

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

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*Deputy Secretary.*

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[Release No. 34-38196; File No. SR-NASD-96-51]

**Self-Regulatory Organizations; Notice of Proposed Rule Change by the National Association of Securities Dealers, Inc. Amending Rule 11890 Regarding Clearly Erroneous Transactions**

January 22, 1997.

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 December 17, 1996, 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 and The Nasdaq Stock Market, Inc. ("Nasdaq"). On January 17, 1997, the NASD and Nasdaq submitted to the Commission Amendment No. 1 to the proposed rule change.<sup>1</sup> 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**

Pursuant to Section 19(b)(1) under the Act and Rule 19b-4 thereunder, the NASD and Nasdaq are submitting this rule filing to amend Rule 11890, the rule related to clearly erroneous transactions. The proposed amended language for Rule 11890 is set forth below. [new text is italicized; deleted text is bracketed].

**11890. Clearly Erroneous [Trades] Transactions**

**(a) Authority to [Declare] Review Transactions [Void]**

(1) [In circumstances in which the Association deems it necessary to maintain a fair and orderly market and to protect investors and the public interest, the Association may, pursuant to the procedures set forth in paragraph (b) below, declare any transaction

arising out of the use or operation of any automated quotation, execution, or communication system owned or operated by the Association or any subsidiary thereof and approved by the Commission, null and void on the grounds that one or more of the terms of the transaction are clearly erroneous.

(2) For the purposes of this Rule, the terms of a transaction are clearly erroneous when there is an obvious error in any term, such as price, number of shares or other unit of trading, or identification of the security.

(2) *Officers of The Nasdaq Stock Market, Inc. ("Nasdaq") designated by the President of Nasdaq shall, pursuant to the procedures set forth in paragraph (b) below, have the authority to review any transaction arising out of the use or operation of any automated quotation, execution, or communication system owned or operated by Nasdaq and approved by the Commission. A Nasdaq officer shall review transactions with a view toward maintaining a fair and orderly market and the protection of investors and the public interest. Based upon this review, the Officer shall decline to act upon a disrupted transaction if the officer believes that the transaction under dispute is not clearly erroneous, or, if the officer determines the transaction in dispute is clearly erroneous, he or she shall declare that the transaction is null and void or modify one or more terms of the transaction. When adjusting the terms of a transaction, the Nasdaq officer shall seek to adjust the price and/or size of the transaction to achieve an equitable rectification of the error that would place the parties to a transaction in the same position, or as close as possible to the same position, that they would have been in had the error not occurred. Nasdaq shall promptly provide oral notification of a determination to the parties involved in a disputed transaction and thereafter issue a written confirmation of the determination.*

**(b) Procedures for Reviewing [Declaring a] Transactions [Void]**

(1) Any member or person associated with a member that seeks to have a transaction reviewed [declared null and void] pursuant to paragraph (a) hereof, shall submit a written complaint, via facsimile or otherwise, to Nasdaq Market Operations in accordance with the following time parameters:

(A) for transactions occurring prior to 10:00 a.m., Eastern Time, complaints must be submitted 10:30 a.m., Eastern Time; and

(B) for transactions occurring on or after 10:00 a.m., Eastern Time,

*complaints must be submitted within thirty minutes.*

[notify an officer of the Association designated by the President of the transaction during Nasdaq operating hours on the same business day the transaction occurs, and shall provide such official all facts and information necessary for a determination under paragraph (a). Information communicated orally shall be confirmed promptly in writing.]

(2) *Once a complaint has been received in accord with subparagraph (b)(1) above:*

(A) *the complainant shall have up to thirty (30) minutes, or such longer period as specified by Nasdaq staff, to submit any supporting written information concerning the complaint necessary for a determination under paragraph (a)(2), via facsimile or otherwise;*

(B) *the counterparty to the trade shall be verbally notified of the complaint by Nasdaq staff and shall have up to thirty (30) minutes, or such longer period as specified by Nasdaq staff, to submit any supporting written information concerning the complaint necessary for a determination under paragraph (a)(2), via facsimile or otherwise; and*

