

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 Amex. All submissions should refer to file number SR-Amex-00-43 and should be submitted by October 26, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43368; File No. SR-NASD-98-26]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval to Amendment No. 9 to a Proposed Rule Change by the National Association of Securities Dealers, Inc. To Institute, on a Pilot Basis, New Primary Nasdaq Market Maker Standards for Nasdaq National Market Securities

September 27, 2000.

On September 20, 2000, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly-owned subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq"), submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to: (1) Continue to suspend the current PMM standards until June 30, 2001; and (2) extend the NASD's Short Sale Rule pilot until June 30, 2001 ("Amendment No. 9").³

Amendment No. 9 to the proposed rule change, SR-NASD-96-28, is described in Items I and II below, which Items have been prepared by the NASD. The Commission is publishing this notice and order to solicit comments on Amendment No. 9 from interested

persons and to approve the amendment on an accelerated basis.

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

In the current amendment, Nasdaq is proposing to extend the Short Sale Rule pilot and the suspension of the existing PMM standards from September 30, 2000 until June 30, 2001. The proposed rule language, as amended, follows. Additions are italicized; deletions are bracketed.

NASD Rule 3350

(a)-(k) No Changes.

(l) This Rule shall be in effect until [September 30, 2000] *June 30, 2001.*

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

In its filing with the Commission, the NASD 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. The NASD 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) Background on the NASD's Short Sale Rule

Section 10(a) of the Exchange Act⁴ gives the Commission plenary authority to regulate short sales of securities registered on a national securities exchange, as needed to protect investors. Although the Commission has regulated short sales since 1938, that regulation has been limited to short sales of exchange-listed securities. In 1992, Nasdaq, believing that short-sale regulation is important to the orderly operation of securities markets, proposed a short sale rule for trading of its National Market securities that incorporates the protections provided by Rule 10a-1 of the Exchange Act.⁵ On June 29, 1994, the Commission approved the NASD's short sale rule, Rule 3350 ("Short Sale Rule"), applicable to short sales⁶ in Nasdaq

National Market ("NNM") securities on an eighteen-month pilot basis through March 5, 1996.⁷ The NASD and the Commission have extended NASD Rule 3350 numerous times, most recently, until September 30, 2000.⁸

Nasdaq's short-sale rule employs a "bid" test rather than a tick test because Nasdaq trades are not necessarily reported to the tape in chronological order. Nasdaq's short sale rule prohibits short-sales at or below the inside bid when the current inside bid is below the previous inside bid. Nasdaq calculates the inside bid from all market makers in the security (including bids on exchanges trading Nasdaq securities on an unlisted trading privileges basis), and disseminates symbols to denote whether the current inside bid is an "up-bid" or a "down-bid." To effect a "legal" short-sale on a down-bid, the short-sale must be executed at a price at least 1/16th above the current inside bid. The rule is in effect from 9:30 a.m. E.T. until 4 p.m. E.T. each trading day.

To reduce the compliance burdens on its members, Nasdaq's short sale rule also incorporates seven exemptions contained in Rule 10a-1 under the Exchange Act that are relevant to trading on Nasdaq.⁹ In addition, in an effort to not constrain the legitimate hedging needs of options market makers, the NASD's short sale rule contains a limited exception for standardized options market makers. The Rule also contains an exemption for warrant market makers similar to the one available for options market makers.

(2) Background on the NASD's Primary Market Maker Standards

To ensure that market maker activities that provide liquidity and continuity to the market are not adversely constrained when the short sale rule is involved,

must adhere to the definition of a "short sale" contained in Rule 3b-3 of the Exchange Act, which is incorporated into Nasdaq's short sale rule by NASD Rule 3350(k)(1).

⁷ See Securities Exchange Act Release No. 34277 (June 29, 1994), 59 FR 34885 (July 7, 1994) ("Short Sale Rule Approval Order").

⁸ See *supra*, note 3.

