

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51223; File No. SR-NASD-2005-010]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 To Modify Restrictions on Computer-Generated Quoting

February 17, 2005.

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 January 25, 2005, the National Association of Securities Dealers, Inc. ("NASD"), through its 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. Nasdaq filed the proposal as a "non-controversial" rule change 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. On February 16, 2005, the Exchange filed Amendment No. 1 to the proposal. 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

Nasdaq proposes to amend NASD Rules 4705 and IM-4613 to modify restrictions on autoquoting and computer-generated quoting of Nasdaq-listed stocks. Nasdaq will implement the proposed rule change 30 days after the date of its filing.

The text of the proposed rule change is available on the Nasdaq's Web site <http://www.nasdaq.com>, at the Nasdaq's Office of the Secretary, and at the Commission's Public Reference Room.

#### 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

Nasdaq is proposing to amend its rules governing autoquoting and computer-generated quoting (collectively, "CGQ")<sup>5</sup> in Nasdaq-listed stocks to provide market participants with greater latitude in using technology to manage their quotation activity. The limitations contained in IM-4613 were originally implemented due to capacity and operational constraints that no longer exist. The Commission recently approved Nasdaq's proposal to remove restrictions on CGQ in exchange-listed securities.<sup>6</sup> In a similar vein, this proposed rule change will eliminate member filing requirements that are currently associated with CGQ in Nasdaq-listed securities. Market participants have developed sophisticated systems that generate quote updates through automated means. In many cases, these systems reflect trading strategies in which quoted prices are based on several factors, such as the last sale, bids, offers, and sizes of stocks, futures, and options, and statistically derived relationships among these instruments. IM-4613 currently interprets Rule 4613, which governs quotation activity in Nasdaq, to allow CGQ only under certain conditions. In light of substantial experience administering the restrictions of the current rule, Nasdaq has concluded that the conditions currently imposed upon CGQ are unnecessary, and should be replaced with a flexible rule allowing Nasdaq to impose temporary restrictions on CGQ if Nasdaq determines that they are necessary to protect the integrity of Nasdaq's systems.

<sup>5</sup> IM-4613 currently defines "autoquoting" as the use of any system that "track[s] changes to the inside quotation in Nasdaq and automatically react[s] by generating another quote to keep the market maker's quote away from the best market" and defines "computer-generated quoting" as "effecting, without a physical entry, a quote update that is not designed to keep a \* \* \* quote away from the Nasdaq and/or national best bid/best offer." For the sake of simplicity, the term "CGQ" is used in this filing to refer to all forms of automated entry or updating of quotes or orders.

<sup>6</sup> Securities Exchange Act Release No. 50683 (November 17, 2004), 69 FR 68204 (November 23, 2004) (SR-NASD-2004-107).

IM-4613 provides that a market maker must request approval to engage in CGQ by submitting an application to Nasdaq, and must update its application to reflect subsequent changes. In 2003, Nasdaq streamlined the approval process by allowing firms to proceed with CGQ after providing five days' notice, unless Nasdaq specifically rejects or imposes conditions upon a firm's application.<sup>7</sup> Because the capacity of Nasdaq systems is well in excess of current and foreseeable quoting and trading volumes, however, Nasdaq has not found occasion to reject or condition approval of any firm's application. Moreover, Nasdaq has found that the information provided through the applications and their updates is less useful to a technical understanding of firms' CGQ activity than ongoing personal contact between Nasdaq and programmers and traders at the firms that engage in CGQ. Accordingly, Nasdaq has concluded that the requirement to file and update the application imposes an unwarranted paperwork burden on firms and should be eliminated.

Moreover, Nasdaq believes that the provision of IM-4613 that restricts CGQ at prices away from the inside market is now unnecessary in light of Nasdaq's capacity and the fully automated nature of the Nasdaq market. Quotes at prices away from the inside market are regularly executed by orders that "sweep the book," and therefore such quotes offer liquidity at prices acceptable to the market participants that enter orders accessing them.<sup>8</sup> Moreover, since the Nasdaq Market Center allows market participants to establish quotes at multiple levels, Nasdaq believes that market participants with multiple quotes should be permitted to use automation to manage their quotes away from the inside market as well as their quotes at the inside market.

Nasdaq notes, however, that IM-4613 contains an important safeguard, in that it allows Nasdaq to restrict or impose conditions on CGQ by one firm or multiple firms in order to protect the integrity of Nasdaq's systems if necessary. Although Nasdaq has not had occasion to use this authority and, consistent with the reduced restrictions

<sup>7</sup> Securities Exchange Act Release No. 48274 (August 1, 2003), 68 FR 47119 (August 7, 2003) (SR-NASD-2003-102).

