

## 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 self-regulatory organization 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 self-regulatory organization 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

#### 1. Purpose

The Exchange has proposed the rule change in order to ensure that CHX-listed companies are not subject to more stringent voluntary delisting requirements than those imposed by other exchanges. In prior years, many exchanges included in their listing standards the requirement that an issuer seeking to delist voluntarily first obtain shareholder approval. Over time, this requirement has been deleted by each exchange (other than the CHX) and generally has been replaced with the requirement that the issuer demonstrate that its board of directors has authorized delisting. See, e.g., Amex Rule 18; PCX Rule 3.4(b); Phlx Rule 809.

#### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) <sup>3</sup> of the Act, in general, and section 6(b)(5) <sup>4</sup> of the Act, in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to, and to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change will 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

Written comments on the proposed rule change 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, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. 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, located at the above address. Copies of such filing will also be available for inspection and copying at the principal office of the self-regulatory organization. All submissions should refer to File No. SR-CHX-99-17 and should be submitted by November 10, 1999.

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

**Margaret H. McFarland,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42003; File No. SR-NASD-99-57]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 by National Association of Securities Dealers, Inc. Relating to the Extension of Certain Nasdaq Services and Facilities Until 6:30 p.m. Eastern Time

October 13, 1999.

Pursuant to Section 19(b)(1) of the Securities Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 5, 1999, the National Association of Securities Dealers, Inc. ("NASD"), through its wholly-owned subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by Nasdaq. On October 13, 1999, Nasdaq submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change and Amendment No. 1 on a pilot basis through March 1, 2000.

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

Pursuant to the provisions of Section 19(b)(1) under the Act,<sup>4</sup> Nasdaq is filing a proposed rule change to establish a pilot program extending the availability of several Nasdaq services and facilities until 6:30 p.m. Eastern Time. In addition, Nasdaq is proposing to extend the applicability of NASD Interpretive Material 2110-2 (the "Manning Rule") until 6:30 p.m. Eastern Time. Below is the text of the proposed rule change.

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Letter to Belinda Blaine, Associate Director, Division of Market Regulation ("Division"), Commission, from Thomas P. Moran, Assistant General Counsel, Nasdaq, dated October 12, 1999 ("Amendment No. 1"). In Amendment No. 1, Nasdaq proposes to amend the initial filing to request that the Commission approve its proposed extended hours trading session on a pilot basis beginning on October 25, 1999, through March 1, 2000. Nasdaq also explains in Amendment No. 1 how certain concerns regarding calculation of a 4 p.m. closing price will be addressed and how the Manning Rule will apply.

<sup>4</sup> 15 U.S.C. 78s(b)(1).

<sup>3</sup> 15 U.S.C. 78f(b).

<sup>4</sup> 15 U.S.C. 78f(b)(5).

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

Proposed new language is italicized;  
proposed deletions are in brackets.

\* \* \* \* \*

### IM-2110-2. Trading Ahead of Customer Limit Order

#### (a) General Application<sup>5</sup>

To continue to ensure investor protection and enhance market quality, the Association's Board of Governors is issuing an interpretation to the Rules of the Association dealing with member firms' treatment of their customer limit orders in Nasdaq securities. This interpretation, *which is applicable from 9:30 a.m. to 6:30 p.m. Eastern Time*, will require members acting as market makers to handle their customer limit orders with all due care so that market makers do not "trade ahead" of those limit orders. Thus, members acting as market makers that handle customer limit orders, whether received from their own customers or from another member, are prohibited from trading at prices equal or superior to that of the limit order without executing the limit order. [provided that, prior to September 1, 1995, this prohibition shall not apply to customer limit orders that a member firm receives from another member firm and that are greater than 1,000 shares.] Such orders shall be protected from executions at prices that are superior but not equal to that of the limit order. In the interests of investor protection, the Association is eliminating the so-called disclosure "safe harbor" previously established for members that fully disclosed to their customers the practice of trading ahead of a customer limit order by a market-making firm.<sup>1</sup>

<sup>1</sup> "For purposes of the pilot program expanding the operation of certain Nasdaq transaction and quotation reporting systems and facilities in SR-NASD-99-57 during the period from 4 p.m. to 6:30 p.m. Eastern Time, members may generally limit the life of a customer limit order to the period of 9:30 a.m. to 4 p.m. Eastern Time. If a customer does not formally assent ("opt-in") to processing of their limit order(s) during the extended hours period commencing after the normal close of the Nasdaq market, limit order protection will not apply to that customer's order(s)."

\* \* \* \* \*

<sup>5</sup> On September 9, 1999, the NASD filed a proposed rule change (SR-NASD-99-44), which became effective upon filing pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(1) thereunder, modifying IM-2110-2 (exclusion of limit orders marketable at the time of receipt). A non-substantive amendment was filed on September 24, 1999. This filing incorporates the amendments filed in SR-NASD-99-44.