⁹ See NASD Rule 3350(c)(2)-(8). The Rule also provides that a member not currently registered as a Nasdaq market maker in a security, and that has acquired the security while acting in the capacity of a block positioner shall be deemed to own such security for the purposes of the Short Sale Rule, notwithstanding that such member may not have a net long position in such security if and to the extent that such member's short position in such security is subject to one or more offsetting positions created in the course of bona fide arbitrage, risk arbitrage, or bona fide hedge activities. In addition, the NASD has recognized that SEC staff interpretations to Rule 10a-1 under the Exchange Act dealing with the liquidation of index arbitrage positions and an "international equalizing exemptions" are equally applicable to the NASD's short sale rule. See NASD Rule 3350(f).

⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4

³ See letter from Jeffrey S. Davis, Assistant General Counsel, Nasdaq, to Katherine England, Assistant Director, Division of Market Regulation, Commission dated September 20, 2000. The current suspension and extension would expire on September 30, 2000. See Securities Exchange Act Release No. 42219 (December 9, 1999), 64 FR 70753 (December 17, 1999).

⁴ 15 U.S.C. 78j(a).

⁵ 17 CFR 240.10a-1.

⁶ A short sale is a sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller. To determine whether a sale is a short sale, members

NASD Rule 3350(c)(1) provides an exemption for "qualified" Nasdaq market makers) *i.e.*, market makers that meet the PMM standards). Presently, NASD Rule 4612 provides that a member registered as a Nasdaq market maker pursuant to NASD Rule 4611 may be deemed a PMM if that member meets certain threshold standards.

Since NASD Rule 3350 has been in effect, there have been two methods used to determine whether a market maker is eligible for the PMM exemption. Specifically, from September 4, 1994 through February 1, 1996, Nasdaq market makers that maintained a quotation in a particular NNM security for 20 consecutive business days without interruption were exempt from Rule 3350 for short sales in that security, provided the short sales were made in connection with bona fide market making activity ("the 20-day" test).¹⁰ From February 1, 1996 until the February 14, 1997, the "20-day" test was replaced with a four-part quantitative test known as the PMM standards.¹¹

Beginning on February 14, 1997, the PMM standards were suspended for all NNM securities due to the impact of the SEC's Order Handling Rules, and corresponding NASD rule change and system modifications on the operation of the four quantitative standards.¹² For

¹⁰ See Short Sale Rule Approval Order, *Supra* note 7.

¹¹ *Id.* Under the PMM standards, a market maker was required to satisfy at least two of the following four criteria each month to be eligible for an exemption from the short sale rule: (1) The market maker must be at the best bid or best offer as shown on Nasdaq no less than 35 percent of the time; (2) the market maker must maintain a spread no greater than 102 percent of the average dealer spread; (3) no more than 50 percent of the market maker's quotation updates may occur without being accompanied by a trade execution of at least one unit of trading; or (4) the market maker executes 1½ times its "proportionate" volume in the stock. If a PMM did not satisfy the threshold standards after a particular review period, the market maker lost its designation as a PMM (*i.e.*, the "P" next to its market maker identification was removed). Market makers could re-qualify for designation as a PMM by satisfying the threshold standards in the next review period.

¹² See Securities Exchange Act Release Nos. 38294 (February 14, 1997), 62 FR 8289 (February 24, 1997) (order granting temporary accelerated approval of suspension of PMM standards until October 1, 1997; File No. SR-NASD-97-07); 39198 (October 3, 1997), 62 FR 53365 (October 14, 1997) (order granting temporary accelerated approval of continuing suspension until April 1, 1998; File No. SR-NASD-97-73); 39819 (March 30, 1998), 63 FR 16841 (April 6, 1998) (order granting temporary accelerated approval of continuing suspension until May 1, 1998; File No. SR-NASD-98-26); 39936 (April 30, 1998), 63 FR 25253 (May 7, 1998) (order granting temporary accelerated approval of continuing suspension until July 1, 1998; Amendment No. 3 to File No. SR-NASD-98-26); 40140 (June 26, 1998), 63 FR 36464 (July 6, 1998) (order granting temporary accelerated approval of

example, the requirement that market makers display customer limit orders adversely affected the ability of market makers to satisfy the "102% Average Spread Standard." Since that time all market makers have been designated as PMMs.