<sup>8</sup> Nasdaq notes, however, that Rule 4613(c) continues to require that a market maker's quotations be reasonably related to the prevailing market. Accordingly, a market maker whose quotation is so far away from the inside market as to preclude an execution against the quote may be required to re-enter its quotations under the rule and may be suspended if it fails to do so.

<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).

on CGQ reflected in this rule change, Nasdaq does not currently foresee circumstances that would require its use, nevertheless Nasdaq believes that this authority should be retained with appropriate modifications to ensure that Nasdaq has the flexibility to respond to exigent circumstances. Specifically, Nasdaq proposes to adopt a new paragraph in Rule 4705, which governs the general terms and conditions of participation in the Nasdaq Market Center, to provide that Nasdaq may impose upon any Nasdaq Market Center Participant such temporary restrictions upon the automated entry or updating of orders or Quotes/Orders as Nasdaq may determine to be necessary to protect the integrity of Nasdaq's systems. Thus, the modified rule would be broader than the current rule in several respects. First, it would recognize that order entry and updating, like quotation entry and updating, can be automated, and that a rule allowing the restriction of automated activity should not reflect an artificial distinction between these two forms of interaction with the market. Second, the modified rule would apply to all Nasdaq Market Center Participants, whether market makers, electronic communications networks, or order entry firms, in recognition of the fact that automated activity is not limited to market makers, and would apply to both Nasdaq-listed and exchange-listed securities. The modified rule would be narrower, however, in that it contemplates only such temporary restrictions on automated activity as may be necessary to address, for example, a system problem at a particular firm or an unexpected period of extremely high message traffic. Although the rule does not define temporary, it would be Nasdaq's intent to file a proposed rule change to impose a permanent restriction on a particular aspect of automated activity if it appeared that the circumstances giving rise to a particular restriction could not be mitigated within a one-month period. Any temporary restriction imposed will be communicated to affected participants in writing, to ensure that the market participants have a clear understanding of the scope of the restriction and to provide a clear record in the event that a market participant seeks review of the restriction.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A of the Act,<sup>9</sup> in general and with Section 15A(b)(6) of

the Act,<sup>10</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, remove impediments to a free and open market and a national market system, and, in general, to protect investors and the public interest. Easing restrictions on CGQ will allow market participants to make greater use of automation in establishing their quotations, which should enhance the price discovery process and allow members to increase the number of stocks in which they are registered as market makers. At the same time, Nasdaq's retained authority to impose restrictions on CGQ will allow Nasdaq to address any temporary system problems that may arise. The proposed rule change will also remove certain paperwork burdens that are currently imposed upon market makers engaging in CGQ.

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

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

### C. 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

Because the foregoing rule change, as amended, does not:

- (i) Significantly affect the protection of investors or the public interest;
- (ii) Impose any significant burden on competition; and
- (iii) Does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective<sup>11</sup> pursuant to Section 19(b)(3)(A) of the Act<sup>12</sup> and Rule 19b-4(f)(6) thereunder.<sup>13</sup>

At any time within 60 days of the filing of the proposed rule change, as amended, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of

investors, or otherwise in furtherance of the purposes of the Act.<sup>14</sup>

## 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. Comments may be submitted by any of the following methods:

### Electronic Comments

- Use the Commission's Internet comment form <http://www.sec.gov/rules/sro.shtml>; or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-NASD-2005-010 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2005-010. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Web site (<http://www.sec.gov/rules/sro.shtml>). 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 also will be available for inspection and copying at the principal office of Nasdaq. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2005-010 and should be submitted on or before March 18, 2005.

<sup>9</sup> 15 U.S.C. 78o-3(b)(6).

<sup>11</sup> Nasdaq provided the Commission with notice of its intent to file the proposed rule change at least five days prior to the filing date.

<sup>12</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>13</sup> 17 CFR 240.19b-4(f)(6).

<sup>14</sup> For purposes of calculating the 60-day abrogation period, the Commission considers the proposed rule change to have been filed on February 16, 2005, when Amendment No. 1 was filed.

<sup>9</sup> 15 U.S.C. 78o-3.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

Margaret H. McFarland,

Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51225; File No. SR-NASD-2005-020]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. To Modify Pricing for Non-Members Using Nasdaq's Brut Facility

February 17, 2005.