(b) Exclusion for Limit Orders That Are Marketable at Time of Receipt

No Change.

#### 4617. Normal Business Hours

A Nasdaq market maker shall be open for business as of 9:30 a.m. Eastern Time and shall close no earlier than 4 p.m. Eastern Time. Should a market maker wish to *voluntarily* remain open for business later than 4 p.m. Eastern Time, it shall so notify the Nasdaq Market Operations via a Nasdaq terminal and shall close only on the hour or the half hour, but no later than 6:30 p.m. Eastern Time. *Nasdaq market makers whose quotes are open after 4 p.m. Eastern Time shall be obligated to comply, while their quotes are open, with all NASD Rules that are not by their express terms, or by an official interpretation of the Association, inapplicable to any part of the 4 p.m. to 6:30 p.m. Eastern Time period.*

#### 4630. Reporting Transactions in Nasdaq National Market Securities

##### 4632. Transaction Reporting

(a) When and How Transactions Are Reported

(1)-(3) No Change.

(4) Transaction Reporting Outside Normal Market Hours. (A) Last sale reports of transactions in designated securities executed between 8 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Additionally, last sale reports of transactions in designated securities executed between the hours of 4 p.m. and [5:15] 6:30 p.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution; trades executed and reported after 4 p.m. Eastern Time shall be designated as ".T" trades to denote their execution outside normal market hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(B) Last sale reports of transactions in designated securities executed outside the hours of 8 a.m. and [5:15] 6:30 p.m. Eastern Time shall be reported as follows:

(i) No Change.

(ii) Last sale reports of transactions executed between [5:15] 6:30 p.m. and midnight Eastern Time shall be transmitted through ACT on the next business day (T+1) between 8 a.m. and [5:15] 6:30 p.m. Eastern Time, be designated "as/of" trades to denote their execution on a prior day, and be accompanied by the time of execution. The party responsible for reporting on

T+1, the trade details to be reported, and the applicable procedures shall be governed, respectively, by paragraphs (b), (c), and (d) below.

(5)-(8) No Change.

#### 4640. Reporting Transactions in Nasdaq Small Cap—Market Securities

##### 4642. Transaction Reporting

(a) When and How Transactions Are Reported

(1)-(3) No Change.

(4)(A) Last sale reports of transactions in designated securities executed between 8 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their execution outside normal market hours. Additionally, last sale reports of transactions in designated securities executed between the hours of 4 p.m. and [5:15] 6:30 p.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution; trades executed and reported after 4 p.m. Eastern Time shall be designated as ".T" trades to denote their execution outside normal market hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(B) Last sale reports of transactions executed outside the hours of 8 a.m. and [5:15] 6:30 p.m. Eastern Time shall be reported as follows:

(i) No Change.

(ii) Last sale reports of transactions executed between [5:15] 6:30 p.m. and midnight Eastern Time shall be transmitted through ACT on the next business day (T+1) between 8 a.m. and [5:15] 6:30 p.m. Eastern Time, be designated "as/of" trades to denote their execution on a prior day, and be accompanied by the time of execution. The party responsible for reporting on T+1, the trade details to be reported, and the applicable procedures shall be governed, respectively, by paragraphs (b), (c), and (d) below.

(5)-(8) No Change.

#### 4650. Reporting Transactions in Nasdaq Convertible Debt Securities

##### 4652. Transaction Reporting

(a) When and How Transactions Are Reported

(1)-(3) No Change.

(4) Transactions Reporting Outside Normal Market Hours. (A) Last sale reports of transactions in designated securities executed between 8 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as ".T" trades to denote their

execution outside normal market hours. Additionally, last sale reports of transactions in designated securities executed between the hours of 4 p.m. and [5:15] 6:30 p.m. Eastern Time shall be transmitted through the ACT system within 90 seconds after execution; trades reported after 4 p.m. Eastern Time shall be designated as “.T” trades to denote their execution outside normal market hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(B) Last sale reports of transactions in designated securities executed outside the hours of 8 a.m. and [5:15] 6:30 p.m. Eastern Time shall be reported as follows:

(i) No Change.

(ii) Last sale reports of transactions executed between [5:15] 6:30 p.m. and midnight Eastern Time shall be transmitted through ACT on the next business day (T+1) between 8 a.m. and [5:15] 6:30 p.m. Eastern Time, be designated “as/of” trades to denote their execution on a prior day, and be accompanied by the time of execution. The party responsible for reporting on T+1, the trade details to be reported, and the applicable procedures shall be governed, respectively, by paragraphs (b), (c), and (d) below.

(5)–(7) No Change.