In March 1998, Nasdaq proposed PMM standards that received substantially negative comments.¹³ In light of those comments, Nasdaq staff convened an advisory subcommittee to develop new PMM standards ("Subcommittee") in August 1998. The Subcommittee met nine times and formulated new PMM standards. On December 9, 1998, the NASD/Nasdaq staff met with the Commission staff and the Subcommittee to receive informal feedback on the new PMM standards. At the conclusion of the meeting, Commission staff noted the progress made by the Subcommittee and requested time to digest and more carefully analyze the proposed new PMM standards.

On July 29, 1999, members of the Nasdaq staff conducted a conference call with members of the Commission staff to receive feedback on the PMM standards that Nasdaq presented at the December 9, 1998 meeting. During the meeting, the Commission staff suggested that Nasdaq modify several of the proposed standards and analyze the impact of those modifications on the primary market maker determination. On September 27, 1999, Nasdaq reported that the NASD Economic Research staff had analyzed data based on the Commission's suggested revisions, and concluded that the Commission's modified standards produced unfavorable results.¹⁴

The Commission notes that it has separately proposed amendments to Rule 10a-1 under the Exchange Act,

continuing suspension until October 1, 1998; Amendment No. 4 to File No. SR-NASD-98-26); 40485 (September 25, 1998), 63 FR 52780 (October 1, 1998) (order granting temporary accelerated approval of continuing suspension until March 31, 1999; Amendment No. 5 to File No. SR-NASD-98-26); 41195 (March 19, 1999), 64 FR 14778 (March 26, 1999) (order granting temporary accelerated approval of continuing suspension until June 30, 1999; Amendment No. 6 to File No. SR-NASD-98-26); 41568 (June 28, 1999), 64 FR 36416 (July 6, 1999) (order granting temporary accelerated approval of continuing suspension until December 31, 1999; Amendment No. 7 to File No. SR-NASD-98-26); 42219 (December 9, 1999), 64 FR 70753 (December 17, 1999) (order granting temporary accelerated approval of continuing suspension until September 30, 2000; Amendment No. 8 to File No. SR-NASD-98-26).

¹³ See Securities Exchange Act Release 39819 (March 30, 1998), 63 FR 16841 (April 6, 1998).

¹⁴ See letter from John F. Malitzis, Assistant General Counsel, Nasdaq, to Richard Strasser, Assistant Director, Division of Market Regulation, Commission, dated September 27, 1999.

which applies to exchanges. Nasdaq has announced that it is considering registering as an exchange.

(3) Current Amendment

Nasdaq believes that it is in the best interest of investors to extend the short sale regulation pilot program. In the Short Sale Approval Order, the Commission stated that "recognizing the potential for problems associated with short selling, the changing expectations of Nasdaq market participants and the competitive disparity between the exchange markets and the OTC market, the Commission believes that regulation of short selling of Nasdaq National Market securities is consistent with the Act."¹⁵ In addition, the Commission stated that it "believes that the NASD's short sale bid-test, including the market maker exemptions, is a reasonable approach to short sale regulation of Nasdaq National Market securities and reflects the realities of its market structure."¹⁶ Nasdaq believes the benefits that the Commission recognized when it first approved NASD Rule 3350 apply to equal force today.

Similarly, Nasdaq believes the concerns that caused the Commission to waive the PMM standards in February 1997 continue to exist today. Nasdaq and the Commission agreed to waive the PMM standards to avoid frustrating operation of the Commission's Order Handling Rules, in light of market factors that were not apparent at the time the Order Handling Rules were implemented.¹⁷ Nasdaq has worked to address those concerns to the Commission's satisfaction, including convening a special subcommittee on PMM issues, proposing two different sets of PMM standards, and being continuously available and responsive to Commission staff to discuss this issue. Despite these efforts, the Commission and Nasdaq have been unable to establish satisfactory PMM standards. Nasdaq believes that re-

¹⁵ See Short Sale Rule Approval Order, *supra* note 8.

