

on May 31, 1999. Thirty-nine comment letters were received in response to the Notice. Copies of the comment letters and a brief summary of the comment letters have been provided to the Commission. Of the 39 comment letters received, approximately 13 were in favor of the proposed rule change, 8 supported risk disclosure only, 12 were opposed to the proposed rule change, and 6 expressed no opinion or addressed broader issues. Further, on September 21, 1999, the Commission published the Association's modified proposal and solicited comments in the **Federal Register** on the Original Notice. This comment period expired on October 12, 1999. The Commission received three comment letters in response to the Original Notice. Many of the issues raised by the commenters in response to the Original Notice, also were raised in the comments in response to NTM 99-32. After considering this most recent set of comments, the Association is proposing Amendment No. 1 to the rule filing, as outlined above.

### 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, 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, 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. 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-99-41 and should be submitted by March 23, 2000.

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

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42461; File No. SR-NASD-99-49]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Regulation ATS

February 25, 2000.

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> notice is hereby given that on September 21, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), 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, II, and III below, which Items have been prepared by Nasdaq.<sup>3</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

Nasdaq is proposing to amend Rules 4623 and 4613(e) of the NASD to incorporate the requirements of Regulation ATS into the NASD's rule. Below is the text of the proposed rule change. Proposed new language is in

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

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

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

<sup>3</sup> On November 10, 1999, Nasdaq filed Amendment No. 1, which refiled the proposed rule change pursuant to Rule 19(b)(2) rather than pursuant to Rule 19(b)(3)(A) and Rule 19b-4(f)(6), as it was originally filed. Letter from Peter R. Geraghty, Assistant General Counsel, the Nasdaq Stock Market Inc., to Richard Strasser, Assistant Director, SEC, Market Regulation, dated November 10, 1999.

italics; proposed deletions are in brackets.

#### 4623. *Alternative Trading Systems* [Electronic Communications Networks]

(a) The Association may provide a means to permit *alternative trading systems* ("ATSs"), as such term is defined in *Regulation ATS*, and electronic communications networks ("ECNs"), as such term is defined in SEC Rule 11Ac1-1(a)(8),

(1) to [meet] *comply with SEC Rule 301(b)(3)*;

(2) to *comply with* the terms of the ECN display alternative provided for in SEC Rule 11Ac1-1(c)(5)(ii)(A) and (B) ("ECN display alternatives"); or

(3) to *provide orders to Nasdaq voluntarily*.

In providing any such means, the Association shall establish a mechanism that permits the *ATS* or *ECN* to display the best prices and sizes of orders entered *into the ATS or ECN* by Nasdaq market makers (and other [entities] *subscribers of the ATS or ECN*, if the *ECN or ATS* so chooses []) *or is required by SEC Rule 301(b)(3) to display a subscriber's order in Nasdaq* [into the *ECN*], and allows any NASD member the electronic ability to effect a transaction with such priced orders that is equivalent to the ability to effect a transaction with a Nasdaq market maker quotation in Nasdaq operated systems.

(b) An *ATS* or *ECN* that seeks to utilize the Nasdaq-provided means to comply with *SEC Rule 301(b)(3)*, the *ECN display alternatives*, *or to provide orders to Nasdaq voluntarily* shall:

(1) demonstrate to the Association that *it is in compliance with Regulation ATS* or that it qualifies as an *ECN* meeting the definition in the SEC Rule;

(2) be registered as a NASD member;

(3) enter into and comply with the terms of a Nasdaq Workstation Subscriber Agreement, as amended for *ATSs and ECNs*;

(4) agree to provide for Nasdaq's dissemination in the quotation data made available to quotation vendors the prices and sizes of Nasdaq market maker orders (and *orders from other [entities] subscribers of the ATS or ECN*, if the *ATS or ECN* so chooses []) *or is required by SEC Rule 301(b)(3) to display a subscriber's order in Nasdaq*, at the highest buy price and the lowest sell price for each Nasdaq security entered in and widely disseminated by the *ATS* or *ECN*; and prior to entering such prices and sizes, register with Nasdaq Market Operations as an *ATS* or *ECN*; [and]

(5) provide an automated execution or, if the price is no longer available, an automated rejection of any order routed

to the *ASTS* or ECN through the Nasdaq-provided system[.]; and

(6) not charge to broker-dealers that access the *ATS* or ECN through Nasdaq any fee that is inconsistent with the requirements of SEC Rule 301(b)(4).

