

facilitate a smooth Year 2000 transition.¹⁰

MBSCC has functioned effectively as a registered clearing agency for over ten years. Accordingly, in light of MBSCC's past performance and the need for continuity in the services MBSCC provides to its participants, the Commission believes that it is necessary and appropriate in the public interest and for the prompt and accurate clearance and settlement of securities transactions to extend MBSCC's temporary registration through March 31, 2001. During this temporary registration period, the Commission anticipates that it will act on MBSCC's application for permanent registration. Any comments received during MBSCC's temporary registration will be considered in conjunction with the Commission's review of MBSCC's request for permanent registration as a clearing agency under Section 17A of the Act.¹¹

Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments with respect to whether the Commission should grant MBSCC permanent registration as a clearing agency. 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 request for permanent registration as a clearing agency that are filed with the Commission, and all written communications relating to the extension between the Commission and any person, other than those that may be withheld from the public in accordance with 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of MBSCC. All submissions should refer to File No. 600-22 and should be submitted by April 20, 2000.

Conclusion

It is therefore ordered pursuant to Sections 17A(b) and 19(a) of the Act that MBSCC's temporary registration as a clearing agency (File No. 600-22) be and hereby is extended through March 31, 2001.

¹⁰ Securities Exchange Act Release No. 41910 (September 23, 1999), 64 FR 52816.

¹¹ 15 U.S.C. 78q-1.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42573; File No. SR-NASD-99-53]

Self-Regulatory Organizations; Notice of Filing of Amendment No. 4 to Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to the Establishment of Nasdaq Order Display Facility and to Modifications of the Nasdaq Trading Platform

March 23, 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 March 23, 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") Amendment No. 4 to the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. The proposed rule change and Amendment Nos. 1 and 2 were published for comment in the **Federal Register** on December 6, 1999.³ On March 16, 2000, Nasdaq filed Amendment No. 3 to the proposal.⁴ The Commission is publishing this notice to solicit comments on Amendment No. 4 to the proposed rule change from interested persons.⁵

¹² 17 CFR 200.30-3(a)(16).

¹⁵ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 42166 (Nov. 22, 1999), 64 FR 69125.

⁴ See letter from Richard G. Ketchum, President, NASD, to Belinda Blaine, Associate Director, Division of Market Regulation ("Division"), Commission (March 15, 2000) ("Amendment No. 3"). In Amendment No. 3, the NASD responded to comment letters and submitted substantive, clarifying, and technical amendments to the proposal.

⁵ This 19b-4 filing, representing Amendment No. 4 to SR-NASD-99-53, reflects the substantive amendments proposed in Amendment No. 3 to the filing, and contains some technical changes and clarifying information that the Commission has requested.

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

Nasdaq and the NASD propose the following amendments in response to comment letters submitted to the Commission regarding the proposal as originally noticed. The amended rule language is as follows:⁶

Proposed additions are *italicized* and proposed deletions are placed in [brackets].

4720. SelectNet Service—Deleted

* * * * *

4611. Registration as a Nasdaq Market Maker

(a)–(e) No Change.

(f) Unless otherwise specified by the Association, each Nasdaq market maker that is registered as a market maker in a Nasdaq[National Market security]-*listed security* shall also at all times be registered as a market maker in the Nasdaq National Market Execution System (NNMS) with respect to that security and be subject to the NNMS Rules as set forth in the Rule 4700 Series. [Participation in the Small Order Execution System (SOES) shall be voluntary for any Nasdaq market maker registered to make a market in a Nasdaq SmallCap security.]

(g) No Change.

* * * * *

4613. Character of Quotations

(a) Two-Sided Quotations

(1) For each security in which a member is registered as a market maker, the member shall be willing to buy and sell such security for its own account on a continuous basis and shall enter and maintain a two-sided quotation[s] (*"Principal Quote"*), which is attributed to the market maker by a special maker participant identifier (*"MMID"*) and is displayed in the *Nasdaq Quotation Montage* [in The Nasdaq Stock Market] at all times, subject to the procedures for excused withdrawal set forth in Rule 4619.

(A) A registered market maker in a *Nasdaq-listed security* [listed on The Nasdaq Stock Market] must display a

⁶ The amended rule language contained in this notice reflects the Commission's recent approval of SR-NASD-99-11, regarding the establishment of the Nasdaq National Market System ("NNMS"). See Securities Exchange Act Release No. 42344 (January 14, 2000), 65 FR 3987 (January 25, 2000) (Order for File No. SR-NASD-99-11 functionally integrating the Small Order Execution System ("SOES") and SelectNet system to become the foundation of the NNMS.) In addition, the amended rule language replaces, in the entirety, the rule language contained in the original filing, as well as Amendment Nos. 1, 2 and 3.

quotation size for at least one normal unit of trading (or a larger multiple thereof) when it is not displaying a limit order in compliance with SEC Rule 11Ac1-4, provided, however, that a registered market maker may augment its displayed quotation size to display limit orders priced at the market maker's quotation. *Unless otherwise designated, a "normal unit of trading" shall be 100 shares.*

(2) No Change.

(b) Agency Quote—Amendments Pending Pursuant to SR-NASD-99-09.

(c)-(e) No Change.

IM-4613. Autoquote Policy—No Change

4618. Clearance and Settlement

(a)-(b) No Changes.

(c) All transactions through the facilities of the Nasdaq National Market Execution System[, SOES, and SelectNet services] shall be cleared and settled through a registered clearing agency using a continuous net settlement system.

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4619. Withdrawal of Quotations and Passive Market Making

(a)-(b) No Change.

(c) Excused withdrawal status may be granted to a market maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency and is withdrawn from participation in the Automated Confirmation Transaction service, thereby terminating its registration as a market maker in Nasdaq issues. Provided however, that if the Association finds that the market maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused pursuant to Rule 4620[, the Rules for the Small Order Execution System, as set forth in the Rule 4750 Series,] and the Rule 4700 Series governing the Nasdaq National Market Execution System.

(d) No Change.

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4620. Voluntary Termination of Registration

(a) A market maker may voluntarily terminate its registration in a security by withdrawing its *Principal* [quotations] *Quote* from The Nasdaq Stock Market. A market maker that voluntarily terminates its registration in a security may not re-register as a market maker in that security for twenty (20) business days. Withdrawal from participation as a market maker in a Nasdaq [National Market]-listed security in the Nasdaq National Market Execution System shall

constitute termination of registration as a market maker in that security for purposes of this Rule; provided, however, that a market maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency and is withdrawn from participation in the Automated Confirmation Transaction System and thereby terminates its registration as a market maker in Nasdaq-listed [National Market and SmallCap] issues may register as a market maker at any time after a clearing arrangement has been reestablished and the market maker has complied with ACT participant requirements contained in Rule 6100.

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4632. Transaction Reporting

(a)-(d) No Change.

(e) Transactions Not Required To Be Reported.

The following types of transactions shall not be reported:

(1) transactions executed through the Computer Assisted Execution System (CAES), or the facilities of the Nasdaq National Market Execution System ("NNMS"), or the SelectNet service];

(2)-(6) No Change.

(f) No Change.

4642. Transaction Reporting

(a)-(d) No Change.

(e) Transactions Not Required To Be Reported.

The following types of transactions shall not be reported:

(1) Transactions executed through the Computer Assisted Execution System (CAES); the Small Order Execution System (SOES) or the SelectNet service] or facilities of the Nasdaq National Market Execution System ("NNMS").

(2)-(5) No Change.

(f) No Change.

* * * * *

4700. NASDAQ NATIONAL MARKET EXECUTION SYSTEM (NNMS)

4701. Definitions—*Unless stated otherwise, the terms described below shall have the following meaning.*

[(d)] (a) The term "active NNMS securities" shall mean those NNMS eligible securities in which at least one NNMS Market Maker is currently active in NNMS.

[(i)] (b) The term "Agency Quote" shall mean the quotation that a registered NNMS Market Maker is permitted to display pursuant to the requirements of NASD Rule 4613(b).

(c) The term "Attributable Quote/Order" shall have the following meaning:

(i) For NNMS Market Makers and NNMS ECNs, a bid or offer Quote/Order that is designated for display (price and size) next to the participant's MMID in the Nasdaq Quotation Montage once such Quote/Order becomes the participant's best attributable bid or offer.

(ii) For UTP Exchanges, the best bid and best offer quotation with price and size that is transmitted to Nasdaq by the UTP Exchange, which is displayed next to the UTP Exchange's MMID in the Nasdaq Quotation Montage.

[(h)] (d) The term "Automated Confirmation Transaction" service or "ACT" shall mean the automated system owned and operated by The Nasdaq Stock Market, Inc. which compares trade information entered by ACT Participants and submits "locked-in" trades to clearing.

[(g)] (e) The term "automatic refresh size" shall mean the default size to which an NNMS Market Maker's quote will be refreshed pursuant to NASD Rule 4710(b)(2), if the market maker elects to utilize the Quote Refresh Functionality and does not designate to Nasdaq an alternative refresh size. The [maximum] automatic refresh size default [size] shall be 1,000 shares.

(f) The term "Directed Order" shall mean an order that is entered into the system by an NNMS participant that is directed to a particular Quoting Market Participant.

(g) The term "Displayed Quote/Order" shall mean both Attributable and Non-Attributable (as applicable) Quotes/Orders transmitted to Nasdaq by Quoting Market Participants.

