

generally only involve the issue of what type of supervisory plan is appropriate for the disqualified member or person. Under proposed NASD Rule 9523, the member would be required to file an MC-400 application with the NASD. Member Regulation, however, would have the discretion to recommend the approval of the application in the event an appropriate supervisory plan is established. The member would be required to execute a letter consenting to the imposition of the supervisory plan. The letter and the supervisory plan would then be submitted to the Office of General Counsel and/or the Chairman of the Statutory Disqualification Committee for review and possible approval. While both the Office of General Counsel and the Committee Chairman would have authority to approve the application or refer it to the NAC, only the Committee Chairman would be permitted to reject the application.

*Failure To Respond.* As noted above (under the heading "Investigations"), proceedings initiated under the Rule 8220 Series are designed to address the most serious on-going violations concerning associated persons and members that are failing to provide the Association with information. For this reason, these proceedings are brought on an accelerated basis.

The Association is proposing to create a new Rule 9540 Series that could be used against those who fail to provide the Association with information, required filings, or keep membership applications or supporting documents current. Under the proposed NASD Rule 9540 Series, the Association would send notices informing respondents that failure to provide the Association with previously requested information or required filings or the failure to keep its membership application or supporting documents current will result in suspensions, unless the information is provided to the Association within 20 days. Respondents would have five days to request hearings to challenge proposed suspensions. These hearings would be conducted before three-member hearing panels, and the hearing panels would have the authority to order any fitting sanctions, including expulsions and bars. Respondents who fail to request hearings to challenge the suspension during the six-month period following the receipt of notices initiating proceedings under this rule series will be automatically barred or expelled.

Further, the Association is proposing to include in the proposed NASD Rule 9540 Series a process by which the Department of Member Regulation

could quickly cancel the memberships of firms that fail to meet the Association's eligibility and qualification standards. Under the proposal, the Association would send letters to members informing them that their memberships will be canceled within 20 days of receipt of the letters, unless the firm becomes eligible for continuance in membership within this time period. The members will be provided opportunities to request hearings within five days of service of the notices to challenge the proposed cancellations. The hearings would be held before Hearings Officers.

## 2. Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>6</sup> which require that the rules of an association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and, in general, to protect investors and the public interest. The NASD believes that the proposed rule change is consistent with Section 15A(b)(7) of the Act<sup>7</sup> in that it works to adequately safeguard the interests of investors while establishing fair and reasonable rules for its members and persons associated with its members. The rule change is consistent with Section 15A(b)(8) of the Act<sup>8</sup> in that it furthers the statutory goals of providing a fair procedure for disciplining members and associated persons.

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

NASD Regulation 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*

On August 10, 1999, the proposed rule change was published for comment in NASD *Notice to Members Number 99-73*. No comments were received in response to the Notice to Members.

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

Within 35 days of the 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 NASD consents, the Commission will:

(A) By order approve the 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 proposal 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 at 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-99-76 and should be submitted by May 31, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42754; File No. SR-NASD-00-18]

### **Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. and Amendment No. 1 thereto Relating to the Entry of Locking/Crossing Quotations Prior to the Nasdaq Market Opening**

May 3, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934

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

<sup>7</sup> 15 U.S.C. 78o-3(b)(7).

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

<sup>9</sup> 17 CFR 200.30-3(a)(12).

("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on April 13, 2000, 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 ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. On April 18, 2000, the NASD and Nasdaq submitted Amendment No. 1 to the proposal.<sup>3</sup> The Commission is publishing this notice, as amended, 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 proposes to amend NASD Rule 4613(e) as it relates to the entry of locking/crossing quotations prior to the market's open. Proposed new language is *italicized*.

#### 4613. Character of Quotations

(a)-(d) No Changes

(e) Locked and Crossed Markets

(1) A market maker shall not, except under extraordinary circumstances, enter or maintain quotations in Nasdaq during normal business hours if:

(A) the bid quotation entered is equal to ("*lock*") or greater than ("*cross*") the asked quotation of another market maker entering quotations in the same security; or

(B) the asked quotation is equal to ("*lock*") or less than ("*cross*") the bid quotation of another market maker entering quotations in the same security.

(C) Obligations Regarding Locked/Crossed Market Conditions Prior to Market Opening

(i) No Change.