### 6600. Reporting Transactions in Over-the-Counter Equity Securities

#### 6620. Transaction Reporting

(a) When and How Transactions Are Reported

(1)–(2) No Change.

(3) Transaction Reporting Outside Normal Market Hours. (A) Last sale reports of transactions in OTC Equity Securities executed between 8 a.m. and 9:30 a.m. Eastern Time shall be transmitted through ACT within 90 seconds after execution and shall be designated as “.T” trades to denote their execution outside normal market hours. Last sale reports of transactions in OTC Equity Securities executed between the hours of 4 p.m. and [5:15] 6:30 p.m. Eastern Time shall also be transmitted through ACT within 90 seconds after execution; trades executed and reported after 4 p.m. Eastern Time shall be designated as “.T” to denote their execution outside normal market hours. Transactions not reported within 90 seconds must include the time of execution on the trade report.

(B) Last sale reports of transactions in OTC Equity Securities executed outside the hours of 8 a.m. and [5:15] 6:30 p.m. Eastern Time shall be reported as follows:

(i) No Change.

(ii) Last sale reports of transactions in ADRs, Canadian issues, or domestic OTC Equity Securities that are executed between [5:15] 6:30 p.m. and midnight Eastern Time shall be transmitted through ACT on the next business day (T+1) between 8 a.m. and [5:15] 6:30 p.m. Eastern Time, be designated “as/of” trades to denote their execution on a prior day, and be accompanied by the time of execution. The party responsible for reporting on T+1, the trade details to be reported, and the applicable procedures shall be governed, respectively, by paragraphs (b), (c), and (d) below; and

(iii) No Change.

(4)–(6) No Change.

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

In its filing with the Commission, 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 III below. Nasdaq 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

Trading securities outside of normal market hours is not a new phenomenon. Nasdaq presently makes available several systems until 5:15 p.m. Eastern Time to facilitate trading after the close of the Nasdaq market at 4 p.m. Eastern Time. Recently, however, several alternative trading systems have initiated their own after-hours trading sessions. As such, there are now several different market venues available for trading after 4:00 p.m. Eastern Time. Presently there is no facility available to aggregate the activity in these various markets, making it difficult for market participants to determine the best prices available. Furthermore, information regarding transactions executed on these different markets is currently not widely available to investors, depriving them and other market participants of full, verifiable information on which to base trading decisions.

To remedy this situation, Nasdaq is proposing to establish a pilot program to extend, effective October 25, 1999 through March 1, 2000, the availability of its trade reporting and quotation

dissemination facilities until 6:30 p.m. Eastern Time to encourage the collection and public dissemination of securities transactions taking place after the 4 p.m. close of the Nasdaq market. These facilities are presently available until 5:15 p.m. Eastern Time. At the outset, Nasdaq wishes to stress that the above proposals are made in response to requests from other market participants that wish to expand their trading activity in the hours after the regular close of the Nasdaq market. It is Nasdaq's view that the importance of bringing increased transparency in the form of more visible quotes and transaction reports to the time period after the Nasdaq market's close imposes an obligation on Nasdaq to make available these systems and services as quickly as possible. Nasdaq remains committed to working with the Commission and other primary markets to carefully evaluate the complex issues surrounding any future expansion of regular market trading hours. Under the pilot proposal, Nasdaq will extend to 6:30 p.m. Eastern Time the operating hours of the following services: (1) SelectNet Service (“SelectNet”); (2) Automated Confirmation Transaction Service (“ACT”); (3) Nasdaq Quotation Dissemination Service (“NQDS”); and (4) Nasdaq Trade Dissemination Service (“NTDS”). The posting of quotations and trading of securities by NASD members during the period of time after Nasdaq's normal market close and before 6:30 p.m. Eastern Time shall be voluntary.

Under the pilot, any Nasdaq market maker that chooses to post quotations and trade during the 4 p.m. to 6:30 p.m. Eastern Time period shall be obligated to post firm two-sided quotations when opening and making its market, but may enter or leave the market on the hour or half-hour up to 6:30 p.m. Eastern Time. NASD member firms that do not choose to open their market and instead send customer or proprietary orders to other market participants for display and/or execution (or that choose to hold those orders until the next day's regular trading session) will likewise not be obligated to post firm two-sided quotes.<sup>6</sup> Regardless of an NASD member's quotation activity, all transactions in Nasdaq National Market, SmallCap, Convertible Debt and over-the-counter equity securities executed between the hours 8 a.m. and 6:30 p.m. Eastern Time

<sup>6</sup>Nasdaq market makers that do not elect to open their quotes would still be obligated to trade report transactions during the 4 p.m. to 6:30 p.m. Eastern Time period consistent with current trade reporting rules applicable during regular market hours.

must be reported to ACT within 90 seconds.