(h) The term "Firm Quote Rule" shall mean SEC Rule 11Ac1-1.

(i) The term "Liability Order" shall mean an order that when delivered to a Quoting Market Participant imposes an obligation to respond to such order in a manner consistent with the Firm Quote Rule.

(j) The term "limit order" shall mean an order to buy or sell a stock at a specified price or better.

(k) The term "market order" shall mean an unpriced order to buy or sell a stock at the market's current best price.

(l) The term "marketable limit order" shall mean a limit order that, at the time it is entered into the NNMS, if it is a limit order to buy, is priced at the current inside offer or higher, or if it is a limit order to sell, is priced at the inside bid or lower.

(m) The term "mixed lot" shall mean an order that is for more than a normal unit of trading but not a multiple thereof.

(n) The term "Non-Attributable Quote/Order" shall mean a bid or offer Quote/Order that is entered by a Nasdaq Quoting Market Participant and is designated for display (price and size) on an anonymous basis in the Nasdaq Order Display Facility.

(o) The term "Non-Directed Order" shall mean an order that is entered into the system by an NNMS participant and is not directed to any particular Quoting Market Participant.

(p) The term "Non-Liability Order" shall mean an order that when delivered to a Quoting Market Participant imposes no obligation to respond to such order under the Firm Quote Rule.

[(a)] (q) The term "Nasdaq National Market Execution System," [or] "NNMS," or "system" shall mean the automated system owned and operated by The Nasdaq Stock Market, Inc. which enables NNMS Participants to execute transactions in active NNMS authorized securities; to have reports of the transactions automatically forwarded to the National Market Trade Reporting System, if required, for dissemination to the public and the industry, and to "lock in" these trades by sending both sides to the applicable clearing corporation(s) designated by the NNMS Participant(s) for clearance and settlement; and to provide NNMS Participants with sufficient monitoring and updating capability to participate in an automated execution environment.

[(c)] (r) The term "NNMS eligible securities" shall mean designated Nasdaq-listed [National Market (NNM)] equity securities.

(s) The term "NNMS ECN" shall mean a member of the Association that meets all of the requirements of NASD Rule 4623, and that participates in the NNMS with respect to one or more NNMS eligible securities.

(i) The term "NNMS Auto-Ex ECN" shall mean an NNMS ECN that participates in the automatic-execution functionality of the NNMS system, and accordingly executes Non-Directed Orders via automatic execution for the purchase or sale of an active NNMS security at the Nasdaq inside bid and/or offer price.

(ii) The term "NNMS Order-Delivery ECN" shall mean an NNMS ECN that participates in the order-delivery functionality of the NNMS system, accepts delivery of Non-Directed Orders, and provides an automated execution of Non-Directed Orders (or an automated rejection of such orders if the price is no longer available) for the purchase or sale of an active NNMS security at the Nasdaq inside bid and/or offer price.

[(b)] (t) The term "NNMS Market Maker" shall mean a member of the

Association that is registered as a Nasdaq Market Maker and as a Market Maker for purposes of participation in NNMS with respect to one or more NNMS eligible securities, and is currently active in NNMS and obligated to execute orders through the automatic-execution functionality of the NNMS system for the purchase or sale of an active NNMS security at the Nasdaq inside bid and/or [ask] offer price.

[(e)] (u) The terms "NNMS Participant" shall mean [either] an NNMS Market Maker, NNMS ECN, UTP Exchange, or NNMS Order Entry Firm registered as such with the Association for participation in NNMS.

[(f)] (v) The term "NNMS Order Entry Firm" shall mean a member of the Association who is registered as an Order Entry Firm for purposes of participation in NNMS which permits the firm to enter orders [of limited size] for execution against NNMS Market Makers.

(w) The term "Nasdaq Quotation Montage" shall mean the portion of Nasdaq WorkStation presentation that displays for a particular stock two columns (one for bid, one for offer), under which is listed in price/time priority the MMIDs for each NNMS Market Maker, NNMS ECN, and UTP Exchange registered in the stock and the corresponding quote (price and size) next to the related MMID.

(x) The term "Nasdaq Quoting Market Participant" shall include only the following: (1) NNMS Market Makers; or (2) NNMS ECNs.

(y) The term "odd-lot order" shall mean an order that is for less than a normal unit of trading.

(z) The term "Quote/Order" shall mean a single quotation or shall mean an order or multiple orders at the same price submitted to Nasdaq by a Nasdaq Quoting Market Participant that is displayed in the form of a single quotation. When this term is used in connection with a UTP Exchange, it shall mean the best bid and/or the best offer quotation transmitted to Nasdaq by the UTP Exchange.

(aa) The term "Quoting Market Participant" shall include any of the following: (1) NNMS Market Makers; (2) NNMS ECNs; and (3) UTP Exchange Specialists.

(bb) The term "Reserve Size" shall mean the system-provided functionality that permits a Nasdaq Quoting Market Participant to display in its Displayed Quote/Order part of the full size of a proprietary or agency order, with the remainder held in reserve on an undisplayed basis to be displayed in

whole or in part after the displayed part is executed.

(cc) The term "Nasdaq Order Display Facility" shall mean the portion of Nasdaq WorkStation presentation that displays without attribution to particular Quoting Market Participant's MMID the three best price levels in Nasdaq on both the bid and offer side of the market and the aggregate size of Attributable and Non-Attributable Quotes/Orders at each price level.

(dd) The term "UTP Exchange" shall mean any registered national securities exchange that has unlisted trading privileges in Nasdaq National Market securities pursuant to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination Of Quotation and Transaction Information For Exchange-Listed Nasdaq/National Market System Securities Traded On Exchanges On An Unlisted Trading Privilege Basis ("Nasdaq UTP Plan").

4705. NNMS Participant Registration

(a) Participation in NNMS as an NNMS Market Maker requires current registration as such with the Association. Such registration shall be conditioned upon the NNMS Market Maker's initial and continuing compliance with the following requirements:

(1) execution of an NNMS Participant application agreement with the Association;

(2) membership in, or access arrangement with, a clearing agency registered with the Commission which maintains facilities through which NNMS compared trades may be settled;

(3) registration as a market maker in The Nasdaq Stock Market pursuant to the Rule 4600 Series and compliance with all applicable rules and operating procedures of the Association and the Commission;

(4) maintenance of the physical security of the equipment located on the premises of the NNMS Market Maker to prevent the improper use or access to Nasdaq systems, including unauthorized entry of information into NNMS; and

(5) Acceptance and settlement of each NNMS trade that NNMS identifies as having been effected by such NNMS Market Maker, or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified NNMS trade by the clearing member on the regularly scheduled settlement date.

(b) Pursuant to Rule 4611(f), participation as an NNMS Market Maker is required for any Nasdaq market maker

registered to make a market in an NNMS security.

(c) Participation in NNMS as an NNMS Order Entry Firm requires current registration as such with the Association. Such registration shall be conditioned upon the NNMS Order Entry Firm's initial and continuing compliance with the following requirements:

(1) execution of an NNMS Participant application agreement with the Association;

(2) membership in, or access arrangement with, a clearing agency registered with the Commission which maintains facilities through which NNMS compared trades may be settled;

(3) compliance with all applicable rules and operating procedures of the Association and the Securities and Exchange Commission;

(4) maintenance of the physical security of the equipment located on the premises of the NNMS Order Entry Firm to prevent the improper use or access to Nasdaq systems, including unauthorized entry of information into NNMS; and

(5) acceptance and settlement of each NNMS trade that NNMS identifies as having been effected by such NNMS Order Entry Firm or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified NNMS trade by the clearing member on the regularly scheduled settlement date.

(c) Participation in NNMS as an NNMS ECN requires current registration as an NASD member and shall be conditioned upon the following:

(1) the execution of an NNMS Participant application agreement with the Association.

(2) compliance with all requirements in NASD Rule 4623 and all other applicable rules and operating procedures of the Association and the Securities and Exchange Commission;

(3) membership in, or access arrangement with, a clearing agency registered with the Commission which maintains facilities through which NNMS compared trades may be settled;

(4) maintenance of the physical security of the equipment located on the premises of the NNMS ECN to prevent the improper use or access to Nasdaq systems, including unauthorized entry of information into NNMS; and

(5) acceptance and settlement of each trade that is executed through the facilities of the NNMS, or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified NNMS trade by the clearing member on the regularly scheduled settlement date.

[(d)] (e) The registration required hereunder will apply solely to the qualification of an NNMS Participant to participate in NNMS. Such registration shall not be conditioned upon registration in any particular eligible or active NNMS securities.

[(e)] (f) Each NNMS Participant shall be under a continuing obligation to inform the Association of noncompliance with any of the registration requirements set forth above.

(g) The Association and its subsidiaries shall not be liable for any losses, damages, or other claims arising out of the NNMS or its use. Any losses, damages, or other claims, related to a failure of the NNMS to deliver, display, transmit, execute, compare, submit for clearance and settlement, or otherwise process an order, Quote/Order, message, or other data entered into, or created by, the NNMS shall be absorbed by the member, or the member sponsoring the customer, that entered the order, Quote/Order, message, or other data into the NNMS.