(ii) Locked/Crossed market Between 9:20 and 9:29:59 a.m.—If a market maker locks or crosses the market between 9:20 and 9:29:59 a.m. Eastern Time, the market maker must immediately send through SelectNet to the market maker whose quotes it is locking or crossing a Trade-or-move Message that is at the receiving market maker's quoted price and that is for at least 5,000 shares (in instances where there are multiple market makers to a

lock/cross, the locking/crossing market maker must send a message to each party the lock/cross and the aggregate size of all such messages must be at least 5,000 shares); *provided, however, that if a market participant is representing an agency order (as defined in subparagraph (iv) of this rule), the market participant shall be required to send a Trade-or-Move Message(s) in an amount equal to the agency order, even if that order is less than 5,000 shares.* A market maker that receives a Trade-or-Move Message during this period and that is a party to a lock/cross, must within 30 seconds of receiving such message either: fill the incoming Trade-or-Move Message for the full size of the message; or move its bid down (offer up) by a quotation increment that unlocks/uncrosses the market. A market participant shall not be subject to the 5,000 share requirement of this rule if the market participant is representing agency interest only.

(iii) No Change.

(iv) *For the purposes of this rule "agency order" shall mean an order(s) that is for the benefit of the account of a natural person executing securities transactions with or through or receiving investment banking services from a broker/dealer, or for the benefit of an "institutional account" as defined in NASD Rule 3110. An agency order shall not include an order(s) that is for the benefit of a market maker in the security at issue, but shall include an order(s) that is for the benefit of a broker/dealer that is not a market maker in the security at issue.*

(2)-(3) No Change.

### 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

Nasdaq is proposing a rule to amend NASD Rule 4613(e), to permit market participants, when representing agency interests, to lock/cross the market at the actual size of the agency order, instead

of 5,000 shares as currently required by rule.

#### 1. Background

On February 7, 2000, the Commission approved amendments to NASD Rule 4613(e), which relate to the entry of locking/crossing quotes by Nasdaq market participants—market maker and electronic communications networks ("ECNs")—prior to the market's open.<sup>4</sup> As amended and approved by the Commission, NASD Rule 4613(e) provides that if a market participant locks/crosses the market between 9:20 a.m. and 9:29:59 a.m. Eastern Time, the market participant *must* send the market maker(s) or ECN(s) being locked/crossed, a SelectNet<sup>®</sup> message that has appended to it a "TRD OR MOV" administrative message ("*Trade-or-Move Message*")<sup>5</sup> The aggregate size of these Trade-or-Move Messages must be at least 5,000 shares.<sup>6</sup> (Thus, in order to lock/cross the market during this 10 minute before the market opens, a market participant must send a Trade-or-Move Message for 5,000 shares and be willing to trade at least this amount.)<sup>7</sup> The party being locked or crossed must respond to the Trade-or Move Message within 30 seconds by trading in full with the incoming message or moving its quotation to a price level that resolves the locked/crossed market.<sup>8</sup>

#### 2. Purpose

The 5,000 share requirement that is currently in the rule requires market makers, ECNs, and customers thereof, who initiate a lock/cross to send a Trade-or Move(s) for a total of at least 5,000 shares. This requirement applies even if the market maker or ECN is representing an agency order for less than 5,000 shares. Therefore, as currently written and approved, an ECN, market maker, and customer thereof, may not lock/cross the market unless he/she is willing to trade at least 5,000 shares. Some market participants have raised concerns that NASD Rule 4613(e) may exclude certain agency interests from being reflected in the pre-opening market if that interest is less than 5,000 shares.<sup>9</sup>

<sup>4</sup> See Exchange Act Release No. 42400 (February 7, 2000), 65 FR 7407 (February 14, 2000) (order approving File No. SR-NASD-99-23 to amend NASD Rule 4613(e)).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> Under the current rule, a market participant would be prohibited from locking/crossing the market in the ten minute period prior to the open unless the actively locking/crossing market participant is willing to trade at least 5,000 shares.

<sup>8</sup> See note 4, *above*.

<sup>9</sup> *Id.*

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

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

<sup>3</sup> See letter from Robert E. Aber, General Counsel and Senior Vice President, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated April 14, 2000 ("Amendment No. 1"). In Amendment No. 1, Nasdaq corrected an inadvertent misstatement contained in an example describing the proposal's operation.

In light of these concerns, Nasdaq proposes to amend NASD Rule 4613(e) to allow a market participant to lock/cross the market for less than 5,000 shares if they are representing only agency orders. Under the amendment, if between 9:20 a.m. and 9:29:59 a.m., a market participant receives an agency order that would lock/cross the market, the market participant may lock/cross the market and send a Trade-or Move Message for the "actual size" of the agency order, instead of 5,000 shares. (For purposes of the amended rule, an agency order would not include an order for the account of a market maker in the issue, but would include orders for individuals, institutions and broker/dealers who are not market makers in the security at issue). In essence, agency orders would be "exempt" from the 5,000 share requirement. Market participant whose proprietary quotes lock/cross the market between 9:20 and 9:29:59 a.m., would still be subject to the 5,000 aggregate share size requirement for Trade-or Move Messages. Thus, if a market participant wishes to lock/cross the market while acting as principal, the market participant must send an aggregate of at least 5,000 shares, through a Trade-or Move Message, to the parties being locked/crossed.

