locked and crossed markets that occur. Therefore, it disagrees with Morgan Stanley's argument. The Commission also notes that the rules change will continue to permit retail investors to have immediate access to the best prices displayed by Nasdaq market makers on Nasdaq because SOES will continue to execute trades during locked and crossed markets. By contrast, Morgan Stanley's suggestion that the NASD not permit executions against a market maker's quotation that has been locked

or crossed until the locking or crossing market maker has notified the NASD, and the NASD, in turn, has notified the market maker that its quotation has been locked or crossed, would be highly inefficient and would be inconsistent with the NASD's statutory mandate that its rules remove impediments to and perfect the mechanism of a free and open market. The Commission also notes that each of the alternatives suggested by Morgan Stanley would inhibit the ability of investors to obtain executions at a market maker's displayed quotations if it were implemented. Thus, the Morgan Stanley alternatives do not give due recognition to the interests of investors or to the interest of the NASD in discouraging locked and crossed markets.

The 5-second interval between SOES executions during locked and crossed markets will apply to all SOES users and participants. Although the proposal will limit to a small extent the ability to investors to obtain executions in locked and crossed markets by providing a 5-second interval between executions, the Commission believes that the rule change appropriately balances the interests of investors and the need for market makers to have a very brief period to update their quotations expeditiously in locked or crossed markets. The rule change also is intended to enhance the production of fair and orderly quotations in NNM securities. This, in turn, should encourage market makers to enter more competitive quotations.

The Quote Rule requires that brokers and dealers execute orders to buy and sell securities at their published quotes unless communicating a revised bid or offer or unless updating their quotations in response to an execution. The 5-second interval is intended to provide market makers with an opportunity to update their quotations in response to an execution. Market makers who do not so will be required to execute further transactions at their published bid or offer.<sup>12</sup> The Commission notes that if the NASD adopted either alternative suggested by Morgan Stanley, Nasdaq market makers would not be required to execute orders to buy and sell securities at their published quotes even when they are not communicating a revised bid or offer or

updating their quotations in response to an execution.<sup>13</sup>

#### IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change SR-NASD-95-54 be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

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[Release No. 38106; File No. SR-NYSE-96-27]

#### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by New York Stock Exchange, Inc., Relating to an Interpretation of Rule 409 ("Statements of Accounts to Customers")

December 31, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on December 5, 1996,<sup>2</sup> the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. 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 Exchange has filed with the Commission a proposed rule change which consists of an interpretation with respect to the meaning and administration of existing Exchange

<sup>13</sup> Morgan Stanley argues that market makers whose quotes have been locked or crossed may not always have adequate notice that their quotation has been locked or crossed. It recommends that the NASD provide a market maker whose quotation has been locked or crossed with a warning window on its screen. While the suggestion has merit, the Commission does not believe that it is a necessary prerequisite for approving a rule change providing market makers with five additional seconds to update their quotations.

<sup>14</sup> 17 CFR 200.30-3(a)(12) (1989).

<sup>15</sup> U.S.C. 78s(b)(1).

<sup>2</sup> On December 5, 1996, the NYSE filed Amendment No. 1 with the Commission. The proposed rule change was submitted on September 25, 1996. However, amendments to the rule language were improperly identified in contravention of Section 19(b); therefore, the filing is deemed to be filed on the later date. See letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Katherine A. England, Assistant Director, Division of Market Regulation, SEC, dated December 5, 1996.

Rule 409 ("Statements of Accounts of Customers"). Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

#### RULE 409: STATEMENTS OF ACCOUNTS TO CUSTOMERS

(a)

##### /01 Applicability

*Compliance with Rule 409(a) and the accuracy of statements of accounts thereunder is the responsibility of the member organization carrying the customer account for which the statement is required, unless such responsibility has been allocated to a non-member carrying organization pursuant to an Exchange approved agreement under Rule 382.*

##### /02 Information To Be Disclosed

*Statements of accounts to customers must clearly and prominently disclose on the front of the statement:*

- 1. the identity of the introducing and carrying organization and their respective phone numbers for service;<sup>1</sup>*
- 2. where the customers' assets included on the statement are carried;*
- 3. that the carrying organization is a member of SIPC and whether any of the customers' assets included on the statement are not covered by SIPC;*
- 4. the opening and closing balances for the account.*

##### /03 Use of Third Party Agents

*Prior to utilizing a "third party agent" to prepare and/or transmit statements of accounts to customers, a member organization shall represent/undertake in writing to the Exchange that:*

- 1. the third party is acting as agent for the member organization;*
- 2. the member organization retains responsibility for compliance with Rule 409(a);*
- 3. the member organization has developed procedures/controls for reviewing and testing the accuracy of statements of accounts prepared and/or transmitted by the third party agent;*
- 4. the member organization will retain copies of statements of accounts prepared and/or transmitted by the third party agent in accordance with applicable books and records requirements.*

*Allocation of responsibilities for preparation and/or transmission of statements to any person other than a carrying organization pursuant to an agreement approved by the Exchange in accordance with Rule 382 (Carrying*

<sup>1</sup> If the phone number of the clearing organization appears on the back of the statement it must be in "bold" or "highlighted" letters.

<sup>12</sup> See Securities Exchange Act Release No. 29801 (October 10, 1991), 56 FR 52098 (approving 15-second interval following a market maker's receipt of a SOES execution report to update its quotation before being required to execute another order in that security through SOES).