4706 Order Entry Parameters

(a) Non-Directed Orders—An NNMS Participant may enter a Non-Directed Order into the NNMS in order to access the best bid/best offer as displayed in Nasdaq. A Non-Directed Order must be a market or marketable limit order, must be a round lot or a mixed lot, and must indicate whether it is a short sale, short-sale exempt, or long sales. If after entry but before delivery, a Non-Directed Order becomes non-marketable, the system will hold the order for 90 seconds, after which the order will be returned to the NNMS participant entering the order. The system will not process a Non-Directed Order to sell short if the execution of such order would violate NASD Rule 3350. Limit orders may be entered into the system prior to the market's open, but will be held in queue, and if not marketable on the open, will be returned to the participant entering the order. Non-Directed Orders will be processed as described in Rule 4170(b). The NNMS shall not accept Non-Directed Orders that are All-or-None or have a minimum size of execution.

(b) Directed Orders—A participant may enter a Directed Order into the NNMS to access a specific Attributable Quote/Order displayed in the Nasdaq Quotation Montage. A Directed Order must be a Non-Liability Order, and as such, at the time of order entry must be designated as: (i) an "All-or-None" order ("AON") that is at least one normal unit of trading (e.g., 100 shares) in excess of the Attributable Quote/

Order of the Quoting Market Participant to which the order is directed; or (ii) a "Minimum Acceptable Quantity" order ("MAQ"), with a MAQ value of at least one normal unit of trading in excess of Attributable Quote/Order of the Quoting Market Participant to which the order is directed. A Directed Order may have a time in force of 1 to 99 minutes.

(c) Entry of Agency and Principal Orders—NNMS Participants are permitted to enter into the NNMS both agency and principal orders for delivery and execution processing.

(d) Order Size—Any round or mixed lot order up to 999,999 shares may be entered into the NNMS for normal execution processing. Odd-lot orders, and the odd-lot portion of a mixed lot, are subject to a separate execution process, as described in Rule 4710(e).

(e) Open Quotes—The NNMS will only deliver an order or an execution to a Quoting Market Participant if that participant has an open quote.

(f) Odd-Lot Orders—The system will accept odd-lot orders for processing through a separate facility. Odd-lot orders must be Non-Directed Orders, and may be market, marketable limit or limit orders. The system shall accept odd-lot orders at a rate no faster than one order per/second from any single participant. Odd-lot orders, and the odd-lot portion of a mixed lot order, shall be processed as described in Rule 4170(e).

4707 Entry and Display of Quotes/Orders

(a) Entry of Quotes/Orders—Nasdaq Quoting Market Participants may enter Quotes/Orders into the NNMS subject to the following requirements and conditions:

(1) Nasdaq Quoting Market Participants shall be permitted to transmit to the NNMS multiple principal and agency Quotes/Orders at a single as well as multiple price levels. Such Quote/Order shall indicate whether its is an "Attributable Quote/Order" or "Non-Attributable Quote/Order," and the amount of Reserve Size (if applicable).

(2) Upon entry of a Quote/Order into the system, the NNMS shall time-stamp it, which time-stamp shall determine the ranking of the Quote/Order for purposes of processing Non-Directed Orders as described in Rule 4710(b).

(3) Consistent with Rule 4613, an NNMS Market Maker is obligated to maintain a two-sided Attributable Quote/Order (other than an Agency Quote) at all times, for at least one normal unit of trading.

(4) Nasdaq Quoting Market Participants may continue to transmit to

the NNMS only their best bid and best offer Attributable Quotes/Orders. Notwithstanding NASD Rule 4613 and subparagraph (a)(1) of this rule, nothing in these rules shall require a Nasdaq Quoting Market Participant to transmit to the NNMS multiple Quotes/Orders.

(b) *Display of Quotes/Orders in Nasdaq*—The NNMS will display a Nasdaq Quoting Market Participant's Quotes/Orders as follows:

(1) *Attributable Quotes/Orders*—The price and size of a Nasdaq Quoting Market Participant's best priced Attributable Quote/Order on both the bid and offer side of the market will be displayed in the Nasdaq Quotation Montage under the Nasdaq Quoting Market Participant's MMID, and also will be displayed in the Nasdaq Order Display Facility as part of the aggregate trading interest at a particular price when the price of such Attributable Quote/Order falls within the best three price levels in Nasdaq on either side of the market. Upon execution or cancellation of the Nasdaq Quoting Market Participant's best-priced Attributable Quote/Order on a particular side of the market, the NNMS will automatically display the participant's next best Attributable Quote/Order on that side of the market.

(2) *Non-Attributable Quotes/Orders*—The price and size of a Nasdaq Quoting Market Participant's Non-Attributable Quote/Order on both the bid and offer side of the market will be displayed in the Nasdaq Order Display Facility as part of the aggregate trading interest at a particular price when the price of such Non-Attributable Quote/Order falls within the best three price levels in Nasdaq on either side of the market. A Non-Attributable Order will not be displayed in the Nasdaq Quotation Montage under the Nasdaq Quoting Market Participant's MMID. Non-Attributable Quotes/Orders that are the best priced Non-Attributable bids or offers in the system will be displayed in the Nasdaq Quotation Montage under an anonymous MMID, which shall represent and reflect the aggregate size of all Non-Attributable Quotes/Orders in Nasdaq at that price level. Upon execution or cancellation of a Nasdaq Quoting Market Participant's Non-Attributable Quote/Order, the NNMS will automatically display a Non-Attributable Quote/Order in the Nasdaq Order Display Facility (consistent with the parameters described above) if it falls within the is within the best three price levels in Nasdaq on either side of the market.

(c) *Reserve Size*—Reserve Size shall not be displayed in Nasdaq, but shall be

electronically accessible as described in Rule 4710(b).

(d) *Summary Scan*—The "Summary Scan" functionality, which is a query-only non-dynamic functionality, displays without attribution to Quoting Market Participants' MMIDs the aggregate size of Attributable and Non-Attributable Quotes/Orders for all levels (on both the bid and offer side of the market) below the three price levels displayed in the Nasdaq Order Display Facility.

4710. Participant Obligations in NNMS

(a) Registration

Upon the effectiveness of registration as a NNMS Market Maker or, NNMS ECN, NNMS Order Entry Firm, the NNMS participant may commence activity within NNMS for exposure to orders or entry of orders, as applicable. The operating hours of NNMS may be established as appropriate by the Association. The extent of participation in Nasdaq by an NNMS Order Entry Firm shall be determined solely by the firm in the exercise of its ability to enter orders into Nasdaq.

(b) [Market Makers] Obligations to and Processing of Non-Directed Orders

(1) [An NNMS Market Maker] *General Provisions*—A Quoting Market Participant in an NNMS Security shall be subject to the following requirements for Non-Directed Orders:

(A) For each NNM security in which it is registered [as an NNMS Market Maker, the market maker], a Quoting Market Participant must accept and execute individual Non-Directed orders against its quotation including its Agency Quote (if applicable), in an amount equal to or smaller than the combination of the Displayed [quotation] Quote/Order and Reserve Size (if applicable) of such [quotation(s)] Quote/Order, when the Quoting Market Participant is at the best bid/best offer in Nasdaq. [For purposes of this rule, the term "reserved size" shall mean that a NNMS Market Maker or a customer thereof wishes to display publicly part of the full size of its order or interest with the remainder held in reserve on an undisplayed basis to be displayed in whole or in part as the displayed part is executed. To utilize the reserve size function, a minimum of 1,000 shares must initially be displayed in the market maker's quote (including the Agency Quote), and the quotation must be refreshed to 1,000 shares consistent with subparagraph (b)(2)(A) of this rule.] Quoting Market Participants shall participate in the NNMS as follows:

(i) NNMS Market Makers and NNMS Auto-Ex ECNs shall participate in the automatic-execution functionality of the NNMS, and shall accept the delivery of an execution up to the size of the participant's Displayed Quote/Order and Reserve Size.

(ii) NNMS Order-Delivery ECNs shall participate in the order-delivery functionality of the NNMS, and shall accept the delivery of an order up to the size of the NNMS Order-Delivery ECN's Displayed Quote/Order and Reserve Size. The NNMS Order-Delivery ECN shall be required to execute such order in a manner consistent with the Firm Quote Rule.

(iii) UTP Exchanges shall participate in the NNMS as described in subparagraph (f) of this rule and as otherwise described in the NNMS rules and the UTP Plan.

(B) *Processing of Non-Directed Orders*—Upon entry of a Non-Directed Order into the system, the NNMS will ascertain who the next Quoting Market Participant in queue to receive an order is and shall deliver an execution to NNMS Quoting Market Participants that participate in the automatic-execution functionality of the system, or shall deliver a Liability Order to Quoting Market Participants that participate in the order-delivery functionality of the system. Non-Directed Orders entered into the NNMS system shall be delivered to or automatically executed against Quoting Market Participants' Displayed [quotations] Orders/Quotes and Reserve Size, including Agency Quotes (if applicable), in price[/] and then time priority, subject to the following processing. For Quotes/Orders [quotations] at the same price level, the NNMS system will attempt to access interest in the system in the following priority and order:

(i) Displayed Quotes/Orders of NNMS Market Makers, NNMS ECNs that do not charge a quote-access fee to non-subscribers, and Non-Attributable agency quotes/orders of UTP Exchanges (as permitted by subparagraph (f) of this rule), in time priority between such participants;

(ii) Displayed Quotes/Orders of NNMS ECNs that charge a quote-access fee to non-subscribers, in time priority between such participants;

(iii) Reserve Size of NNMS Market Makers and NNMS ECNs that do not charge a quote-access fee to non-subscribers, in time priority between such participants;

(iv) Reserve Size of NNMS ECNs that charge a quote-access fee to non-subscriber, in time priority between such participants; and

(v) *Principal Quotes/Orders of UTP Exchanges, in time priority between such participants*[yield priority to all Displayed quotations over reserve size, so that the system will execute against Displayed quotations in time priority and then against reserve size in time priority].