Along with the expanded operating times of the above systems and services, Nasdaq also wishes to make clear to members which NASD Rules will be in force during the extended SelectNet and ACT sessions. Except as modified by this filing, only those rules that are limited by their express terms, or by an official interpretation of the Association, to a specific time period outside of the 4 p.m. to 6:30 p.m. Eastern Time period shall not be in force during the extended SelectNet/ACT/NQDS/NTDS sessions. Towards that end, Nasdaq is proposing to modify NASD rule 4617 (Normal Business Hours) to make clear to Nasdaq market makers who voluntarily open their markets after the close that, except as modified by this filing, they are obligated to conduct their business during the extended SelectNet/ACT/NQDS/NTDS sessions in conformity with all NASD Rules whose applicability is not limited to specific times outside the 4 p.m. to 6:30 p.m. Eastern Time period. In addition, Nasdaq's Board of Directors, at its meeting on October 6, 1999, approved a proposal to amend NASD IM-2110-2 (also known as the "Manning Rule") to extend its applicability until 6:30 p.m. Eastern Time. The Manning Rule prohibits an NASD member firm which is holding a customer limit order from trading from that member's market making proprietary account at a price that would satisfy the customer's limit order without executing that customer limit order. This interpretation previously applied only during regular Nasdaq market hours.<sup>7</sup>

NASD's Short Sale Rule,<sup>8</sup> however, will not initially be applicable beyond normal market hours. In NASD Notice to Members 94-68, the NASD limited the Short Sale Rule's applicability to normal market hours (9:30 a.m. to 4 p.m. Eastern Time). In addition, technological constraints currently prevent Nasdaq from calculating a best bid/offer during the period between 4 p.m. and 6:30 p.m. Eastern Time. As a result, Nasdaq cannot provide the last bid directional arrow that is relied on by market participants to remain in compliance with the rule. Nasdaq believes that it will be technologically possible to calculate and provide an inside quote for the extended SelectNet session by on or about December 6, 1999. During the interim, Nasdaq will evaluate after-the-close trading activity to determine whether an extension of the Short Sale Rule to the 4 p.m. to 6:30 p.m. Eastern Time period is appropriate. Prior to the provision of an inside quote,

NASD members will, however, continue to be required to make affirmative determinations that they will receive delivery of a security from their customers or that the member can borrow the security on behalf of the customer for delivery by settlement date before accepting short sale orders during the extended SelectNet and ACT sessions.<sup>9</sup>

Finally, given the importance of timely trade reporting for transparency purposes, Nasdaq's trade reporting rules for NMS, SmallCap, Convertible Debt, and over-the-counter equity securities (Rules 4632, 4642, 4652, 6620) will be modified to mandate 90 second ACT trade reporting for all transactions in these securities executed after Nasdaq's regular market close and before 6:30 p.m. Eastern Time. Nasdaq staff will continue to initiate trading halts<sup>10</sup> and adjudicate clearly erroneous trade disputes in the extended SelectNet and ACT sessions using the same standards and methods as employed during normal market hours.<sup>11</sup> Nasdaq's MarketWatch and NASD Regulation's Market Regulation Department will be staffed to provide oversight of trading and quotation activity up to 7 p.m. Eastern Time.

*Amendment No. 1.* Among other things, Nasdaq's Amendment No. 1 addresses issues concerning the dissemination of regular session closing price reports under the pilot program. Specifically, the Amendment confirms that systems operations until 6:30 p.m. Eastern Time will not interfere with the ability of investors to obtain 4 p.m. closing prices in Nasdaq securities. Closing prices are currently disseminated by vendors shortly after the 4 p.m. close even though the Nasdaq systems operate until 5:15 p.m. Eastern Time; systems operations until 6:30 p.m. Eastern Time will not change this practice. Trades effected after 4 p.m. Eastern Time will continue to be

<sup>9</sup> See NASD Rule 3370.

<sup>10</sup> Nasdaq notes that this trading halt authority will be limited to individual stocks only and will be undertaken in consultation with other primary markets operating after 4 p.m. Eastern Time. Market-wide trading halt rules currently in effect rely solely on percentage-based declines in the Dow Jones Industrial Average ("DJIA"), a narrow index that does not contain any Nasdaq stocks and which will not be calculated after the 4 p.m. close. In the event that a circuit breaker halt, triggered during regular market hours, prevents a normal close of U.S. primary markets, Nasdaq proposes that no extended SelectNet or ACT sessions be commenced that day.

<sup>11</sup> Nasdaq has also been informed by the staff of NASD Regulation, Inc. of its view that nothing in the instant proposals modifies or limits an NASD member's obligation to comply with the rules of NASD Regulation's Order Audit Trail System ("OATS") when reporting trading activity taking place between 4 p.m. and 6:30 p.m. Eastern Time. Nasdaq's MarketWatch and NASD Regulation's Market Regulation Department will be staffed to provide oversight of trading and quotation activity up to 7 p.m. Eastern Time.

designated as ".T" trades that do not affect closing price in the relevant security.

