

publishes its reasons for so finding or (ii) as to which the NASD 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, 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 number SR-NASD-00-48 and should be submitted by October 26, 2000.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>4</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43367; File No. SR-NASD-00-42]

#### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Proposed Recording and Recordkeeping Requirements of Certain Quotation Data

September 27, 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 June 3, 2000, the National Association of Securities Dealers, Inc. ("NASD"), through its wholly owned subsidiary, NASD Regulation, Inc. ("NASD Regulation") 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 NASD Regulation. 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

NASD Regulation is proposing to add new NASD Rule 6630 to require members to record and maintain their quotations displayed in certain automated, inter-dealer quotation systems, such as the Electronic Pink Sheets ("EPS"), and to report such data to NASD Regulation upon request.

Below is the text of the proposed rule change. Additions are italicized; deletions are in brackets.

\* \* \* \* \*

#### 6600. [REPORTING TRANSACTIONS IN] OVER-THE-COUNTER EQUITY SECURITIES

This Rule 660 Series sets forth *recording and reporting requirements for certain quotations and unpriced indications of interest displayed on inter-dealer quotation systems* and the trade reporting requirements applicable to members' transactions in equity securities for which real-time trade reporting is not otherwise required (hereinafter referred to as "OTC Equity Securities"). Members shall utilize the Automated Confirmation Transaction Service (ACT) for trade reporting in OTC Equity Securities. Rules 6610 and 6620 No Change.

#### Rule 6630. Recording of Quotation Information

##### (a) Quotation Recording Requirements

(1) *Subject to the terms and conditions contained herein, each OTC Market Maker that displays priced quotations (bid and/or offer) or unpriced indications of interest in OTC Equity Securities in an inter-dealer quotation system that permits quotation updates on a real-time basis shall record each item of information described in paragraph (b) of this Rule. This quote activity record must reflect all changes in an OTC Market Maker's priced quotation or quotation size displayed or unpriced indication of interest, and the time any such change was effected.*

(2) *Members shall record each item of information required to be recorded under this Rule in such form as is prescribed by the Association from time to time.*

##### (3) Maintaining and Preserving Records

(A) *Each member shall maintain and preserve records of the information required to be recorded under this Rule for the period of time and accessibility specified in SEC Rule 17a-4(a).*

(B) *The records required to be maintained and preserved under this Rule may be immediately produced or reproduced on "micrographic media" as defined in SEC Rule 17a-4(f)(1)(i) or by means of "electronic storage media" as defined in SEC Rule 17a-4(f)(1)(ii) that meet the conditions set forth in SEC Rule 17a-4(f) and may be maintained and preserved for the required time in that form.*

##### (b) Information to be Recorded

*The quotation activity record required pursuant to paragraph (a) of this Rule shall contain, at a minimum, the following information for every priced quotation (bid and/or offer) or unpriced indication of interest displayed by the member during the trading day:*

- (1) *Submitting firm;*
- (2) *Inter-dealer quotation system or medium;*
- (3) *Trade date;*
- (4) *Time quotation displayed (expressed in hours, minutes and seconds);*
- (5) *Security name and symbol;*
- (6) *Bid and bid quotation size (if applicable);*
- (7) *Offer and offer quotation size (if applicable);*
- (8) *Prevailing Inside Bid; and*
- (9) *Prevailing Inside Offer*

*If no updates were entered to an OTC Market Maker's quotation or quotation size for any given trading day, the member must record the information in subparagraphs (b)(1) through (7).*

##### (c) Quotations Not Required To Be Recorded

*The recording requirements contained in paragraphs (a) and (b) of this Rule shall not apply to quotations of OTC Equity Securities that are displayed on an inter-dealer quotation system that is:*

- (1) *qualified pursuant to Section 17B of the Act; or*
- (2) *operated by a member of the Association.*

##### (d) Reporting Requirements

###### (1) General Requirement

*Members shall report information required to be recorded under this Rule to the Association upon its request.*

<sup>4</sup> 17 CFR 200.30-3(a)(12).

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

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

*(2) Method of Transmitting Data*

Members shall transmit this information in such form prescribed by the Association.

*(e) Reporting Agent Agreements*

(1) "Reporting Agent" shall mean a third party that enters into any agreement with a member pursuant to which such third party agrees to fulfill such member's obligations under this Rule.

(2) Any member may enter into an agreement with a Reporting Agent pursuant to which the Reporting Agent agrees to fulfill the obligations of such member under this Rule. Any such agreement shall be evidenced in writing, which shall specify the respective functions and responsibilities of each party to the agreement that are required to effect full compliance with the requirements of this Rule.

(3) All written documents evidencing an agreement described in paragraph (e)(2) shall be maintained by each party to the agreement.