The following exceptions shall apply to the above execution parameters. First, if a Nasdaq Quoting Market Participant enters a Non-Directed Order into the system, before sending such Non-Directed Order to the next Quoting Market Participants in queue, the NNMS will first attempt to match off the order against the Nasdaq Quoting Market Participant's own Quote/Order if the participant is at the best bid/best offer in Nasdaq. Second, if Displayed Quotes/Orders at a price level are simultaneously exhausted and there is Reserve Size available at that price, when Displayed Quotes/Orders are refreshed from Reserve Size the system will establish order-receipt priority for these refreshed Quotes/Orders based on the size of a participant's Displayed Quote/Order and then based on the original order-entry time for same-sized refreshed Displayed Quotes/Orders.

(C) *Decrementation Procedures*—The size of a [displayed quotation] Quote/Order displayed in the Nasdaq Order Display Facility and/or the Nasdaq Quotation Montage will be decremented upon the delivery of a Liability Order or the delivery of an execution of a [an NNMS] Non-Directed order in an amount equal to [or greater than one normal unit of trading] the system-delivered order or execution; provided, however, that [the execution of] if an NNMS order that is a mixed lot (i.e., an order that is for more than a normal unit of trading but not a multiple thereof), the system will only deliver a Liability Order or an execution for the number of round lots contained in the mixed lot order, and will only decrement [a displayed quotation's] the size of a Displayed Quote/Order by the number of shares represented by the number of round lots contained in the mixed lot order. The odd-lot portion of the mixed lot will be executed at the same price against the next NNMS Market Maker in subparagraph (e) of this rule.

(i) If an NNMS Auto-Ex ECN has its bid or offer Attributable Quote/Order and Reserve Size decremented to zero without transmission of another Attributable Quote/Order to Nasdaq, the system will zero out the side of the quote that is exhausted. If both the bid and offer are decremented to zero without transmission of a revised Attributable Quote/Order, the ECN will be placed

into an excused withdrawal state until the ECN transmits to Nasdaq a revised Attributable Quote/Order.

(ii) If an NNMS Order-Delivery ECN declines or partially fills a Non-Directed Order without immediately transmitting to Nasdaq a revised Attributable Quote/Order that is at a price inferior to the previous price, or if an NNMS Order-Delivery ECN fails to respond in any manner within 5 seconds of order delivery, the system will cancel the delivered order and send the order (or remaining portion thereof) back into the system for immediate delivery to the next Quoting Market Participant in queue. The system then will zero out the ECN's Quote/Orders at that price level on that side of the market, and the ECN's quote on that side of the market will remain at zero until the ECN transmits to Nasdaq a revised Attributable Quote/Order. If both the bid and offer are zeroed out, the ECN will be placed into an excused withdrawal state until the ECN transmits to Nasdaq a revised Attributable Quote/Order.

(iii) If an NNMS ECN's Quote/Order has been zeroed out or if the ECN has been placed into excused withdrawal as described in subparagraphs (b)(1)(C)(i) and (ii) of this rule, the system will continue to access the ECN's Non-Attributable Quotes/Orders that are in the NNMS, as described in Rule 4707 and subparagraph (b) of this rule.

(D) *Interval Delay*—After the NNMS system has executed all Displayed Quotes/Orders and Reserve Size interest at a price level [an order against a market maker's displayed quote and reserve size (if applicable), that market maker shall not be required to execute another order at its bid or offer in the same security until a predetermined time period has elapsed from the time the order was executed, as measured by the time of execution in the Nasdaq system. This period of time shall initially be established as 5 seconds, but may be modified upon Commission approval and appropriate notification to NNMS participants.], the following will occur:

(i) If the NNMS system cannot execute in full all shares of a Non-Directed Order against the Displayed Quotes/Orders and Reserve Size interest at the initial price level and a price two price levels (i.e., two minimum trading increments) away, the system will pause for 5 seconds before accessing the interest at the next price level in the system; provided, however, that once the Non-Directed order can be filled in full within two price levels, there will be no interval delay between price levels

and the system will execute the remainder of order in full; or

(ii) If the Non-Directed Orders is specially designated by the entering market participant as a "sweep order," the system will execute against all Displayed Quotes/Orders and Reserve Size at the initial price level and the two price levels being displayed in the NODF without pausing between the displayed price levels. Thereafter, the system will pause 5 seconds before moving to the next price level, until the Non-Directed Order is executed in full.

The interval delay described in this subparagraph may be modified upon Commission approval and appropriate notification to NNMS Participants.

(E) All entries in NNMS shall be made in accordance with the requirements set forth in the NNMS User Guide, as published from time to time by Nasdaq.

(2) Refresh Functionality

(A) *Reserve Size Refresh*—Once a Nasdaq Quoting Market Participant's [an NNMS Market Maker's displayed quotation] Displayed Quote/Order size on either side of the market in the security has been decremented to zero due to NNMS [executions] processing Nasdaq will refresh the [market maker's] displayed size out of Reserve Size to a size-level designated by the Nasdaq Quoting Market Participant [NNMS Market Maker], or in the absence of such size-level designation, to the automatic refresh size. [If the market maker is using the reserve size function for its proprietary quote or Agency Quote the NNMS Market Maker must refresh to a minimum of 1,000 shares, consistent with subparagraph (b)(1)(A) of this rule]. To utilize the Reserve Size functionality, a minimum of 1,000 shares must initially be displayed in the Nasdaq Quoting Market Participant's Displayed Quote/Order, and the Displayed Quote/Order must be refreshed to at least 1,000 shares. This functionality will not be available for use by UTP Exchanges.

(B) [Auto]Quote Refresh ("QR")—Once an NNMS Market Maker's Displayed Quote/Order [quotation] size and Reserve Size on either side of the market in the security has been decremented to zero due to NNMS executions, the NNMS Market Maker may elect to have The Nasdaq Stock Market refresh the market maker's quotation as follows:

(i) Nasdaq will refresh the market maker's quotation price on the bid or offer side of the market, whichever is decremented to zero, by an price interval designated by the NNMS Market Maker; and

(ii) Nasdaq will refresh the market maker's displayed size to a level

designated by the NNMS Market Maker, or in the absence of such size level designation, to the automatic refresh size.

(iii) This functionality shall produce an Attributable Quote/Order. In addition, if an NNMS Market Maker is utilizing the QR functionality but has an Attributable Quote/Order in the system that is priced at or better than the quote that would be created by the QR, the NNMS will display the Attributable Quote/Order, not the QR-produced quote.

(iv) An NNMS Market Maker's Agency Quote shall not be subject to the functionality described in this subparagraph, nor shall this functionality be available to Quoting Market Participants other than NNMS Market Makers.

(3) Entry of Locking/Crossing Quotes/Orders [Except as otherwise provided in subparagraph (b)(10) of this rule, at any time a locked or crossed market, as defined in Rule 4613(e), exists for an NNMS security, a market maker with a quotation for that security (including an Agency Quote) that is causing the locked or crossed market may have orders representing shares equal to the size of the bid or offer that is locked or crossed executed by the NNMS system against the market maker's quote (including an Agency Quote) at the quoted price if that price is the best price. During locked or crossed markets, the NNMS system will execute orders against those market makers that are locked or crossed in predetermined time intervals. This period of time initially shall be established as five (5) seconds, but may be modified upon approval by the Commission and appropriate notification to NNMS participants.] The system shall process locking/crossing Quotes/Orders as follows:

(A) Locked/Crossed Quotes/Orders During Market Hours—If during market hours, a Quoting Market Participant enters into the NNMS a Quote/Order that will lock/cross the market (as defined in NASD Rule 4613(e)), the system will not display the Quote/Order as a quote in Nasdaq; instead the system will treat the Quote/Order as a marketable limit order and enter it into the system as a Non-Directed Order for processing as follows:

(i) For locked-market situations, the order will be routed to the Quoting Market Participant next in queue whom would be locked, and the order will be executed at the lock price;

(ii) For crossed-market situations, the order will be entered into the system and routed to the next Quoting Market Participants in queue who would be crossed, and the order will be executed

at the price of the Displayed Quote/Order that would have been crossed.

Once the lock/cross is cleared, if the participant's order is not completely filled, the system will reformat the order and display it in Nasdaq (consistent with the parameters of the Quote/Order) as a Quote/Order on behalf of the entering Quoting Market Participant.

(B) Locked/Crossed Quotes/Orders at the Open—If the market is locked or crossed at 9:30 a.m., Eastern Time, the NNMS will clear the locked and/or crossed Quotes/Order by executing the oldest bid/offer against the oldest offer(bid) against which it is marketable at the price of the oldest Quote/Order. Nasdaq then will begin processing Non-Directed Orders as described in subparagraph (b) of this rule.

[(4) For each NNM security in which a market maker is registered, the market maker may enter orders into the NNMS for its proprietary account as well as on an agency or riskless principal basis.]

[(5)] (4) An NNMS Market Maker may terminate its obligation by keyboard withdrawal (or its equivalent) from NNMS at any time. However, the market maker has the specific obligation to monitor its status in NNMS to assure that a withdrawal has in fact occurred. Any transaction occurring prior to the effectiveness of the withdrawal shall remain the responsibility of the market maker.