Amendment No. 1 also describes how Nasdaq will address issues involving the use of closing prices for NAV calculations by mutual funds. In particular, under the Nasdaq proposal, certain specialized closing price reports for non-OTC Bulletin Board and foreign ordinary issues, as well as some American Depository Receipts ("ADRs"), will not be issued by Nasdaq in time to permit funds to report their NAVs to Nasdaq's Mutual Fund Quotation Service ("MFQS") by that system's 5:50 p.m. Eastern Time deadline. Accordingly, Nasdaq has indicated that it will post an electronic file with this closing price information on the OTC Bulletin Board web site between 5:20 p.m. and 5:40 p.m. Eastern Time (with an internal goal of posting by 5:30 p.m. Eastern Time).

In addition, some funds and vendors have raised general concerns about what they perceived to be lack of time to modify and test their systems before the planned introduction of inside quotations up to 6:30 p.m. Eastern Time. Amendment No. 1 indicates that, in response to these concerns, Nasdaq has pushed back the planned start-up date for distributing after-hours inside quotations from November 1 to December 6, 1999. While Nasdaq acknowledges that this later start-up date will not satisfy every concern raised by vendors and funds, Nasdaq believes that the delay until December 6 should provide sufficient time for essential systems modifications and testing. Nasdaq states that it will continue to work with vendors and the mutual fund industry on these issues.

Amendment No. 1 also clarifies how the Manning Rule will apply during the extended hours of the pilot from 4 p.m. to 6:30 p.m. Eastern Time. Nasdaq confirms in Amendment No. 1 that, on October 6, 1999, the Board of Directors of Nasdaq approved the expansion of the applicability of the Manning Rule to 6:30 p.m. Eastern Time. Nasdaq also clarifies the application of the Manning Rule after 4 p.m. Eastern Time by adding a footnote to IM-2100-2(a) discussing the handling of customer limit orders if the customer does not formally opt-in to processing limit orders during the extended hours period.

Based on the above, Nasdaq believes that the proposed rule changes are consistent with the provisions of Section 15A(b)(b) of the Act in that they are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of

<sup>7</sup> See NASD Notice to Members 95-67.

<sup>8</sup> NASD Rule 3350.

trade, and to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information with respect to, and facilitating transactions in securities.

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

Nasdaq does 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.

#### *C. SRO's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

Although written comments were not solicited, Nasdaq has received four letters from market participants expressing concerns relating to the proposed rule change.<sup>12</sup> Nasdaq has addressed these comment letters in Amendment No. 1.

### **III. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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.

<sup>12</sup> Letter to Richard G. Ketchum, President, NASD, from Craig S. Tyle, General Counsel, Investment Company Institute, dated September 24, 1999; Letter to Richard G. Ketchum, President, NASD, and Patrick J. Campbell, Chief Operating Officer and Executive Vice President, The Nasdaq-Amex Market Group, Inc., from Jenni Neumann, Senior Vice President, Global Database Management, Bridge Information Systems, dated September 27, 1999; Letter to Richard G. Ketchum, President, NASD, from David Byrnes, Senior Vice President, Americas Information Management Group, Reuters Information, dated September 28, 1999; and Letter to Richard G. Ketchum, President, NASD, from Thomas J. Higgins, Principal and Treasurer of the Vanguard Funds, The Vanguard Group, dated September 29, 1999.

SR-NASD-99-57 and should be submitted by November 10, 1999.

### **IV. Commission's Findings and Order Granting Accelerated Approval of the Proposed Rule Change**

For the reasons discussion below, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the NASD and, in particular, the requirements of Sections 11A and 15A.<sup>13</sup>

Specifically, the Commission believes that the proposed rule change as amended furthers the goals of the national market system as reflected in Sections 11A(a)(1)(C)(iii) and (iv) of the Act.<sup>14</sup> Congress found in those provisions that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities, and to assure the practicability of brokers executing investors' orders in the best market. Section 11A(a)(1) further found that the linking of all markets for qualified securities through communication and data processing facilities would foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investors' orders, and contribute to best execution of such orders.<sup>15</sup> The proposed rule change as amended will assure the availability of information with respect to quotations and transactions because it makes Nasdaq's systems, which are used by market participants to communicate quotes and orders and to report trades, available until 6:30 p.m. Eastern Time. Currently, there is not consolidated source of information on trades and quotations after 5:15 p.m. Eastern Time, making it difficult for investors to determine the best prices available. Nasdaq's proposal will enhance transparency by requiring that transactions in NMS, SmallCap, Convertible Debt, and over-the-counter equity securities that take place up to 6:30 p.m. Eastern Time be reported within 90 seconds. In addition, to the extent that a market maker chooses to participate in the after-hours session, its quotations will be disseminated through NQDS. As a result, investors will be

<sup>13</sup> In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>14</sup> 15 U.S.C. 78k-1(a)(1)(C) (iii) and (iv).