(C) *either party to a disputed trade may request the written information provided by the other party pursuant to this subparagraph.*

(3) *Notwithstanding paragraph (b)(2) above, once a party to a disputed trade communicates that it does not intend to submit any further information concerning a complaint, the party may not thereafter provide additional information unless requested to do so by Nasdaq staff. If both parties to a disputed trade indicate that they have no further information to provide concerning the complaint before their respective thirty-minute information submission period has elapsed, then the matter may be immediately presented to a Nasdaq officer for a determination pursuant to paragraph (a)(2) above.*

(4) *Each member and/or person associated with a member involved in the transaction shall provide the Association with any information requested by the Association in order to resolve the matter on a timely basis notwithstanding the time parameters set forth in paragraph (b)(2) above.*

(5) *Once a party has applied to Nasdaq for review, the transaction shall be reviewed and a determination rendered, unless both parties to the transaction agree to withdraw the application for review prior to the time a decision is rendered pursuant to paragraph (a)(2).*

<sup>5</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> See letter from Robert E. Aber, Vice President and General Counsel, Nasdaq, to Katherine A. England, Assistant Director, SEC, dated January 17, 1997. Amendment No. 1 corrects typographical errors in the text of the proposed rule change.

[(2) An officer of the Association designated by the President shall review the information submitted and determine whether the transaction in dispute is clearly erroneous and detrimental to the maintenance of a fair and orderly market and the protection of investors and the public interest and may declare that the transaction be null and void. The official may decline to act upon a disputed transaction if he or she believes that action is unnecessary or inappropriate. The Association shall immediately issue a written determination of the matter, setting forth the actions taken and the reasons therefor.]

*(c) Procedures for Reviewing Transactions Executed During System Disruptions or Malfunctions*

*In the event of a disruption or malfunction in the use or operation of any automated quotation, execution, or communications system owned or operated by Nasdaq and approved by the Commission, Nasdaq, acting through an officer designated by the President of Nasdaq pursuant to paragraph (a)(2), may, on its own motion pursuant to the standards set forth in paragraph (a), declare transactions arising out of the use or operation of such systems during the period of such disruption or malfunction null and void or modify the terms of these transactions; provided that, in the absence of extraordinary circumstances, a Nasdaq officer must take action pursuant to this paragraph within thirty (30) minutes of detection of the erroneous transaction(s), but in no event later than 6:00 p.m., Eastern Time, on the next trading day following the date of the trade at issue. When Nasdaq takes action pursuant to this subparagraph, the member firms involved in the transaction shall be notified as soon as is practicable and shall have a right to appeal such action in accordance with paragraph (d)(1) below.*

*(d) [(3)] Review by the Market Operations Review Committee ("MORC")*

*(1) A member or person associated with a member may appeal a determination made under paragraphs (a)(2) or (c) [the determination under subparagraph (2)] to the MORC [Market Operations Review Committee] provided such appeal is made in writing, via facsimile or otherwise, within [four market hours of] thirty (30) minutes after the member or person associated with a member receives verbal notification of such determination. [For the purposes of this*

*Rule, "market" hours shall mean those hours the Nasdaq market is open in the United States, Eastern Time.] Once a written appeal has been received, the counterparty to the trade will be notified of the appeal and both parties shall be able to submit any additional supporting written information, via facsimile or otherwise, up until the time the appeal is considered by the Committee. Either party to a disputed trade may request the written information provided by the other party during the appeal process. An appeal to the Committee shall not operate as a stay of the determination made pursuant to paragraph (a)(2) above. Once a party has appealed a determination to the Committee, the determination shall be reviewed and a decision rendered, unless both parties to the transaction agree to withdraw the appeal prior to the time a decision is rendered by the Committee. Upon consideration of the record, and after such hearings as it may in its discretion order, the Committee, pursuant to the standards set forth in paragraph (a), shall affirm, modify, reverse, [dismiss,] or remand the determination made under [sub]paragraph (a)(2) or (c) above.*