[(6)] (5) [An NNMS Market Maker will be suspended from NNMS if its bid or offer has been decremented to zero due to NNMS executions and will be permitted a standard grace period, the duration of which will be established and published by the Association, within which to take action to restore a two-sided quotation in the security for at least one normal unit of trading. An NNMS Market Maker that fails to reenter a two-sided quotation within the allotted time will be deemed to have withdrawn as a market maker ("Timed Out of the Box"). Except as provided below in this subparagraph and in subparagraph (b)(7) of this rule, an NNMS Market Maker that withdraws in an NNM security may not re-register as a market maker in that security for twenty (20) business days.] If an NNMS Market Maker's Attributable Quote/Order is reduced to zero on one side of the market due to NNMS executions, the NNMS will close the Market Maker's quote in the NNMS with respect to both sides of its market, and the NNMS Market Maker will be permitted a standard grace period of three minutes within which to take action to restore its Attributable Quote/Order, if the market maker has not authorized use of the QR functionality or does not otherwise have

an Attributable Quote/Order on both sides of the market in the system. An NNMS Market Maker that fails to transmit an Attributable Quote/Order in a security within the allotted time will have its quotation restored by the system at the lowest bid price and the highest offer price in that security. Except as provided in subparagraph (b)(6) of this rule, an NNMS Market Maker that withdraws from a security may not re-register in the system as a market maker in that security for twenty (20) business days. The requirements of this subparagraph shall not apply to a market maker's Agency Quote.

[(A) Notwithstanding the above, a market maker can be reinstated if:

(i) the market maker makes a request for reinstatement to Nasdaq Market Operations as soon as practicable under the circumstances, but within at least one hour of having been Timed Out of the Box, and immediately thereafter provides written notification of the reinstatement request;

(ii) it was a Primary Market Maker at the time it was Timed Out of the Box;

(iii) the market maker's firm would not exceed the following reinstatement limitations:

a. for firms that simultaneously made markets in less than 250 stocks during the previous calendar year, the firm can receive no more than four (4) reinstatements per year;

b. for firms that simultaneously made markets in 250 or more but less than 500 stocks during the previous calendar year, the firm can receive no more than six (6) reinstatements per year;

c. for firms that simultaneously made markets in 500 or more stocks during the previous calendar year, the firm can receive no more than twelve (12) reinstatements per year; and

(iv) the designated Nasdaq officer makes a determination that the withdrawal was not an attempt by the market maker to avoid its obligation to make a continuous two-sided market. In making this determination, the designated Nasdaq officer will consider, among other things:

a. whether the market conditions in the issue included unusual volatility or other unusual activity, and/or the market conditions in other issues in which the market maker made a market at the time the firm was Timed Out of the Box;

b. the frequency with which the firm has been Timed Out of the Box in the past;

c. procedures the firm has adopted to avoid being inadvertently Timed Out of the Box; and

d. the length of time before the market maker sought reinstatement.

(B) If a market maker has exhausted the reinstatement limitations in subparagraph[s] (b)(6)(A)(iii) above, the designated Nasdaq officer may grant a reinstatement request if he or she finds that such reinstatement is necessary for the protection of investors or the maintenance of fair and orderly markets and determines that the withdrawal was not an attempt by the market maker to avoid its obligation to make a continuous two-sided market in instances where:

(i) a member firm experiences a documented problem or failure impacting the operation or utilization of any automated system operated by or on behalf of the firm (chronic system failures within the control of the member will not constitute a problem or failure impacting a firm's automated system) or involving an automated system operated by Nasdaq;

(ii) the market maker is a manager or co-manager of a secondary offering from the time the secondary offering is announced until ten days after the offering is complete; or

(iii) absent the reinstatement, the number of market makers in a particular issue is equal to two (2) or less or has otherwise declined by 50% or more from the number that existed at the end of the prior calendar quarter, except that if a market maker has a regular pattern of being frequently Timed Out of the Box, it may not be reinstated notwithstanding the number of market makers in the issue.

[(7)] (6) Notwithstanding the provisions of subparagraph [(6)] (5) above:

(A) an NNMS Market Maker that obtains an excused withdrawal pursuant to Rule 4619 prior to withdrawing from NNMS may reenter NNMS according to the conditions of its withdrawal; and

(B) a NNMS Market Maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency, and is thereby withdrawn from participation in ACT and NNMS for NNM securities, may reenter NNMS after a clearing arrangement has been reestablished and the market maker has complied with ACT participant requirements. Provided however, that if the Association finds that the ACT market maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused.

[(8)] (7) The Market Operations Review Committee shall have jurisdiction over proceedings brought by market makers seeking review of their removal from NNMS pursuant to

subparagraphs (b)(5)[(6) or (b)(7)] of this rule.

[(9)] (8) In the event that a malfunction in the [NNMS Market Maker's] *Quoting Market Participant's* equipment occurs, rendering [on-line] communications with NNMS inoperable, the [NNMS Market Maker] *Quoting Market Participant* is obligated to immediately contact Nasdaq Market Operations by telephone to request withdrawal from NNMS *and a closed-quote status*, and *if the Quoting Market Participants is an NNMS Market Maker* an excused withdrawal from Nasdaq. Such request must be made] pursuant to Rule 4619. If withdrawal is granted, Nasdaq Market Operations personnel will enter the withdrawal notification into NNMS from a supervisory terminal *and shall close the quote*. Such manual intervention, however, will take a certain period of time for completion and, *unless otherwise permitted by the Association pursuant to its authority under Rule 11890*, the [NNMS Market Maker] *Quoting Market Participants* will continue to be obligated for any transaction executed prior to the effectiveness of [his] the withdrawal *and closed-quote status*.

[(10)] In the event that there are no NNMS Market Makers at the best bid (offer) disseminated by Nasdaq, market orders to sell (buy) entered into NNMS will be held in queue until executable, or until 90 seconds has elapsed, after which such orders will be rejected and returned to their respective order entry firms.]

(c) *Directed Order Processing*—A participant may enter a directed order into the NNMS to access a specific Quote/Order in the Nasdaq Quotation Montage and to begin the negotiation process with a particular Quoting Market Participant. The system will deliver an order to the Quoting Market Participant designated as the recipient of the order. Upon delivery, the Quoting Market Participants shall owe no liability under the Firm Quote Rule to that order and the system will not decrement the receiving Quoting Market Participant's Quote/Order.

[(c)] (d) NNMS Order Entry Firms
All entries in NNMS shall be made in accordance with the procedures and requirements set forth in the NNMS User Guide. Orders may be entered in NNMS by the NNMS Order Entry Firm through either its Nasdaq terminal or computer interface. The system will transmit to the firm on the terminal screen and printer, if requested, or through the computer interface, as applicable, an execution report generated immediately following the execution.

[(d) Order Entry Parameters

(1) NNMS will only accept market and marketable limit orders for execution and will not accept market or marketable limit orders designated as All-or-None ("AON") orders; provided, however, that NNMS will not accept any limit orders, marketable or unmarketable, prior to 9:30 a.m., Eastern Time. For purposes of this subparagraph, an AON order is an order for an amount of securities equal to the size of the order and no less.

(2) Additionally, the NNMS will only accept orders that are unpreferred, thereby resulting in execution in rotation against NNMS Market Makers, and will not accept preferred orders.

(3) NNMS will not accept orders that exceed 9,900 shares, and no participant in the NNMS system shall enter an order into the system that exceeds 9,900.]

[(e) Electronic Communication Networks

An Electronic Communications Networks, as defined in SEC Rule 11Ac1-1(a)(8), may participate in the NNMS System if it complies with NASD Rule 4623 and executes with the Association a Nasdaq Workstation Subscriber Agreement, as amended, for ECNs.]

(e) Odd-Lot Processing

(1) *Participation in Odd-Lot Process*—All NNMS Market Makers may participate in the Odd-Lot Process for each security in which the market maker is registered.

(2) *Execution Process*

(a) *Odd-lot orders will be executed against an NNMS Market Maker only if it has an odd-lot exposure limit in an amount that would fill the odd-lot order. A NNMS Market Maker may, on a security-by-security basis, set an odd-lot exposure limit from 0 to 999,999 shares.*

(b) *An odd-lot order shall be executed automatically against the next available NNMS Market Maker when the odd-lot order becomes executable (i.e., when the best price in Nasdaq moves to the price of the odd-lot limit order). Such odd-lot orders will execute at the best price available in the market, in rotation against NNMS Market Makers who have an exposure limit that would fill the odd-lot order.*

(c) *For odd-lots that are part of a mixed lot, once the round-lot portion is executed, the odd-lot portion will be executed at the round-lot price against the next NNMS Market Maker in rotation (as described in subparagraph (e)(2)(b) of this rule) even if the round-*

lot price is no longer the best price in Nasdaq.

(d) Odd-lot executions will decrement the odd-lot exposure limit of an NNMS Market Maker but will not decrement the size of NNMS Market Maker's Displayed Quote/Order.

(e) After the NNMS system has executed an odd-lot against an NNMS Market Maker, the system will not deliver another odd-lot order against the same market maker until a predetermined time period has elapsed from the time the last execution was delivered, as measured by the time of execution in the Nasdaq system. This period of time shall initially be established as 5 seconds, but may be increased upon Commission approval and appropriate notification to NNMS Participants or may be decreased to an amount less than five seconds by the NNMS Market Maker.