<sup>15</sup> 15 U.S.C. 78k-1(a).

better able to evaluate prices before entering their order after primary trading hours. In sum, by providing the consolidated quotation display and last sale tape for transactions taking place between 4 p.m. and 6:30 p.m. Eastern Time, Nasdaq's proposal should enhance investor protection and confidence because it will give market participants more complete information upon which to base trading decisions.

The Commission also believes that the proposed rule change is consistent with Section 15A of the Act<sup>16</sup> in that it is 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 proposed rule change accomplishes these objectives by making Nasdaq's systems available to market participants who choose to offer trading to customers outside of traditional market hours, by providing for greater transparency, and by linking the various market participants engaged in trading during those hours through SelectNet.

Amendment No. 1 also confirms that the extended trading pilot will not interfere with the ability of investors to obtain 4 p.m. closing prices in Nasdaq securities. Moreover, Nasdaq has outlined measures that it has taken to address specific concerns of vendors and the mutual fund industry concerning the availability of closing prices for NAV calculations and the need for sufficient time to modify and test their systems before the planned introduction of inside quotations after 4 p.m. Eastern Time. While Nasdaq acknowledges that these measures will not satisfy every concern raised by vendors and funds, the delay until December 6th for the dissemination of after-hours inside quotations should provide sufficient time for essential systems modifications and testing. Nasdaq has indicated that it will continue to work with vendors and the mutual fund industry on these issues. In light of the need for improved transparency during the after-hours session, and Nasdaq's willingness to continue to work with vendors and mutual funds to ensure an orderly extension of price reporting, the Commission believes that Nasdaq's

<sup>16</sup> 15 U.S.C. 78o-3.

determination to proceed with its pilot on schedule is reasonable.

In addition, the proposed rule change as amended furthers the objectives of Section 15A of the Act by specifically extending rules designed to protect investors beyond the traditional market hours while Nasdaq's systems are operating. For example, the Manning Rule previously did not apply after 4 p.m. Eastern Time. Originally, the NASD believed Manning obligations should not apply after 4 p.m. Eastern Time because the after-hours market was fundamentally different from the regular market.<sup>17</sup> With the advent of on-line retail trading and other technological advances, however, the nature of the after-hours market is changing. In particular, the increasing presence of retail customers during the after-hours market has led the NASD to reconsider the application of the Manning Rule between 4 p.m. and 6:30 p.m. Eastern Time. Accordingly, upon approval of the pilot, members acting as market makers during these hours will be required to handle their customer limit orders with due care so that they do not trade ahead of those limit orders. Members acting as market makers that handle customer limit orders, whether received from their own customers or from another member, will be prohibited from trading at prices equal or superior to that of the limit order without executing the limit order. The Commission believes that the application of the protections of the Manning and other NASD rules during after-hours trading will significantly enhance investor protection.<sup>18</sup>

#### Commission Rules

The Commission has received inquiries from market participants seeking clarification regarding which Commission rules apply to NASD members who choose to trade after 4 p.m. Eastern Time while Nasdaq's systems are in operation. The Commission wishes to clarify that, by their terms, SEC Rules 11Ac1-1(c)(2) (the "Firm Quote Rule"), 11Ac1-1(c)(5) (the "ECN Display Alternative"), 11Ac1-4 (the "Limit Order Display Rule") and Rule 301(b) ("Regulation ATS") apply to NASD member firms

that choose to trade between 4 p.m. and 6:30 p.m. Eastern Time.<sup>19</sup>

In general, SEC Rule 11Ac1-1(b)(1)(ii) requires an association to disseminate the best bid, offer, and quotation sizes for subject securities whenever "last sale information with respect to reported securities is reported [by a member acting in the capacity of an OTC market maker] pursuant to an effective transaction reporting plan."<sup>20</sup> NASD members, including OTC market makers, who choose to trade from 4 p.m. to 6:30 p.m. Eastern Time will be required to report last sale information pursuant to the NASD's rules, and the NASD will disseminate quotes during this time period. These procedures, in turn, trigger the Commission's Firm Quote Rule, which generally obligates OTC market makers to execute any order to buy or sell a subject security, other than an odd-lot order, presented to it by another broker or dealer, or any other person belonging to a category of persons with whom such responsible broker or dealer customarily deals, at a price at least as favorable to such buyer or seller as the responsible broker's or dealer's published bid or published offer.