(c) When a NASD member attempts to electronically access through a Nasdaq-provided system an *ATS* or ECN-displayed order by sending an order that is larger than the *ATS*'s or ECN's Nasdaq-displayed size and the *ATS* or ECN is displaying the order in Nasdaq on a reserved size basis, the NASD member that operates the *ATS* or ECN shall execute such Nasdaq-delivered order:

(1) Up to the size of the Nasdaq-delivered order, if the *ATS* or ECN order (including the reserved size and displayed portions) is the same size or larger than the Nasdaq delivered order; or

(2) Up to the size of the *ATS* or ECN order (including the reserved size and displayed portions), if the Nasdaq-delivered order is the same size or larger than the *ATS* or ECN order (including the reserved size and displayed portions).

No *ATS* or ECN operating in Nasdaq pursuant to this rule is permitted to provide a reserved-size function unless the size of the order displayed in Nasdaq is 100 shares or greater. For purposes of this rule, the term "reserved size" shall mean that a customer entering an order into an *ATS* or ECN has authorized the *ATS* or ECN to display publicly part of the full size of the customer's order with the remainder held in reserve on an undisplayed basis to be displayed in whole or in part as the displayed part is executed.

#### 4613. Character of Quotations

\* \* \* \* \*

(e) Locked and Crossed Markets

(1) \* \* \*

The prohibitions of this rule include the entry of a locking or crossing quotation at or after 9:25:00 a.m. Eastern Time if such quotation continues to lock or cross the market at the market's opening, and requires a market maker, [or] ECN, or an *ATS* that enters a locking or crossing quotation at or after 9:25:00 a.m. Eastern Time to take action to avoid the lock or cross at the market's open or immediately thereafter, but in no case more than 30 seconds after 9:30:00 a.m.

(2) No Changes

(3) For purposes of this rule, the term "market maker" shall include:

(i) any NASD member that enters into an ECN, as that term is defined in SEC Rule 11Ac1-1(a)(8), priced order

that is displayed in The Nasdaq Stock Market; [and]

(ii) any NASD member that operates the ECN when the priced order being displayed has been entered by a person or entity that is not a NASD member[.];

(C) any NASD member that enters into an *ATS*, as that term is defined in SEC Regulation *ATS*, an order that is displayed in The Nasdaq Stock Market; and

(D) any NASD member that operates the *ATS* when the order being displayed has been entered by a person or entity that is not a NASD member.

## 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 IV 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

#### 1. Purpose

Recently, the Commission adopted a set of rules under the Act<sup>4</sup> that govern alternative trading systems, including electronic communication networks ("ECN").<sup>5</sup> Regulation *ATS* governs alternative trading systems that choose to register as broker-dealers (hereinafter referred to as "ATs"). The most familiar type of *ATS* is an ECN; however, the definition of *ATS* encompasses other types of trading systems that register as broker-dealers. For example, an electronic trading system that only accepts orders from institutions and non-market-maker broker-dealers would be an *ATS*. Such a system would not be an ECN, however, because, by definition, an ECN is a system that accepts orders from market makers.<sup>6</sup>

The NASD's current rules capture only those *ATs* that meet the definition of ECN. Therefore, it is necessary to amend these rules to capture those

*ATs* that do not meet the definition of ECN. The NASD also must make several other changes to incorporate the requirements of Regulation *ATS* into its rules. Nasdaq is proposing to amend NASD Rule 4623, which currently governs ECNs that display orders in Nasdaq ("ECN Rule"), and NASD Rule 4613(e), which governs locked and crossed markets ("Locked and Crossed Market Rule"). The amendments will: (1) incorporate into the ECN Rule the new obligations that are imposed on ECNs under Regulation *ATS*, (2) extend the current ECN Rule so that it captures other types of *ATs*, and (3) extend the current Locked and Crossed Market Rule to capture other types of *ATs*.

#### ECN Rule

Regulation *ATS* requires *ATs* (including ECNs) that account for a significant percentage of the volume in a security listed on Nasdaq to display in the public quotation stream the orders of all subscribers of the *ATS*, which includes orders from institutions and broker-dealers that are not market makers.<sup>7</sup> Currently, the ECN Rule only requires ECNs to display orders entered by market makers. Accordingly, Nasdaq is proposing to amend the ECN Rule to require ECNs to display in Nasdaq any subscriber orders required under Regulation *ATS*.

As discussed above, Regulation *ATS* also governs alternative trading systems that are organized other than as ECNs. Consequently, these other types of *ATs* may be required to display orders in Nasdaq. Nasdaq is proposing to expand the current ECN Rule to encompass these other types of *ATs*. These systems will have to fulfill a series of obligations identical to those imposed on ECNs that display orders in Nasdaq.