(f) UTP Exchanges

Unless specified otherwise in these rules or in the Nasdaq UTP Plan, UTP Exchanges shall participate in the NNMS as follows:

(1) Order Entry—UTP Exchanges shall be permitted to enter Directed and Non-Directed orders into the system subject to the conditions and requirements of Rules 4706. Directed and Non-Directed Orders entered by UTP Exchanges shall be processed (unless otherwise specified) as described subparagraphs (b) and (c) of this rule.

(2) Display of UTP Exchange Quotes/Orders in Nasdaq

(a) UTP Exchange Principal Orders/Quotes—UTP Exchanges shall be permitted to transmit to the NNMS a single bid Quote/Order and a single offer Quote/Order. Upon transmission of the Quote/Order to Nasdaq, the system shall time stamp the Quote/Order, which time stamp shall determine the ranking of the Quote/Order for purposes of processing Non-Directed Orders. The NNMS shall display the best bid and best offer Quote/Order transmitted to Nasdaq by a UTP Exchange in the Nasdaq Quotation Montage under the MMID for the UTP Exchange, and shall also display such Quote/Order in the Nasdaq Order Display Facility as part of the aggregate trading interest when the UTP Exchange's best bid/best offer Quote/Order falls within the best three price levels in Nasdaq on either side of the market.

(b) UTP Exchange Agency Quotes/Orders—A UTP Exchange may transmit to the NNMS orders that meet the following requirements: are 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; are not for the benefit of a broker and/or dealer; and are designated as Non-Attributable Quotes/Orders ("UTP Agency Order/Quote"). Upon transmission of a UTP Agency Quote/Order to Nasdaq, the system shall time stamp the order, which time stamp shall determine the ranking of these Quote/Order for purposes of processing Non-Directed Orders, as described in subparagraph (b) of this rule. A UTP Agency Quote/Order shall not be displayed in the Nasdaq Quotation Montage under the MMID for the UTP Exchange. Rather, UTP Agency Quotes/Orders shall be reflected in the Nasdaq Order Display Facility and Nasdaq Quotation Montage in the same manner in which Non-Attributable Quotes/Orders from Nasdaq Quoting Market Participants are reflected in Nasdaq, as described in Rule 4707(b)(2).

(3) Non-Directed Order Processing—UTP Exchanges shall participate in the automatic-execution functionality of the system, shall accept an execution of an order up to the size of the UTP Exchange's displayed Quote/Order, and shall otherwise participate in the Non-Directed Order processing described in subparagraph (b) of this rule. UTP Exchanges shall be subject to the decrementation procedures described in subparagraph (b)(1)(C) of this rule.

(4) Directed Order Processing—UTP Exchanges shall participate in the Directed Order processing as described in subparagraph (c) of this rule.

4711–4714—No Change

4718. Termination of System Service

The Association or its subsidiaries may, upon notice, terminate System service to a participant in the event that a participant fails to abide by any of the rules or operating procedures of the System or any other relevant rule or requirement, or fails to pay promptly for services rendered.

* * * * *

4750. SMALLCAP SMALL ORDER EXECUTION SYSTEM (SOES)

4751–4757—Deleted

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 and 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. The NASD and Nasdaq have 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 the original filing, the NASD and Nasdaq proposed enhancing the Nasdaq quotation montage and Nasdaq's main trading platform—the Nasdaq National Market System ("NNMS").⁷ In particular, Nasdaq proposed to: (1) Add a new display to the Nasdaq Workstation II ("NWII") called the Nasdaq Order Display Facility ("NODF"), which would show the best bid/best offer in Nasdaq and two price levels away, accompanied by the aggregate size at each price level of the "displayed" trading interest of market makers, electronic communication networks ("ECN"), and UTP Exchanges; (2) make substantial enhancements to the NNMS, which would improve the efficiency of the current trading platform; (3) allow market makers and ECNs to designate orders for "display" in Nasdaq on either an attributable (*i.e.*, not anonymous) or non-attributable (*i.e.*, anonymous) basis; (4) establish the Order Collector Facility ("OCF") as part of the NNMS, which would allow Nasdaq market makers and ECNs to give the Nasdaq system multiple quotes/orders at a single as well as multiple price levels, which would be displayed in the Nasdaq Quotation Montage and the NODF, consistent with an order's parameters; (5) establish the OCF as a single point of order entry and single point of delivery of liability orders and executions; and (6) create an odd-lot processing facility in Nasdaq.

The Commission received approximately 21 comment letters.⁸ In

⁷ See note 3, above.

⁸ See letters from: Investment Company Institute, dated January 11, 2000 ("ICI Letter"); Chicago Stock Exchange, dated January 11, 2000 ("CHX Letter"); Bloomberg, dated January 11, 2000 ("Bloomberg Letter"); Merrill Lynch, dated January 20, 2000 ("Merrill Letter"); Morgan Stanley Dean Witter, dated February 3, 2000 ("Morgan Stanley Letter"); Salomon Smith Barney, dated February 3, 2000 ("Salomon Letter"); Goldman, Sachs & Co., dated February 15, 2000 ("Goldman Letter"); ITG, dated January 10, 2000 ("ITG Letter"); BNY ESI & Co., dated January 11, 2000 ("BNY Letter"); Heartland Securities, Corp. dated December 17, 1999 ("Heartland Letter"); Automated Trading Desk, dated December 26, 1999 ("Automated Trading Desk Letter"); The Security Traders Association of New York, dated December 22, 1999 ("STANY Letter"); NexTrade Holdings, Inc., undated ("NexTrade Letter"); Thelen Reid & Priest, LLP on behalf of the Electronic Traders Association, dated

the NASD's and Nasdaq's view, the overwhelming majority of these comments were extremely positive. However, some commenters stated that notwithstanding their overall support, there were aspects of the proposal that raised concerns. A few commenters opposed the proposal in its entirety. In response to the commenters, the NASD and Nasdaq propose to amend the following aspects of the proposal: (1) Odd-lot processing; (2) five-second interval delay between price levels; (3) the order execution algorithm as it relates to ECNs and UTP Exchanges, and displayed size refreshed from reserve; and (4) UTP Exchange participation in the system. The NASD and Nasdaq are working to address concerns regarding Nasdaq technology, competition, system roll-out, and any other relevant comments.

A. Odd-Lot Processing

A number of the commenters raised concerns regarding the odd-lot process. As originally proposed, all market makers in a stock would execute odd-lots entered into the system at the inside bid/offer, in a "round-robin" rotation, regardless of whether the market maker is at the inside bid/offer. Odd-lot executions would not decrement or be driven off a market maker's quoted size in the NODF or the Nasdaq Quote Montage. One commenter stated that it would be unfair to execute odd-lots against dealers without current trading interest in a particular security.⁹ Various commenters stated that the odd-lot process could be "gamed" by splitting up large round lot orders into multiple odd-lot orders in order to jump the processing queue for round lots (e.g., a 1,000 share order would be split up into 10 orders for 99 shares) or to access size greater than the depth at the inside market. Commenters also thought that the originally proposed odd-lot process could create certain arbitrage opportunities.¹⁰

January 11, 2000 (ETA Letter); US Bancorp, Piper Jaffray, dated December 30, 1999 ("US Bancorp Letter"); Island, dated January 11, 2000 ("Island Letter"); Securities Traders Association, dated December 22, 1999 ("STA Letter"); American Century Investment Management, dated January 10, 2000 ("American Century Letter"); Instinet, dated February 16, 2000 ("Instinet Letter"); Franklin Portfolio on behalf of the Nasdaq Institutional Trader's Advisory Council ("ITAC Letter"); and Mount Pleasant Brokerage date December 27, 1999 ("Mount Pleasant Letter").

⁹ See e.g., STANY Letter; STA Letter; Morgan Stanley Letter; Salomon Smith Barney Letter; Merrill Lynch Letter; and US Bancorp.

¹⁰ In the NNMS (which Nasdaq expects will be implemented on May 15, 2000), odd-lots are processed against only those market makers who are at the inside bid or offer, in round-robin fashion. An odd-lot execution does not decrement a market

In light of the concerns raised in comment letters, the NASD and Nasdaq propose to amend the odd-lot process to: (1) Add an "odd-lot exposure limit" for market makers; (2) provide a market maker interval delay between odd-lot executions against the same market maker; and (3) establish an odd-lot order entry parameter of one order per second, per firm. While odd-lots would still be processed in a round-robin fashion against a market maker even if it is not at the inside, odd-lots would be processed only against those market makers who have an available exposure limit.

A market maker could set its exposure limit, on a security-by-security basis, from 0 to 999,999 shares. The system would not execute an odd-lot order against a market maker unless the market maker had a sufficient exposure limit to fill the odd-lot order. If no market maker had an odd-lot exposure, the system would suspend the processing of odd-lots until the exposure limit was refreshed. Odd-lot executions would decrement the exposure limit (but not the quote/order sizes displayed in the Nasdaq Quotation Montage and/or NODF) by the size of the odd-lot order. When a market maker's odd-lot exposure limit was reduced to zero, the participant would be taken out of the odd-lot rotation unless, and until, the market maker set a new exposure limit.