(4) Each member remains responsible for compliance with the requirements of this Rule, notwithstanding the existence of an agreement described in this paragraph. If a member knows or has reason to believe that its Reporting Agent is not complying with the requirements of this Rule, the member must immediately withdraw its quotations or unpriced indications of interest until such time that the member is satisfied that the quotation data is being properly maintained and reported.

\* \* \* \* \*

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

In its filing with the Commission, NASD Regulation 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. NASD Regulation 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

In September 1999, EPS, which is operated by the Pink Sheets LLC ("Pink Sheets") began displaying real-time, on-

line stock quotations for approximately 5,000 securities. Some NASD members may now enter quotations in the EPS, which are displayed over the Internet at the EPS website on a real-time basis. Prior to the availability of EPS, the "pink sheets" consisted of weekly lists of quotes printed in hard copy by Pink Sheets. Pink Sheets updated these non-binding quotations by means of a daily facsimile to subscribers. Market participants could learn of changes to intra-day quotations only by telephone or similar means of communication to market makers in the security.

Because the EPS now displays quotations on a real-time basis, NASD Regulation staff requires access to this quotation data to surveil adequately for member compliance with applicable rules and regulations and, when necessary, to reconstruct market activity. For example, member activities in the EPS are subject to NASD Rule 3320, "Offers at Stated Prices," which requires that a member's quotations be "firm," *i.e.*, that the member buy or sell at least a normal unit of trading in the quoted stock at its then prevailing quotations, unless clearly designated otherwise. In addition, NASD Rule 6750 provides that every member firm that functions as a market maker in over-the-counter ("OTC") equity securities on an inter-dealer quotation system that permits quotation updates on a real-time basis must honor those quotations for the minimum size applicable to the market maker's firm bid or ask. Although complete trade execution data would be available through existing trade reporting requirements and systems, NASD Regulation staff does not otherwise have access to historical quotation activity at the time of trades.<sup>3</sup> Therefore, NASD Regulation is proposing that members that participate in an inter-dealer quotation system,<sup>4</sup> such as the EPS, that permits quotation updates on a real-time basis, be required to record and maintain their quotation data.

Under the proposed rule change, members that publish quotations on the EPS (or any similar automated quotation system) would be required to record and maintain priced quotations and unpriced indications of interest data and to report such quotation data to

<sup>3</sup> While quotation data generally is provided directly by the exchange or system on which it is displayed, in this instance, the operator of the system, Pink Sheets, is not a registered broker-dealer, a member of the NASD, or a national securities exchange.

<sup>4</sup> As defined in Rule 15c2-11(e) of the Act, 17 CFR 240.15c2-11(e), the term inter-dealer quotation system means any system of general circulation to brokers or dealers which regularly disseminates quotations of identified brokers or dealers.

NASD Regulation upon its request. The proposed rule change would require members to record and report the time of the quotation displayed, the bid and bid quotation size, the offer and offer quotation size, and the prevailing inside bid and offer in the inter-dealer quotation system at the time of the quotation. The member would need to record this information for all updates in quotations or quotation size.

The proposed rule change also would require that members preserve such records in accordance with Rule 17a-4(a) under the Act.<sup>5</sup> Specifically, under Rule 17a-4,<sup>6</sup> members would be required to preserve these records for a period of not less than six years, the first two years in an accessible place.

The proposed rule change would not apply to quotations provided on an inter-dealer quotation system that is qualified pursuant to Section 17B of the Act,<sup>7</sup> because by definition, such a system would be sponsored and regulated by a registered securities association or national securities exchange, and quotation information would be available from the system directly. This includes, for example, the OTC Bulletin Board, which is sponsored and regulated by the NASD. In addition, the proposed rule change would not apply to an inter-dealer quotation system that is operated by a member of the NASD because the NASD would obtain quotation data (or in some cases, the display of limit orders) directly from the member that operates the system.

The proposed rule change would permit a member to use a reporting agent to provide the quotation data to NASD Regulation.<sup>8</sup> NASD Regulation believes that most, if not all, members would use the services of a reporting agent, which would likely be the operator of the system, such as Pink Sheets with respect to the EPS. In this regard, NASD Regulation anticipates that the system operator, as reporting agent, would provide NASD Regulation all relevant quotation data directly on a daily or ongoing basis. The member, however, would remain ultimately responsible for compliance with all requirements of the proposed rule, notwithstanding the use of a reporting agent. If a member knows or has reason to believe that it or its reporting agent is not complying with the requirements of the rule, the member would be

<sup>5</sup> 17 CFR 240.17a-4(a).

<sup>6</sup> 17 CFR 240.17a-4.

<sup>7</sup> 15 U.S.C. 78q-2.