*(2) [(4)] The decision of the Committee shall be final and binding upon any member or person associated with a member and shall constitute final Association action on the matter in issue. Any adverse determination by a Nasdaq officer pursuant to paragraph (a)(2) or (c) or any adverse decision by the Committee pursuant to paragraph (d)(1) shall be rendered without prejudice as to the rights of the parties to the transaction to submit their dispute to arbitration.*

\* \* \* \* \*

**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 and Nasdaq 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 and Nasdaq have 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*

The NASD and Nasdaq have determined to amend Rule 11890, the

NASD's rule governing the review and resolution of erroneous transaction complaints. In general, the proposed amendments provide greater specificity regarding declarations of erroneous transactions. As explained in more detail below, the proposed amendments would:

- Provide Nasdaq officials the authority to efficiently and expeditiously adjust the price and size of erroneous transactions (currently Nasdaq officials may only nullify, affirm, or decline to act with respect to an allegedly erroneous transaction);
- Shorten the time period to submit erroneous transactions complaints from same day submission to submission within 30 minutes of the transaction;
- Clarify the procedures by which the parties to an allegedly erroneous transaction may submit written information concerning the transaction;
- Provide Nasdaq officials the requisite authority to cancel or adjust erroneous transactions on their own motion;
- Discourage regulatory arbitrage by prohibiting a member from withdrawing an erroneous transaction complaint unless the other party to the trade agrees to withdraw the matter;
- Shorten the time period to appeal an erroneous transaction determination from four "market" hours to thirty minutes; and
- Clarify that an appeal of an erroneous transaction determination does not operate as a stay of the determination.

**A. Background**

In April 1990, the SEC approved an NASD proposal to add Section 70 to the Uniform Practice Code (now NASD rule 11890) to permit the NASD to declare clearly erroneous transactions null and void if they arise out of the use or operation of any automated quotation, execution, or communication system owned or operated by the NASD. Previously, the NASD had no authority to cancel a transaction, even if one or more terms of the transaction clearly was in error. For example, one of the catalysts for adopting Rule 11890 was that a member had complained that a trade executed over Nasdaq's SelectNet service was ten points away from the inside quotation, clearly an error, but the contra party refused to cancel the trade. With the adoption of rule 11890, the NASD now has the ability to resolve disputes involving obvious errors in an expeditious manner, akin to an exchange floor governor ruling.<sup>2</sup>

<sup>2</sup> See, e.g., New York Stock Exchange Rule 75.

Briefly, the current procedures for canceling a clearly erroneous trade require one party to contact the NASD on trade day and in writing state the basis for the requested action. Thereafter, an officer of Nasdaq: (1) advises the contra party to the trade that the transaction is in dispute; (2) obtains additional information concerning the transaction, if necessary; (3) reviews the trade information; and (4) makes a determination as to whether the trade should stand or be broken. If either party wishes to appeal the staff determination, it may seek review by the MORC.

While the current Erroneous Transaction procedures have served as a vehicle to correct or cancel erroneous transactions, experience with the operation of Rule 11890 has shown that the Rule can be improved to enhance the fairness and expediency with which erroneous transaction complaints are resolved. Experience with the Rule also has revealed shortcomings in the scope of Nasdaq's authority to take action with respect to clearly erroneous transactions. In particular, there have been instances in the past where it would have been appropriate for Nasdaq to declare a series of transactions erroneous even though the parties to the transactions were immediately unaware of any error. The proposed changes to the rule are intended to eliminate the shortcomings and to provide additional capabilities to resolve clearly erroneous transactions.

#### B. Proposed Changes to Rule 11890

(i) *Authority of Nasdaq Officers to Adjust the Terms of Erroneous Transactions:* While Nasdaq officers and the MORC both have the authority to nullify, affirm, or decline to act with respect to an allegedly erroneous transaction, only the MORC can presently adjust the terms of an erroneous transaction. In order to enhance the efficiency with which erroneous transaction disputes are resolved, it is appropriate to grant Nasdaq officers the requisite authority with respect to allegedly erroneous transactions that the MORC possesses. Accordingly, the NASD and Nasdaq propose that Rule 11890 be amended to afford Nasdaq officers the authority to adjust the terms of a clearly erroneous transaction. In particular, the NASD and Nasdaq believe Nasdaq officers should be able to adjust the price and/or size of a transaction to achieve an equitable correction of an error that would place the parties to the transaction in the same position, or as close as possible to the same position, that they would have been in had the error not occurred.