Next, there also would be a maximum five-second interval delay between executions against the same market maker in the same security. Once an odd-lot is executed against a market maker, if the market maker had an available exposure limit there would be a five-second interval delay before the market maker was subject to another odd-lot execution. During the five-second interval delay, the market maker could adjust its odd-lot exposure limit up or down. A market maker would also be able to adjust the interval-delay time down (i.e., down to 0-4 seconds), so that it receives executions more frequently than five seconds apart. Lastly, the system would be programmed to accept odd-lot orders at a rate of, no faster than, one order per second from any single NNMS participant. This would prevent a single

maker's quote. However, if a market maker has reserve size in the system, an odd-lot execution will decrement the reserve size held in Nasdaq. The system cannot decrement displayed quotes in Nasdaq, because Nasdaq only can display round lots (i.e., 100 shares or multiples thereof). Since reserve size is not displayed in the Nasdaq Quotation Montage, but rather is held within the system, it is possible to decrement reserve size by the amount of an odd-lot execution.

firm from flooding the system with odd-lots.¹¹

B. Five-Second Interval Delay Between Price Levels

As originally proposed, if all trading interest is exhausted at a particular price level, there would be a five-second interval delay before the system would attempt to execute an order at a new price level (e.g., the next tick down). Commenters believed the proposed five-second interval delay between price levels was too long and/or unnecessary for liquid stocks and could cause queuing of orders within the system.¹² The rationale underlying the five-second interval delay was the concern that in the present high-speed trading environment it is beneficial to allow sufficient time for market makers to automatically update their quotes to ensure that a series of orders do not exhaust the interest at or near the inside, resulting in a partial execution at a significantly inferior price. Nevertheless, the NASD and Nasdaq recognize that the concerns raised by commenters have merit. In response, the NASD and Nasdaq propose that the system have a more limited interval delay parameter, as follows.

First, the system would limit the five-second interval delay to situations where an order is partially filled at one price level, and the remaining shares of the order would not be filled in full at the next two trading increments ("ticks") away (i.e., within $\frac{1}{8}$ of a point for stocks currently priced above \$10, or within 10 cents in a decimals environment with a five-cent minimum trading increment). In these situations, there would be a five-second interval delay or pause before the order moved to the next increment away from the original increment. At any point after a delay, if the remainder of the order could be filled in full within two ticks, there would be no further delays and the order would be filled completely. In other words, if a large market order

¹¹ Some commenters suggested that the system decrement a market maker's quote (as displayed in the Nasdaq Quotation Montage and the NODF) as a method of addressing the concerns with the odd-lot processing. Nasdaq considered this approach but determined that it would be extremely complex and difficult to approach from a systems perspective. For example, because Nasdaq only displays quotations in round lots, the system could not decrement a quote to reflect an odd-lot execution until there were enough odd-lot executions against the same quote to equal one round lot. Accordingly, Nasdaq has proposed the alternative outlined above, as it addresses the concerns raised by commenters and also is technologically more feasible.

¹² See e.g., STA Letter; STANY Letter; American Century Letter; ICI Letter; ETA Letter; US Bancorp Letter; Salomon Smith Barney Letter; and Merrill Lynch Letter.

moves through many prices, it would delay before every price move except for the last two. Additionally, orders would be processed in time sequence. Thus, if an order was in interval delay because it met the above parameters, the orders behind the "interval-delay order" would not jump the queue.

For example, assume that at 10:00:01 a.m., the inside market in Stock G is \$104.50 to \$104.55. At 10:00:02 a.m., Order 1, which is a market sell order for 2,000 shares, is entered into the system. At 10:00:03 a.m., Order 2, which is a market sell order for 5,000 shares is entered into the system, and one second later Order 3, also a 5,000 share market sell order, is entered into the system. Thus, the following quotes/orders are being displayed in the system.

MMA \$104.50–100 (total, including reserve)
 ECN1 \$104.45–1,900 (total, including reserve)
 MMC \$104.40–1,000 (total, including reserve)
 MMD \$104.35–1,000 (total, including reserve)
 MME \$104.30–1,000 (total, including reserve)
 MMF \$104.25–2,000 (total, including reserve)

As amended, the first 100 shares for Order 1 executes against MMA at \$104.50, and since there would be sufficient size at \$104.45 to satisfy the remaining shares 1,900 shares of the order, the remaining shares executes against ECN1 at \$104.45, with no delay.¹³ As to Order 2, since it could not be filled in full at the \$104.40 price level or within two ticks away, 1,000 shares would execute at \$104.40 and there would be a five-second interval delay between each price level until the order can be filled within two ticks. Note that during the interim, Order 3 would remain in queue behind Order 2, until Order 2 is executed in full.

Second, a market participant would be able to set a parameter on an individual order so that the order would trade through all interest (*i.e.*, displayed and reserve interest) at the three price levels being displayed in the NODF at the time of entry, without pausing five

seconds in between each displayed price ("Sweep Order"). However, a Sweep Order may only execute through a maximum of the two price levels displayed in the NODF (and into the third price level). If the Sweep Order were not executed in full at the third price level, the order would pause for five seconds between each subsequent price level. For example, if a 10,000 share market order were entered into the system and received the appropriate designation, the order would sweep all the shares at the three price levels in the NODF at the time of entry, and would pause for five seconds before moving to the fourth (as well as subsequent) price level(s) if the order were not fully executed at such level.

The NASD and Nasdaq believe that these two approaches provide a balance between the need of institutional investors and market professionals for speed, while providing greater price continuity for individual investors.

C. Processing of Non-Directed Orders and ECNs and UTP Exchange Participation

As originally proposed, the system would execute non-directed orders entered into the system in general price/time priority. However, within a price level, the system would execute non-directed orders against displayed quotes/orders of market makers and ECNs that participate in the automatic-execution functionality of the system ("Auto-Ex ECNs"), within time priority of this class of market participants. The system then would execute against the displayed quotes/orders of ECNs that participate in order-delivery ("Order-Delivery ECNs"). After displayed size of Nasdaq market makers and ECNs was exhausted, the system would execute against reserve size of market makers and Auto-Ex ECNs, and then reserve size of Order-Delivery ECNs. Lastly, the system would execute against the quotes of UTP Exchanges.

i. *ECNs.* Some commenters believe that Order-Delivery ECNs should have the same standing to receive non-directed orders against their quotes as market makers and Auto-Ex ECNs. These commenters believe that executing first against market makers and Auto-Ex ECNs and then against Order-Delivery ECNs who are displaying orders at the same price raises competitive concerns. In light of these concerns, the NASD and Nasdaq propose to alter the order execution algorithm with respect to ECNs. The NASD and Nasdaq believe that all ECNs (who are NASD members), market makers, and non-attributed UTP Exchange agency interest, at a given

price level should be executed against in strict time priority, unless an ECN charges a fee to non-subscribers for accessing its quote. ECNs that charge an access fee should be executed after non-attributed UTP Exchange agency interest, market makers, and ECNs who do not charge an access fee because such a fee represents an increase in trading costs and clearly an inferior price.¹⁴ This prioritization is consistent with common industry practice today, where a market participant would route its orders first to market makers and ECNs that do not charge a fee and then to ECNs that charge an access fee, to ensure the investor incurs the lowest possible trading costs. The NASD and Nasdaq believe that any other prioritization would be inconsistent with the statutory mandate of providing investors with best execution of their orders.

ii. *UTP Exchange Participation.* As noted above, as originally proposed, UTP Exchanges would receive non-directed orders behind market makers and ECNs who are at the same price. The system would deliver orders from UTP Exchanges to the next market participant in queue, even if the receiving market participant participates in the automatic execution functionality of the system. Some Nasdaq market participants stated that mandating order delivery for orders from UTP Exchanges was cumbersome from a technology prospective. In addition, the Chicago Stock Exchange ("CHX") believed that the system would disadvantage customer orders that reside on the floor of its exchange because such orders would be executed last even if they had time priority.

Subsequent to the filing of the original proposal, the NASD and Nasdaq have had constructive discussions with the CHX. First, the NASD and Nasdaq has offered to provide automatic execution (against market participants that accept auto-ex) for non-directed orders emanating from the floor of the CHX, if CHX agrees to provide automatic execution for orders directed to the CHX by Nasdaq.¹⁵ This is consistent with Nasdaq's previously-articulated position that it is willing to provide automatic execution against its market if a UTP Exchange is willing to provide

¹³ As explained in the original filing, if ECN1 were an ECN that participates in automatic execution, it could protect itself from incurring dual liability by using the request to cancel feature in the system, even though there was no interval delay between price levels. That is, if while Nasdaq was executing against ECN1's quote an internal subscriber also wished to execute against the 1,900 shares for \$104.45 in the ECN, before filling the subscriber's order ECN1 could send a request to cancel the order to Nasdaq. If Nasdaq had executed against the 1,900 shares at \$104.45, ECN1 would send a message to its customer declining the execution because the order had been filled.

¹⁴ The NASD and Nasdaq note that Commission staff and at least one commentator raised concerns about ECN fees and best execution. See ITG Letter.

¹⁵ To be clear, the NASD and Nasdaq are proposing to eliminate from the proposal the requirement that all non-directed orders entered into the system by UTP Exchanges be delivered to the next market participant in queue even if that market participant is a market maker or Auto-Ex ECN.

automatic execution against its specialist's quotes.