For example, at 9:21 a.m. the market is \$20 to \$20 $\frac{1}{8}$ , and MMA is alone at the inside offer. ECN1 receives an order from a public customer to sell shares at \$20 $\frac{1}{8}$ . Under the current rule, ECN1 would be required to lock the market and then send a Trade-or Move Message to MMA for 5,000 shares. Under the proposed amendment, ECN1 would be required to send MMA a Trade-or Move message for the actual size of the agency order—800 shares.<sup>10</sup> If the order that ECN1 received at 9:21 a.m. represented an order that was for the account of MMB, ECN1 would be prohibited from locking for only 800 shares.

As a second example, at 9:21 a.m. the market is \$20 to \$29 $\frac{1}{8}$ , with MMA along at the inside offer. MMG receives an 800 share customer limit order to sell at \$20 $\frac{1}{4}$ , which the customer has requested be displayed in the pre-opening. MMG also wishes to cross the market at the \$20 $\frac{1}{4}$  price, while acting in a proprietary capacity. Note that only the agency interest is exempt from the 5,000 share requirement. Accordingly, MMG must send a Trade-or Move

Message for at least 5,800 shares—5,000 covering his proprietary interest and 800 covering the customer limit order/agency.<sup>11</sup> In short a market maker is not permitted to meet the 5,000 share requirement by "free-riding" off of its customer orders that customers specifically have requested be displayed and executed in the market prior to the open.

The requirement that a market maker send a Trade-or Move Message for the actual size of agency interest plus 5,000 shares, only applies when a market maker wishes to lock/cross the market proprietary and simultaneously is displaying agency interest pursuant to an understanding with the customer. This requirement does not apply when the market maker is holding agency interest where there is not understanding with the customer to have its order displayed and/or executed prior to the market's open, and the market maker otherwise is engaging in *bona fide* market making activity during the pre-opening period.

### 3. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6)<sup>12</sup> and Sections 11A of the Act.<sup>13</sup> Section 15A(b)(6)<sup>14</sup> requires that the rules of a registered national securities association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principals 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. Section 11A(a)(1)(C)<sup>15</sup> provides that it 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) and 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.

Nasdaq believes that the amendment to NASD Rule 4613(e) is consistent with Sections 15A(b)(6) and 11A(a)(1)(C).<sup>16</sup> The proposed amendments create equal access among market participants (market makers and ECNs) consistent with Sections 15A(b)(6) and 11A(a)(1)(C).<sup>17</sup> Locked/crossed markets present serious market integrity and investor protection issues, as they disrupt the orderly function of the market and in turn have an impact on the processing of investor orders. Nasdaq believes that by allowing agency orders to be displayed in the market at their actual share sizes for purposes of resolving locked/crossed markets will increase investor protection by providing: (1) Greater access to the market, (2) increased liquidity, and (3) transparency of orders in the marketplace. Nasdaq believes that these benefits will provide greater trading, processing, and pricing efficiency and stability in the pre-opening market. Nasdaq also believes that by allowing agency quotes to be sent at "actual size" rather than at the 5,000 share size, market participants will have increased opportunities to evaluate and access the depth and liquidity of securities prior to the opening of the market.

### (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.

### 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

<sup>10</sup> Under the prior language of NASD Rule 4613(e), ECN1 would have been required to send 5,000 shares along with its Trade-or Move SelectNet message. This 5,000 share size requirement of the Trade-or-Move SelectNet message would have effectively precluded agency orders from participating in the opening market.

<sup>11</sup> This assumes that the customer has an agreement with MMG that its limit order will be represented and potentially executed prior to the market's open.

<sup>12</sup> 15 U.S.C. 78o-3(b)(6).

<sup>13</sup> 15 U.S.C. 78k-1(a).

<sup>14</sup> 15 U.S.C. 78o-3(b)(6).

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

<sup>16</sup> 15 U.S.C. 78o-3(b)(6) and 15 U.S.C. 78k-1(a)(1)(C).

<sup>17</sup> 15 U.S.C. 78o-3(b)(6) and 15 U.S.C. 78k-1(a)(1)(C).