(ii) *Time Parameters For the Submission of Erroneous Transaction Complaints:* Rule 11890 presently provides that a member can submit an erroneous transaction complaint "during Nasdaq operating hours on the same business day the transaction occurs. . . ." Because members can file erroneous transaction complaints any time during the trading day, however, the rule has been used by some firms to seek to cancel trades that were not erroneous at the time of execution, but which became unprofitable due to subsequent market movement. For example, when a trade occurs on SelectNet at 10:00 a.m. and a party does not complain of an error until 5:00 p.m., the complainant has had the opportunity to watch for positive or negative market movements, prior to requesting NASD action. If the market moves in a direction that is unfavorable to the trade, the member will contact the NASD to cancel the trade after the close of the market, leaving the other side of the transaction at risk, without giving adequate notice of the disputed trade in close proximity to the time of execution.<sup>3</sup>

Accordingly, the NASD and Nasdaq believe that Rule 11890 should be amended to require the timely submission of notifications of allegedly erroneous transactions. The NASD and Nasdaq are proposing two different time periods depending upon the time of day when the allegedly erroneous transaction occurred to take into account the peak trading period that occurs at the market's opening. Because of the pace and volume of trades that occur in the first half hour of trading each morning, the proposal establishes a separate timeframe for reporting clearly erroneous transactions that occur between 9:30 and 10:00. Thus, notifications would be required according to the following time table:

(a) for transactions occurring prior to 10:00 a.m., Eastern Time, complaints must be submitted by 10:30 a.m., Eastern Time; and

(b) for transactions occurring at or after 10:00 a.m., Eastern Time, complaints must be submitted within thirty minutes.

In addition, the NASD proposes to amend Rule 11890 to clarify several procedural aspects concerning the submission of erroneous transaction complaints. Specifically, the amendments would clarify that:

(a) a complaint will not be deemed to have been submitted until Market

<sup>3</sup> In essence, the rule grants a free call option when a potential complainant sold stock and a free put option when the potential complainant bought stock.

Operations receives a written complaint, via facsimile or otherwise;

(b) once a timely complaint is received, a complainant will have up to thirty minutes to submit any supporting written information concerning the complaint, via facsimile or otherwise;

(c) once a timely complaint is received, the counter-party will be notified by Market Operations of the complaint and afforded a thirty-minute period to submit any supporting written information concerning the disputed trade, via facsimile or otherwise;

(d) either party to a disputed trade may request the written information submitted by the other party;

(e) notwithstanding the thirty-minute period to submit information, once a party to a disputed trade communicates that it has no further information to provide, it may not thereafter provide additional information unless requested to do so by the staff; and

(f) if both parties to a disputed trade indicate that they have no further information to provide concerning the complaint before their respective thirty-minute information submission period has elapsed, then the matter may be immediately presented to a Nasdaq officer for a determination.

(iii) *Authority of Nasdaq to Cancel or Adjust Clearly Erroneous Trades on its Own Motion:* Presently, only members can seek to have an allegedly erroneous transaction nullified. There have been occasions, however, where Nasdaq system malfunctions have caused erroneous trades. Accordingly, in order to promote fair and orderly markets, the NASD and Nasdaq believe it would be appropriate to provide designated Nasdaq officials the authority to cancel or modify the terms of transactions in the event of a disruption or malfunction in the use or operation of any automated quotation, execution, or communication system owned or operated by Nasdaq.<sup>4</sup> Under this provision, the NASD and Nasdaq also believe such senior officials should be authorized to cancel or adjust an erroneous transaction on their own motion within thirty minutes of detection of the erroneous transaction, absent extraordinary circumstances, but in no event later than 6:00 p.m. on the next trading day after the date of the trade(s) in dispute. As with any other erroneous transaction determination, members would have the right to appeal such actions to the MORC.