Second, the NASD and Nasdaq has offered the CHX, and will offer to all other UTP Exchanges, the ability to display agency interest on a non-attributable basis in the NODF. That is, a UTP Exchange's agency orders would be aggregated into the NODF. These orders would not be displayed next to the UTP Exchange's MMID in the Nasdaq Quotation Montage, but instead would be aggregated into the SIZE MMID (which represents all non-attributable/anonymous interest at the best price in the system). The system would execute against the UTP-Exchange's non-attributable agency interest in strict price/time priority with other orders/quotes from Nasdaq market makers and ECNs that do not charge a quote-access fee. This approach should assure that a customer's order in a Nasdaq security, regardless of where it is entered in the National Market System, would be executed on a price/time priority basis. A UTP Exchange's principal (*i.e.*, non-agency) interest would continue to be displayed next to its MMID in the Nasdaq Quotation Montage and accessed after Nasdaq market maker and ECN interest (as well as UTP Exchange agency interest). The NASD and Nasdaq believe that the CHX has preliminarily agreed to this approach. The NASD and Nasdaq intend to work with all relevant UTP Plan participants to resolve the linkage issue.

iii. *Reserve Size.* One commenter suggested that when displayed size is completely exhausted, quotes/orders refreshed out of reserve size should be accessed in a slightly different manner than as described in the original proposal. Specifically, the commenter suggested that after the displayed size of market participants quoting at the same price level is exhausted simultaneously and then displayed size is refreshed from reserve, the system should establish a quoting market participant's priority to receive non-directed orders based on the new size of the displayed quotes (instead of the market participant's time of original quote/order entry) with time priority governing as to any two (or more) market participants at the same size.¹⁶ In this narrow instance, there would be parity among the market participants with none, arguably, having time priority because their displayed interest was taken out simultaneously. The NASD and Nasdaq proposes to amend the filing to incorporate this approach into the order execution algorithm since

it appears logical, in this instance, to reward Nasdaq Quoting Market Participants displaying greater size.

For example, assume that MMA and MMB are each at the inside bid quoting 1,000 shares. MMA, who is first in time to receive an order, has a reserve refresh size of 1,000 shares, and MMB who is second in time has a reserve refresh size of 3,000. A sell market order for 2,000 shares is entered into the system, and the system executes against MMA for 1,000 shares and MMB for 1,000 shares. As originally proposed, MMA and MMB would now be refreshed out of reserve to 1,000 and 3,000 shares respectively, but MMA would have priority to receive the next non-directed order in the system because MMA had original time priority. As amended, because MMB would be displaying 3,000 shares and MMA only 1,000 shares, MMB would receive the next order, as it is displaying a larger size refreshed out of reserve. The NASD and Nasdaq believe that this could encourage market participants to display greater size to the market, which could enhance liquidity and transparency.

iv. *Order Execution Algorithm.* Based on the above, the NASD and Nasdaq propose to amend the order execution algorithm to execute non-directed orders entered into the system as follows: (1) displayed quotes of market makers, ECNs that do not charge a quote-access fee to non-subscribers, non-attributable agency quotes of UTP Exchanges, in time priority between such participants; (2) displayed quotes of ECNs that charge a quote-access fee to non-subscribers, in time priority between such participants; (3) reserve size of market makers and ECNs that do not charge a quote-access fee to non-subscribers in time priority between such participants; (4) reserve size of ECNs that charge a quote-access fee to non-subscribers in time priority between such participants; and (5) principal quotes of UTP Exchanges, in time priority between such participants. The exception to the above would be if a non-directed order was from a market maker or ECN at the inside, the system would match off a non-directed order against that market maker or ECN (in lieu of sending it to the next market participant in queue). Second, if displayed size is exhausted and there is still reserve size available at that price, for the purpose of delivering the next order, the system would determine priority first based on the displayed size of the refreshed quotes and then based on time.

2. Statutory Basis

The NASD and Nasdaq believe that the proposed amendments are consistent with the provisions of Sections 15A(b)(6) and (b)(11) of the Act,¹⁷ as well as Sections 11A(a)(1)(C) and 11A(a)(1)(D) of the Act.¹⁸ Section 15A(b)(6)¹⁹ requires that the rules of a registered national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. Section 15A(b)(11) of the Act²⁰ requires that the rules of a registered national securities association be designed to produce fair and informative quotations, prevent fictitious or misleading quotations and to promote orderly procedures for collecting, distributing, and publishing quotations. Section 11A(a)(1)(C) of the Act²¹ states that is in the public interest and appropriate for the protection of investors and the maintenance of fair and order markets to assure (1) economically efficient execution of securities transactions; (2) fair competition among brokers and dealers; (3) the availability to brokers, dealers and investors of information with respect to quotations and transactions in securities; (4) the practicability of brokers executing investors' orders in the best market; and (5) an opportunity for investors' orders to be executed without the participation of a dealer. Section 11A(a)(1)(D)²² states that Congress finds that the linking of all markets for qualified securities through communication and data processing facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investors' orders, and contribute to best execution of such orders.

The NASD and Nasdaq believe that the amendments to the odd-lot process balance the concerns raised by commenters regarding potential gaming

¹⁷ 15 U.S.C. 78o-3(b)(6) and (b)(11).

¹⁸ 15 U.S.C. 78k-1(a)(1)(C) and (a)(1)(D).

¹⁹ 15 U.S.C. 78o-3(b)(6).

²⁰ 15 U.S.C. 78o-3(b)(11).

²¹ 15 U.S.C. 78k-1(a)(1)(C).

²² 15 U.S.C. 78k-1(a)(1)(D).

¹⁶ See Goldman Sachs Letter.

and the need for a fair and orderly method of executing odd-lot orders. The NASD and Nasdaq believe this proposed change would prevent fraudulent and manipulative acts, since it would reduce the opportunity for gaming. Additionally, the proposed changes to the five-second interval delay, provide a balance between the need of institutional investors and market professionals for speed, while providing greater price continuity for individual investors. Thus, the NASD and Nasdaq believe the proposal is consistent with Sections 15A(b)(6) and (b)(11),²³ as well as Section 11A(a)(1)(C) of the Act.²⁴

The NASD and Nasdaq believe the proposed changes to the order execution algorithm addresses competitive concerns raised by some ECNs, in that all ECNs that do not charge a quote-access fee (whether they accept automatic execution or order delivery) would be treated in time priority. Additionally, the change as it relates to ECNs that charge a fee addresses concerns about best execution. Specifically, this change ensures that an investor's order would be routed to the market participant in Nasdaq that is displaying the best price, when considering quote access fees. Accordingly, the NASD and Nasdaq believe that these changes are consistent with Sections 15A(b)(6) and (b)(11) of the Act,²⁵ and Sections 11A(a)(1)(C) and 11A(a)(1)(D).²⁶

The NASD and Nasdaq believe that the changes regarding the handling of agency orders from UTP Exchanges is consistent with Congress view of a national market system. That is, this approach assures that a customer's order in a Nasdaq security, no matter where it is entered in the National Market System, would be executed on a price/time priority basis. Accordingly, the NASD and Nasdaq believe the proposal is consistent with Sections 11A(a)(1)(C) and 11A(a)(1)(D) of the Act.²⁷

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

The NASD and Nasdaq do 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

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 Amendment No. 4, including whether Amendment No. 4 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 Amendment No. 4 to file number NASD-99-53 and should be submitted by April 20, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority,²⁸

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00-7840 Filed 3-29-00; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42571; File No. SR-NASD-99-37]

Self Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change Relating to Use of Hard To Borrow Lists

March 23, 2000.

I. Introduction

On August 4, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary, NASD Regulation, Inc. ("NASD Regulation"), filed with the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to amend NASD Rule 3370. The proposal permits the use of a "Hard to Borrow" list to comply with affirmative determination requirements for short sales. The NASD submitted Amendment No. 1 to the proposed rule change on November 1, 1999.³ Notice of the proposed rule change, as amended, was published in the **Federal Register** on January 7, 2000.⁴ The Commission received no comments on the proposal.⁵ This order approves the proposed rule change.

II. Description of the Proposal

NASD Rule 3370 was designed to prevent abusive short selling and ensure that short sellers satisfy their settlement obligations. The rule currently requires a member or associated person to make an affirmative determination prior to executing certain short sales that it will receive delivery of the subject security, or be able to borrow or otherwise provide delivery of the security, by

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Letter from Alden Adkins, Senior Vice President and General Counsel, NASD Regulation, to Katherine England, Assistant Director, Division of Market Regulation, Commission, dated October 26, 1999.

⁴ See Securities Exchange Act Release No. 42306 (January 3, 2000), 64 FR 49261 ("Notice").

⁵ Per the Commission's request, NASD submitted an additional, technical amendment to the proposed rule change deleting a sentence from the descriptive portion of the Notice. The sentence stated that member firms that rely on "Hard to Borrow" lists would be required under the proposed rule change to maintain such lists. This requirement is not stated in the actual text of the proposed rule change, which was published as part of the Notice. See Letter from Mary N. Revell, Associate General Counsel, NASD Regulation, to Katherine England, Assistant Director, Division of Market Regulation, Commission, dated March 14, 2000.

²³ 15 U.S.C. 78o-3(b)(6) and (b)(11).

²⁴ 15 U.S.C. 78k-1(a)(1)(C).

²⁵ 15 U.S.C. 78o-3(b)(6) and (b)(11).

²⁶ 15 U.S.C. 78k-1(a)(1)(C) and (a)(1)(D).

²⁷ 15 U.S.C. 78k-1(a)(1)(C) and (a)(1)(D).

²⁸ 17 CFR 200.30-3(a)(12).