Similarly, the reporting of last sale information to the NASD triggers the ECN Display Alternative. Under the ECN Display Alternative, an order entered by a market maker into an electronic communications network ("ECN") that widely disseminates the order is deemed to be a bid or offer to be communicated to the market maker's association for at least the minimum quotation size required by the Association's rules if the priced order is for the account of the market maker, or the actual size of the order up to the minimum quotation size required if the priced order is for the account of a customer. The ECN Display Alternative deems the market maker to be in compliance with this requirement if the ECN displays the market maker's order in Nasdaq.<sup>21</sup>

In addition, the Limit Order Display Rule is not limited to regular trading hours, but also applies to OTC market makers that choose to participate in after-hours trading sessions. Simply put,

the Limit Order Display Rule requires an OTC market maker to publish immediately a bid or offer that reflects the price and full size of each customer limit order that improves the bid or offer of the OTC market maker, or that reflects the full size of the customer limit order that is priced equal to the bid or offer of the OTC market maker or the national best bid or offer, and represents more than a *de minimis* change in the size of the OTC market maker's bid or offer.<sup>22</sup>

Regulation ATS also applies to market participants who choose to operate from 4 p.m. to 6:30 p.m. Eastern Time. Currently, any alternative trading system that has five percent or more of the average daily trading volume in a security must display its best orders in that security in the public quotation stream during regular trading hours. Although there may be some confusion as to whether average "daily" trading volume includes trades executed outside of normal market hours, the calculation alternative trading systems must make regarding volume includes *all* trades executed during the twenty-four hours that constitute a day. Any alternative trading system that meets the five percent threshold must therefore display its orders in the public quotation stream whenever the public quotation systems make display possible.

The Commission is aware that there has been confusion among market participants as to the applicability of these rules after 4 p.m. Eastern Time. Consequently, the Commission has issued a no-action letter to the NASD relieving market participants from complying with Rules 11Ac1-1(c)(5) (the ECN Display Alternative), 11Ac1-4 (the Limit Order Display Rule), Rule 301(b) (Regulation ATS), and the NASD's Manning Rule until November 2, 1999.<sup>23</sup> This temporary relief is designed to give market participants (including ECNs) time to make the system changes necessary to comply with these rules during the 4 p.m. to 6:30 p.m. Eastern Time period.<sup>24</sup> The Commission emphasizes, however, that broker-dealers continue to have a duty of best execution for their customer's orders during these hours.

<sup>19</sup> 17 CFR 240.11Ac1-1(c)(2), 17 CFR 240.11Ac1-1(c)(5), 17 CFR 240.11Ac1-4, 17 CFR 242.301(b).

For a complete discussion of these rules and the definitions of the terms used in the following discussion, see the applicable Commission releases.

<sup>20</sup> 17 CFR 240.11Ac1-1(b)(1)(ii).

<sup>21</sup> Therefore, if an ECN is receiving OTC market maker orders before 6:30 p.m. Eastern Time, the ECN must transmit those orders through SelectNet for display in the Nasdaq montage, or the OTC market maker must post the quote separately in its own quote line in the montage in order to be in compliance with the ECN Display Alternative.

<sup>22</sup> There are certain exceptions to the Limit Order Display Rule. Those exceptions would continue to apply during an after-hours trading session. See SEC Rule 11Ac1-4(c), 17 CFR 240.11Ac1-4(c).

<sup>23</sup> Under the terms of this no-action letter, firms are not relieved from their obligation to comply with the Firm Quote Rule (Rule 11Ac1-1(c)(5), 17 CFR 240.11Ac1-1(c)(5)).

<sup>24</sup> See Letter to Robert E. Aber, General Counsel, Nasdaq, from Robert L.D. Colby, Deputy Director, Division, Commission, dated October 12, 1999.

<sup>17</sup> See, e.g., NASD Notice to Members 95-67.

<sup>18</sup> The Commission believes that the clarification of the application of the Manning Rule in Amendment No. 1 provides further enhancement of investor protection. In addition, the Nasdaq staff has indicated that a rule proposal is being developed for consideration by the appropriate Boards that would require that member firms establish procedures to have customers "opt-in" to having their order(s) processed during any period outside of the 9:30 a.m. to 4 p.m. regular trading session for Nasdaq.

Nasdaq has requested that the Commission find good cause pursuant to Section 19(b)(2) of the Act<sup>25</sup> for approving the proposed rule change prior to the 30th day after publication in the **Federal Register**. The Commission finds good cause for granting accelerated approval for the proposed rule change because the Nasdaq pilot will benefit investors by improving the transparency of the current after-hours market and assisting broker-dealers in fulfilling their duty of best execution for their customer orders.