(iv) *Withdrawal of Erroneous Transaction Complaints:* Rule 11890

<sup>4</sup> A list of the Nasdaq officials that have the authority to cancel or modify the terms of a transaction shall be maintained by the Nasdaq Corporate Secretary.

currently permits a member to withdraw an erroneous transaction complaint at any time. Because there are no restrictions on when a complaint can be withdrawn, market participants have in the past withdrawn their complaints when the market moved in their favor subsequent to filing the complaint. Accordingly, in order to facilitate the maintenance of fair and orderly markets and the equitable resolution of erroneous transaction disputes, the NASD and Nasdaq believe that Rule 11890 should be amended to prohibit the withdrawal of a complaint or an appeal of an erroneous transaction determination unless both parties to the trade agree to withdraw the matter.

(v) *Time Parameter to Appeal Erroneous Transaction Determinations:* Presently, members have four "market" hours to appeal an erroneous transaction determination. This period of time is too long in that it unduly extends the period of time that both parties to the trade are subject to market risk. Accordingly, the NASD has proposed that, once a member has received verbal notification of an erroneous transaction determination from the staff, it shall have thirty minutes to appeal the determination. The NASD and Nasdaq also propose that Rule 11890 should be amended to clarify that once a written appeal has been received, the counter-party to the trade will be notified of the appeal and both parties will be able to submit any additional supporting written information up until the time the appeal is considered by the Committee. In addition, the NASD and Nasdaq believe that the Rule should be amended to provide that either party to a disputed trade may request the written information provided by the other party during the appeal process.

(vi) *Clarification of the Appeal Process for Erroneous Transaction Determinations:* In order to clarify the current operation of the appeal process for erroneous transaction determinations, Rule 11890(b)(3) should be amended to provide that:

(a) an appeal of an erroneous transaction determination does not operate as a stay of the initial ruling; and

(b) any decisions by the MORC or the staff are rendered without prejudice as to the rights of the parties to seek arbitration of the disputed transactions.

In proposing these rule changes, the NASD and Nasdaq believe that the process for resolving erroneous transaction complaints will become fairer, more efficient, and more timely, thereby promoting the maintenance of fair and orderly markets and exposing

the parties to an allegedly erroneous transaction to less market risk. In addition, allowing Nasdaq officials to cancel or adjust erroneous transactions on their own motion in the event a disturbance or malfunction with a Nasdaq system will serve to protect the interests of investors. Accordingly, the NASD and Nasdaq believe that the proposed rule change is consistent with the provisions of Section 15A(b)(6) in that it promotes the protection of investors and the public interest.

*(B) Self-Regulatory Organization's Statement on Burden on Competition*

The NASD and Nasdaq do not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

*(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

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 self-regulatory organization 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 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 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 File No. SR-NASD-96-51 and should be submitted by February 19, 1997.

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

Margaret H. McFarland,  
*Deputy Secretary.*

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DEPARTMENT OF STATE

Office of the Secretary

[Public Notice 2506]

**Extension of the Restriction on the Use of United States Passports for Travel to, in or Through Lebanon**

On January 26, 1987, pursuant to the authority of 22 U.S.C. 211a and Executive Order 11295 (31 FR 10603), and in accordance with 22 CFR 51.73(a)(3), all United States passports, with the exception of passports of immediate family members of hostages in Lebanon, were declared invalid for travel to, in or through Lebanon unless specifically validated for such travel. This action was taken because the situation in Lebanon was such that American citizens there could not be considered safe from terrorist acts, and has since been periodically renewed.

Although security conditions in Lebanon continue to improve, the situation there has led me to conclude that Lebanon remains an area ". . . where there is imminent danger to the public health or the physical safety of United States travelers" within the meaning of 22 U.S.C. 211a and 22 CFR 51.73(a)(3).

Accordingly, all United States passports shall remain invalid for travel to, in, or through Lebanon unless specifically validated for such travel under the authority of the Secretary of State.

This Public Notice shall be effective upon publication in the Federal Register and shall expire at midnight July 31, 1997, unless extended or sooner revoked by Public Notice. Upon publication, this Public Notice shall supersede Public Notice 2429, published August 22, 1996 (61 FR 43395).