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 February 1, 2005, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by Nasdaq. Nasdaq has 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. 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

Nasdaq proposes to modify the pricing for non-members using Nasdaq's Brut Facility. Nasdaq proposes to implement the proposed rule change on February 1, 2005. The text of the proposed rule change is available on the NASD's Web site (<http://www.nasd.com>), at the NASD's Office of the Secretary, and at the Commission's Public Reference Room.

#### 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

*Consolidation of Fee Schedule for Nasdaq Market Center and Brut Facility.* In November 2004, Nasdaq established a uniform fee schedule for transactions in Nasdaq-listed securities through the Nasdaq Market Center and Nasdaq's Brut Facility.<sup>5</sup> In SR-NASD-2005-019, Nasdaq proposed a uniform fee schedule for NASD members executing transactions in exchange-listed securities through the Nasdaq Market Center and Nasdaq's Brut Facility.<sup>6</sup> Nasdaq is now proposing to make the uniform fee schedule applicable to non-members trading through Nasdaq's Brut Facility.

Nasdaq states that, as is currently true for the Nasdaq Market Center, there will be no order specific charges or credits associated with orders to buy or sell exchange-listed securities other than exchange-traded funds listed on the American Stock Exchange ("Amex-listed ETFs"), although Nasdaq is introducing a fee of \$0.004 per share executed for orders that are routed by Brut using an exchange's proprietary order delivery system (such as the New York Stock Exchange's SuperDOT system). Moreover, as of February 1, 2005, Amex-listed ETFs will be subject to the same tiered fee schedule as Nasdaq-listed securities. As a result, market participants' combined volume in Nasdaq-listed securities and Amex-listed ETFs in both the Nasdaq Market Center and Brut will be considered when determining each market participants' fees for orders in Nasdaq-listed securities and Amex-listed ETFs. In conjunction with this change, the fee

schedule is also being clarified by moving transaction charges for exchange-listed securities from NASD Rule 7010(d) to NASD Rule 7010(i) and by clarifying that the fee schedule in NASD Rule 7010(i)(1) applies to Nasdaq-listed securities subject to the Nasdaq UTP Plan. Thus, as provided by NASD Rule IM-4400, the fees associated with dually listed securities that are subject to the Consolidated Quotation Service and Consolidated Tape Association national market system plans are the fees for exchange-listed securities, rather than Nasdaq-listed securities. Moreover, the proposed rule change provides that executions in exchange-listed securities against a market participants' own quote or order are subject to the same fees as other transactions; currently, all such executions are free in the Nasdaq Market Center.

*Routing Fees.* Nasdaq is also proposing to modify the fees for orders that are routed from the Nasdaq Brut Facility to other market centers. Fees are based upon multiple volume-based usage tiers that take account of the combined Nasdaq Market Center and Brut volume of a market participant. According to Nasdaq, in the past, a market participants' volume of liquidity provision in Nasdaq-listed securities has determined the tiers to which a market participant was assigned. As discussed above, volume in Amex-listed ETFs will now also be considered in making this volume determination. Moreover, Nasdaq is proposing several modifications to the routing fee schedule. First, the tiers to which a market participant is assigned will now be based in part upon the volume of shares on the Nasdaq Market Center and Brut books that are accessed during a month and the volume of shares routed, as well as the volume of liquidity provided. Moreover, a new tier with a routing charge of \$0.0025 per share executed will be established. Second, orders that are routed outside of both the Nasdaq Market Center and Brut without first attempting to execute against the Brut book (*i.e.*, "Thru Brut orders") will not be counted in determining the routing tier for which a market participant qualifies, and will be assessed a routing charge of \$0.004 per share executed.<sup>7</sup> For other orders, the

<sup>7</sup> Orders routed by Brut to the Nasdaq Market Center would not be assessed the routing charge, but would be assessed Nasdaq's normal execution charge, if executed. Telephone conversation between John Yetter, Associate General Counsel, Nasdaq, and Marc McKayle, Special Counsel, Division of Market Regulation ("Division"), Commission, and David Liu, Attorney, Division, Commission, on February 17, 2005.

<sup>15</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> See Securities Exchange Act Release No. 50670 (November 16, 2004), 69 FR 67979 (November 22, 2004) (SR-NASD-2004-167); Securities Exchange Act Release No. 50787 (December 2, 2004), 69 FR 71459 (December 9, 2004) (SR-NASD-2004-170).

<sup>6</sup> See SR-NASD-2005-019 (February 1, 2005).