The Commission further believes that good cause exists for approving Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The first item covered in Amendment No. 1 merely changes the date for implementation of the after-hours trading session as a pilot program from October 11, 1999 to October 25, 1999. The Commission believes that delaying the implementation date will provide Nasdaq and its member firms with additional time to make any necessary systems changes. The second and third items of Amendment No. 1 address how the Manning Rule will apply during the extended hours of the pilot from 4 p.m. to 6:30 p.m. Eastern Time. In the second item, Nasdaq confirmed that, on October 6, 1999, the Board of Directors of Nasdaq approved the expansion of the applicability of the Manning Rule to 6:30 p.m. Eastern Time. In the third item, Nasdaq clarified the application of the Manning Rule after 4 p.m. Eastern Time by adding a footnote to IM-2110-2(a) discussing the handling of customer limit orders if the customer does not formally opt-in to processing limit orders during the extended-hours period. The Commission believes that the Manning Rule's customer limit order protections should be provided to customers who opt-in to having their orders processed in the extended-hours period, and that, therefore, there is good cause for accelerating the approval of these items in Amendment No. 1. The Commission notes that the remaining items discussed in Amendment No. 1 clarify how Nasdaq will continue to make certain trade information available to the mutual fund industry. These clarifications further ensure that the pilot program will provide protection to investors who participate in the market through mutual funds. Accordingly, the Commission believes that there is good cause for accelerating the approval of all of the items in Amendment No. 1.

While extended operation of some key Nasdaq trade reporting and quotation dissemination systems will significantly improve the current trading environment after the major markets close, the Commission recognizes that Nasdaq's pilot program does not yet include some features that would be essential for a full after-hours trading session. Specifically, Nasdaq's pilot does not require registered market makers in Nasdaq securities to participate in after-hours trading from 4 p.m. to 6:30 p.m. Eastern time and does not envision the use of the Small Order Execution System ("SOES") during this period. In Nasdaq's view, its market will not be open during the hours of the pilot. The Commission believes that, before Nasdaq opens its market for extended trading, it would need to incorporate additional market integrity and investor protection features.<sup>26</sup>

In addition, the Commission has expedited approval of this proposal with the understanding that the systems limitations that currently prevent the calculation of the best bid and offer for Nasdaq stocks after 4 p.m. Eastern Time will be addressed expeditiously. Such calculations will be necessary for the Nasdaq's Short Sale Rule to apply to trading during the 4:30 p.m. to 6:30 p.m. Eastern Time period. The Commission expects that Nasdaq will make every reasonable effort to work with the vendors and the mutual fund community to implement the systems enhancements needed for calculating the inside quote as soon as possible.

## V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>27</sup> that the proposed rule change (SR-NASD-99-57), including Amendment No. 1, is approved as a pilot program through March 1, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>28</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

[FR Doc 99-27308 Filed 10-19-99; 8:45 am]

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<sup>26</sup> See, e.g., n. 18, *supra*.

<sup>27</sup> 15 U.S.C. 78s(b)(2).

<sup>28</sup> 17 CFR 200.30-3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41996; File No. SR-NYSE-98-47]

### Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 2 to Proposed Rule Change To Adopt Rule 440 I Requiring Records of Compensation Arrangements Concerning Floor Brokerage

October 8, 1999.

#### I. Introduction

On December 23, 1998, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to adopt Rule 440 I, requiring records of compensation arrangements concerning floor brokerage. On May 14, 1999, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup>

The proposed rule change and Amendment No. 1 were published for comment in the **Federal Register** on June 2, 1999.<sup>4</sup> The Commission received no comments on the proposal. On June 23, 1999, the NYSE submitted Amendment No. 2 to the proposed rule change.<sup>5</sup> This notice and order approves the proposed rule change as amended and seeks comment from interested persons concerning Amendment No. 2.

#### II. Description of the Proposal

Proposed Rule 440 I would require that every member not associated with a member organization, and each member organization primarily engaged as an agent in executing transactions on the Floor of the Exchange, maintain a

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Letter to Richard Strasser, Assistant Director, Division of Market Regulation ("Division"), SEC, from James E. Buck, Senior Vice President and Secretary, NYSE, dated May 12, 1999. In Amendment No. 1, the Exchange explained why the proposed rule change would apply only to floor members and member organizations but not to "upstairs" members and member organizations.

<sup>4</sup> Securities Exchange Act Release No. 41441 (May 24, 1999), 64 FR 29723.

<sup>5</sup> See Letter to Richard Strasser, Assistant Director, Division, SEC, from Daniel Parker Odell, Assistant Secretary, NYSE, dated June 22, 1999. In Amendment No. 2, the Exchange revised the proposed rule test in Supplementary Material .10(a) to exclude compensation arrangements involving gross compensation of less than \$5,000, rather than the originally proposed level of \$10,000.

<sup>25</sup> 15 U.S.C. 78s(b)(2).