<sup>8</sup> Proposed Rule 6630(e) provides that a "Reporting Agent" means a third party that enters into any agreement with a member pursuant to which such third party agrees to fulfill such member's obligations under this rule.

required immediately to withdraw its priced quotations or unpriced indications of interest until such time that the member is satisfied that the quotation data is being properly maintained and reported. In this regard, NASD Regulation would expect a member to periodically review or monitor a reporting agent's activities to ensure continued compliance.

## 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>9</sup> which requires, among other things, that the Association's rules 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. NASD Regulation believes that the proposed rule change will provide it with the quotation data necessary to surveil for and enforce applicable NASD rules and the federal securities laws.

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

NASD Regulation 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*

The proposed rule change was published for comment in NASD Notice to Members 00-17 (March 2000) ("Notice"). The comment period expired on April 10, 2000. Six comment letters were received in response to the Notice.<sup>10</sup> Copies of the Notice and the comment letters have been provided to the Commission. Of the six comment letters received, two supported the proposal and four opposed the proposal. The majority of commenters, however, generally supported the concept that regulators should have access to the information sought by the NASD, but differed on the means of obtaining the information.

One commenter opposing the proposal stated that the proposed requirements were overly burdensome for members and recommended that the

SEC require that the system operator, not the member, provide the information to the NASD. As an initial matter, NASD Regulation does not have the authority or jurisdiction to require a system operator to provide the necessary information unless the operator is an NASD member. In addition, SEC rules currently do not require the system operators to provide such information to the NASD. Further, although members are ultimately responsible for complying with the proposed rule, the proposed rule permits a member to enter into an agreement with a reporting agent pursuant to which the reporting agent agrees to fulfill the obligations of the member. In this regard, NASD Regulation expects that, in most cases, a system operator will transmit the quotation data to NASD Regulation pursuant to a reporting agent agreement with a member.

Two commenters opposing the proposal recommended, as an alternative, the negotiation of a private contract between NASD Regulation and the system operator. Again, because NASD Regulation does not have jurisdiction over the system operator, NASD Regulation cannot rely on a private contract to obtain the required quotation data, since the system operator could at any time refuse to provide the data to NASD Regulation. Where the system operator is an NASD member, the proposed rule change specifically excludes quotations on such a system from the recording and reporting requirements because NASD Regulation can obtain the quotation data directly from the system operator.

Two commenters viewed as excessively strict the requirement that members immediately withdraw their quotations in the information required by the proposed rule is not furnished to the NASD. In this regard, one commenter suggested that, as an alternative to requiring members to remove quotations entirely, the proposed rule change permit members to maintain unpriced indications of interest. NASD Regulation, however, believes that if quotation information, including unpriced indications of interest, is not properly recorded, NASD Regulation will be unable to ensure that members are in compliance with applicable rules. Therefore, the proposed rule requires members to immediately withdraw their quotations or unpriced indications of interest until such time as the member has obtained assurances that the quotation information is being properly recorded.

In addition, one commenter stated that it is overly burdensome to place on

a member firm the responsibility of determining whether its reporting agent is complying with the requirements of the rule. Instead, the commenter suggests that NASD Regulation notify the member in writing that the reporting agent is not complying. However, NASD Regulation believes that the responsibility should lie with the member to determine that, if it chooses to use a reporting agent, the reporting agent is reporting properly on the member's behalf.

Finally, one commenter stated that the proposed rule change lacks objective standards for the form or means of delivery of the data to NASD Regulation. NASD Regulation has specified in the proposed rule change what quotation data and related information must be recorded and reported, and will prescribe the form in which this data will be required to be transmitted to NASD Regulation in a Notice to Members.

## 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

<sup>9</sup> 15 U.S.C. 78o(b)(6).

<sup>10</sup> Comment letters were received from Thomas Murphy, Bishop, Rosen & Co. ("Bishop Rosen"); Elena Fusillo, Clark Dodge and Company ("Clark Dodge"); Trish Stone-Damen, IRM Distributors, Inc. ("IRM Distributors"); Michael Dorsey, Knight Securities, L.P. ("Knight Securities"); Cromwell Coulson, Pink Sheets ("NQB"); and Cindy Witt, US Bancorp Piper Jaffray ("Piper Jaffray").

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-00-42 and should be submitted by October 26, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43369; File No. SR-PCX-00-23]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment Nos. 1 and 2 by the Pacific Exchange, Inc. Relating to the Conversion to Decimal Pricing

September 27, 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 August 8, 2000, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Exchange filed the proposal pursuant to Section 19(b)(3)(A) of the Act,<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission.<sup>5</sup> The Exchange filed amendments to the proposed rule change on August 25, 2000 and September 22, 2000, respectively.<sup>6</sup> The

Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend certain PCX rules to implement the securities industry's Decimals Implementation Plan submitted to the Commission on July 24, 2000. The text of the proposed rule change is available at the PCX and at the Commission.