¹⁶ *Id.*

¹⁷ Nasdaq stated at the time that it believed the implementation of the Order Handling Rules created the following three issues: (1) Many market makers voluntarily chose to display customer limit orders in their quotes although the Limit Order Display Rule does not yet require it; (2) SOES decrementation for all Nasdaq stocks significantly affected market makers' ability to meet several of the primary market maker standards; and (3) with the inability to meet the existing criteria for a larger number of securities, a market maker may be prevented from registering as a primary market maker in an initial public offering because it fails to meet the 80% primary market maker test contained in Rule 4612(g)(2)(B). See Securities Exchange Act Release No. 38294 (February 14, 1997), 62 FR 8289 (February 24, 1997).

instating the PMM standards set forth in NASD Rule 4612 would be extremely disruptive to the market and harmful to investors.

Nasdaq also notes that the Commission has signaled to the securities industry that it is considering fundamental changes to Rule 10a-1 of the Exchange Act that could impact the manner in which Nasdaq and the other markets regulate short sales. On October 20, 1999, the Commission issued a Concept Release on Short Sales in which it sought comment on, among other things, revising the definition of short sale, extending short sale regulation to non-exchange listed securities, and eliminating short sale regulation altogether.¹⁸ Nasdaq believes it would be inappropriate for Nasdaq to dramatically alter its regulation of short sales while the Commission is considering fundamentally changing Rule 10a-1 of the Exchange Act.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 9, including whether the proposed Amendment 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. SR-NASD-98-26 and should be submitted by October 26, 2000.

IV. Commission's Findings and Order Granting Accelerated Approval of the Amendment

After careful consideration, the Commission finds, for the reasons set forth below, that the extension of the Short Sale Rule pilot and the suspension of the existing PMM standards until June 30, 2001 is consistent with the requirements of the

Act and the rules and regulations thereunder. In particular, the extension is consistent with Section 15A(b)(6)¹⁹ of the Act, which requires that the NASD's rules be designed, among other things, to remove impediments to and perfect the mechanism of a free and open market and a national market system and to promote just and equitable principles of trade.

The Commission finds that continuation of the Short Sale Rule pilot and the continued suspension of the current PMM standards will maintain the status quo while the Commission considering amending Rule 10a-1 under the Exchange Act.

The Commission finds good cause for approving the extension of the Short Sale Rule pilot and the suspension of existing PMM standards prior to the 30th day after the date of publication of notice of the filing in the **Federal Register**. It could be disruptive to the Nasdaq market and confusing to market participants to reintroduce the previous PMM standards while new PMM standards are being developed, and while the Commission is considering amending Rule 10a-1 under the Exchange Act.

It Is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,²⁰ that Amendment No. 9 to the proposed rule change, SR-NASD-98-26, which extends the NASD Short Sale Rule pilot and the suspension of the current PMM standards to June 30, 2001, is approved on an accelerated basis.²¹

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²²

Margaret H. McFarland,

Deputy Secretary.

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¹⁹ 15 U.S.C. 78o-3(b)(6).

²⁰ 15 U.S.C. 78s(b)(2).

²¹ In approving Amendment No. 9, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

²² 17 CFR 200.30-3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43383; File No. SR-NASD-00-48]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. To Require an Issuer To Publicly Disclose the Receipt of a Delisting Notice for Failure To Comply With the Continued Listing Standards of The Nasdaq Stock Market

September 28, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 10, 2000, 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 ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. 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 proposes to require issuers to publicly disclose the receipt of a delisting notice for failure to comply with Nasdaq's continued listing requirements. Below is the text of the proposed rule change. Proposed new language is in italics. Proposed deletions are in brackets.

Rule 4120. Trading Halts

(a) Authority to Initiate Trading Halts.

In circumstances in which Nasdaq deems it necessary to protect investors and the public interest, Nasdaq may, pursuant to the procedures set forth in paragraph (b):

(1)-(4) No change.

(5) Halt trading in a security listed on Nasdaq when Nasdaq requests from the issuer information relating to:

(i) No change;

(ii) The issuer's ability to meet Nasdaq listing qualification requirements, as set forth in the Rule 4300, [and] 4400, and 4800 Series; or

(iii) No change.

(b) No change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

¹⁸ See Securities Exchange Act Release No. 42037 (October 20, 1999), 64 FR 57996 (October 28, 1999).