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 proposal, 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. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the File No. SR-NASD-00-18 and should be submitted by May 31, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 00-11683 Filed 5-9-00; 8:45 am]

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42747; File No. SR-NSCC-98-14]

#### Self-Regulatory Organization; National Securities Clearing Corporation; Order Approving a Proposed Rule Change Relating to Ceasing to Act for a Member

May 2, 2000.

On December 8, 1998, the National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-NSCC-98-14) pursuant to Section 19(b)(1) of the Securities Exchange Act

of 1934 ("Act").<sup>1</sup> Notice of the proposal was published in the **Federal Register** on June 17, 1999.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

#### I. Description

The rule change eliminates the distinction between those instances where NSCC declines or ceases to act for a member because the member is insolvent and where NSCC declines or ceases to act for a member for another reason. The rule change also permits NSCC to complete certain open RVP/DVP transactions of an insolvent broker-dealer that is a member or clears through a member.

##### *a. Declining or Ceasing To Act*

NSCC's procedures for ceasing to act for an insolvent member were set forth in former Section 3 of Rule 18. Its procedures for ceasing to act when the member is not insolvent were set forth in Section 2 of Rule 18. Former Sections 2(a) and (b) (non-insolvency scenario) and Sections 3(a) and (b) (insolvency scenario) set forth the transactions which could be eliminated by NSCC from its processing when it ceased to act for a member. Generally, these sections provided that if NSCC gave notice that it was ceasing to act for a member before NSCC issued the security balance orders in a pending balance order accounting operation or before NSCC issued the consolidated trade summary in a pending continuous net settlement accounting operation for that member's pending trades. NSCC could in its discretion exclude that member's trades from the balance order or continuous net settlement accounting operation. Trades so executed would have to be settled between the parties outside of NSCC.

Under the rule change, new Sections 2(a)(i) and (ii) replace Sections 2(a) and (b) and Sections 3(a) and (b) and specifically tie the exclusion of a trade to whether or not the trade has been guaranteed by NSCC. New Section 2(a)(iii) addresses the exclusion of security orders issued with respect to "special trades" and transactions in foreign securities. Prior to the rule change, the exclusion of these trades was only addressed in the insolvency portion of NSCC's rules, former Section 3(c)(iii).

Former Section 2(c) set forth NSCC's procedures for handling envelope transactions when it ceased to act for a

solvent member. Former Section 3 of NSCC's rules did not address envelope transactions when NSCC ceased to act for an insolvent member. New Section 4 mirrors former Section 2(c) and addresses the completion of envelope transactions of a member for whom NSCC has ceased to act regardless of the solvency status of the member.

Former Sections 2(d)(i) and (ii) and Section 3(b)(ii) governed the completion of CNS trades. According to NSCC, when it ceases to act for a member, it completes CNS trades through a qualified securities depository regardless of whether the member was solvent. However, only former Section 2 (non-insolvency scenario) specifically addressed the completion of these trades through a qualified securities depository. Accordingly, new Section 5 clarifies that CNS transactions will be completed through a qualified securities depository regardless of the solvency status of the relevant member unless in an insolvency scenario the rules of the relevant insolvency regime do not allow NSCC to take certain actions with respect to the completion of CNS trades.

Former Sections 2(d)(iii) and 3(c)(ii) addressed the closing out of any remaining CNS transactions. Under the rule change, this is now covered in new Section 6(a).

Former Sections 2(b) and 3(c)(ii) pertained to the completion of balance order transactions after NSCC ceases to act for a member. Although NSCC's procedures for completing balance order transactions are the same regardless of whether NSCC is ceasing to act for a solvent or insolvent member, only former Section 3 detailed how NSCC would close-out balance order transactions and how members were to submit related close-out losses to NSCC. The rule change adopts new Section 6(b), which is similar to former Sections 3(c) and (d). New Section 6(b) governs the close-out of balance order transactions regardless of whether an insolvency situation exists.

The language contained in former Section 2(e), which set forth NSCC's rights with respect to any balance due to it from a member after NSCC had ceased to act for the member, technically only applied in non-insolvency scenarios. Under the rule change, the language of Section 2(e) now appears in Section 7(a) and applies to both insolvency and non-insolvency scenarios. The language set forth in former Sections 2(f) and (f), which provided that NSCC would maintain a lien on all property a member places with NSCC as security for any and all liabilities of the member to NSCC now appears in Section 7(f).

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

<sup>2</sup> Securities Exchange Act Release No. 41504 (June 9, 1999), 64 FR 32586 (June 17, 1999).

<sup>18</sup> See 17 CFR 200.30-3(a)(12).