### 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 PCX 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 PCX has prepared summaries, set forth in section 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

On June 8, 2000, the Commission issued an order ("Order")<sup>7</sup> requiring the national securities exchanges and the National Association of Securities Dealers, Inc. ("Participants") to act jointly in planning, discussing, developing, and submitting to the Commission a plan that will begin phasing in the implementation of decimal pricing in equity securities and options on or before September 5, 2000 ("Plan"). The Commission directed the Participants to submit the Plan to the Commission by July 24, 2000, and further directed each Participant to file the rule changes necessary to implement the phase-in plan. In compliance with the Order, the Exchange submitted the proposed rule change to implement the Plan.

Equity Trading Rules. The Exchange proposes to amend PCX Rule 7.10(b) to

1 makes certain technical corrections to the proposed rule change. See also Letter dated September 21, 2000, from Hassan Abedi, Attorney, Regulatory Policy, PCX, to Nancy Sanow, Assistant Director, Division, Commission ("Amendment No. 2"). Amendment No. 2 conforms PCX Rule 7.66 to a recent proposed amendment to the Intermarket Trading System Plan ("ITS Plan") relating to decimal pricing.

<sup>7</sup> See Securities Exchange Act Release No. 42914 (June 8, 2000), 65 FR 38010 (June 19, 2000).

establish a \$.01 minimum price variation ("MPV") for equity securities pricing in decimals, as required by the Plan,<sup>7</sup> and to amend Commentary .01 to Rule 7.10 to clarify that the Exchange is prohibited from changing the MPV for securities pricing in decimals while Plan is in effect.<sup>8</sup> The Exchange is also proposing to amend Rule 7.19(c)(1) to provide that a bid or offer will have price priority over another bid or offer only if its price exceeds the price of the other bid or offer by the MPV. The Exchange is proposing to add commentary .06 to PCX Rule 7.41(b) to clarify that for the purposes of the rule, the term "closest trading differential" means the MPV. In addition, the Exchange is proposing to add Commentary .01 to PCX Rule 7.29(a) to clarify that for purposes of the rule, the term "price improvement" means an improvement in price by at least the MPV. The Exchange is also proposing to amend Rule 7.66 to conform the rule to recent amendments to the ITS Plan. Finally, the remaining proposed changes add a decimal reference to Rule 7.12(b), Commentary .05, Rule 7.66(b)(8)(i)(A)(1), and Rule 7.79(e) to supplement the existing fractional references.

#### Options Trading Rules

PCX Rule 6.37(b)(1) currently specifies the maximum bid/ask spread differentials that an options market maker is permitted to create in the course of maintaining a fair and orderly market.<sup>9</sup> The Exchange is proposing to amend this rule to provide the bid/ask spread differentials in decimals. In addition, the Exchange is proposing to amend PCX Rule 6.37(b)(3) and Commentary .10, Rule 6.75, Commentaries .02-.03, Rule 6.80, Commentary .01, Rule 8.102(f), and Rule

<sup>7</sup> The Plan provides for MPVs for equities and options of no less than one cent. The Order requires the Participants to submit joint or individual studies two months after Full Implementation (as defined in the Plan) regarding the impact of decimal pricing on systems capacity, liquidity, and trading behavior, including an analysis of whether there should be a uniform minimum quoting increment. If a Participant wishes to move to quoting in an increment of less than one cent, the Participant should include in its study a full analysis of the potential impact of such trading on the Participant's market and the markets as a whole. Within thirty days after submitting the study, and absent Commission action, the Participants individually must submit for notice, comment, and Commission action, proposed rule changes under Section 19(b) of the Exchange Act to establish their individual choice of minimum increments by which equities or options are quoted on their respective markets.

<sup>8</sup> See Amendment No. 1, *supra* n.6.

<sup>9</sup> For example, if a market maker's bid price is between \$2 and \$5, the maximum difference between that bid price and the corresponding offering price will be  $\frac{1}{2}$  of \$1 (*i.e.*, \$.40).

<sup>11</sup> 17 CFR 200.30-3(a)(12).

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

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

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

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> The Commission agreed to waive the 5-day pre-filing notice requirement. The Commission also finds good cause to waive the 30-day pre-operative waiting period. See Rule 19b-4(f)(6)(iii). 17 CFR 240.19b-4(f)(6)(iii).

<sup>6</sup> See Letter dated August 24, 2000, from Hassan Abedi, Attorney, Regulatory Policy, PCX, to Nancy Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission ("Amendment No. 1"). Amendment No. 1 clarifies that the Exchange is prohibited from changing the minimum price variation for securities pricing in decimals while the Decimals Implementation Plan submitted to the Commission on July 24, 2000 is in effect. Amendment No. 1 also withdraws proposed amendments to PCX Rule 7.40, governing short sales, and clarifies that the minimum price variation for SPDRs and MidCap SPDRs trading in decimals will be \$.01. In addition, Amendment No.