#### Locked and Crossed Markets

The Locked and Crossed Markets Rule, NASD Rule 4613(e), is designed to limit locked and crossed markets by imposing on market makers an obligation to take reasonable measures

<sup>7</sup> Specifically, if during at least 4 of the preceding 6 calendar months an *ATS* accounts for five percent or more of the aggregate average share volume in a Nasdaq National Market ("NNM") or SmallCap security, the *ATS* must display the best prices of orders entered by all subscribers (e.g., market makers, non-market makers, and institutions). For example, if as calculated on July 1, 1999 an *ATS* accounted for 7% of the trading volume in an NNM security during January, February, April, and May 1999, the *ATS* would be required to reflect in Nasdaq its best priced order even if the order is from an institution or other entity that is not a Nasdaq market maker. The Nasdaq securities subject to this requirement are being phased-in according to a schedule set by the Commission. See Securities Exchange Act Release No. 41297 (April 16, 1999), 64 FR 19450 (April 21, 1999).

<sup>4</sup> 17 CFR 242.300 *et seq.* ("Regulation *ATS*").

<sup>5</sup> See Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998).

<sup>6</sup> SEC Rule 11Ac1-1(a)(8), 17 CFR 240.11Ac1-1(a)(8).

before locking or crossing a market. Currently included within the definition of market maker for purposes of this rule is: (1) Any NASD member that enters orders into an ECN, or (2) any NASD member that operates as an ECN (when the priced order being displayed by the ECN has been entered by an entity that is not a NASD member). Reasonable measures include attempting to execute against the contra side of the market prior to entering an order into Nasdaq's systems that would lock or cross the market in a security. Nasdaq is proposing to amend the Locked and Crossed Markets Rule to capture NASD members that place orders in an ATS or operate as an ATS (when the priced order being displayed by the ATS has been entered by an entity that is not a NASD member).

\* \* \* \* \*

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Sections 11A and 15A(b)(6) of the Act.<sup>8</sup> Section 11A(a)(1)(C)<sup>9</sup> provides that is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure: (1) Economically efficient execution of securities transactions; (2) fair competition among brokers and dealers; (3) the availability to brokers, dealers and investors of information with respect to quotations and transactions in securities; (4) the practicability of brokers executing investors orders in the best market; and (5) an opportunity for investors' orders to be executed without the participation of a dealer. Section 15A(b)(6)<sup>10</sup> requires that the rules of a registered 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; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. Nasdaq believes the proposal is consistent with Sections 11A(a)(1)(C) and Section 15A(b)(6)<sup>11</sup> because it will permit

Nasdaq to incorporate ATS orders into the Nasdaq quote montage and provide NASD members with the ability to access these orders. In addition, to limit market disruptions caused by locked or crossed markets, the proposal would require members that submit orders to ATSs and ATSs, in certain circumstances, to take reasonable measures before locking or crossing a market. Finally, the amendments would incorporate into the NASD's rules the new obligations imposed on ECNs by Regulation ATS.

### (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, 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.

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A. by order approve such proposed rule change, or

B. institute proceedings to determine whether the proposed rule change should be disapproved.

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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 SR-NASD-99-49 and should be submitted by March 23, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

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

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## SMALL BUSINESS ADMINISTRATION

[Applicant No. 99000356]

### EDF Ventures, L.P.; Notice Seeking Exemption Under Section 312 of the Small Business Investment Act, Conflicts of Interest

Notice is hereby given that EDF Ventures, L.P. ("EDF"), 425 North Main Street, Ann Arbor, MI 48104, an applicant for a Federal License under the Small Business Investment Act of 1958, as amended ("the Act"), in connection with the completed financing of a small concern is seeking an exemption under section 312 of the Act and section 107.730, Financings which Constitute Conflicts of Interest of the Small Business Administration ("SBA") rules and regulations (13 CFR 107.730 (1998)). An exemption may not be granted by SBA until Notices of this transaction have been published. EDF Ventures, LP plans to provide equity financing to Xtera Communications, Inc., 1334 Bordeaux Drive, Sunnyvale, CA 94089. The financing will be used for research, development, and working capital purposes.

The financing is brought within the purview of section Sec. 107.730(a)(1) of the Regulations because Enterprise Development Fund II, L.P., an associate of EDF Ventures, LP owns greater than 10 percent of Xtera Communications, Inc., and therefore Xtera Communications is considered an Associate of EDF Ventures, LP as defined in Sec. 107.50 of the regulations.

Notice is hereby given that any interested person may, not later than fifteen (15) days from the date of publication of this Notice, submit written comments on the transaction to the Associate Administrator for Investment, U.S. Small Business

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

<sup>8</sup> 15 U.S.C. 78k-1 and 78o-3(b)(6).

<sup>9</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>10</sup> 15 U.S.C. 78o-3(b)(6).

<sup>11</sup> 15 U.S.C. 78k-1 and 78o-3(b)(6).