

Form T-4 is used to apply for an exemption from certain provisions of the Trust Indenture Act. The information required by Form T-4 is mandatory. All information is provided to the public upon request. Form T-4 takes 5 burden hours to prepare and is filed by 3 respondents for a total of 15 burden hours.

Rule 14f-1 requires issuers to disclose a change in a majority of issuer directors. The information filed under Rule 14f-1 must be filed with the Commission. All information submitted is provided to the public upon request. It takes 18 burden hours to prepare the necessary information and is filed by 44 respondents for a total of 792 burden hours.

Rule 12d1-3 requires a certification that a security has been approved by an exchange for listing and registration pursuant to Section 12(d) of the Securities Exchange Act to be filed with the Commission. The information required under Rule 12d1-3 must be filed with the Commission. All information filed with the Commission is available to the public upon request. It takes one-half hour to prepare the necessary information and is filed by 688 respondents for a total of 344 burden hours.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

Written comments regarding the above information should be directed to the following persons: (i) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10102, New Executive Office Building, Washington, D.C. 20503; and (ii) Michael E. Bartell, Associate Executive Director, Office of Information Technology, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Comments must be submitted to OMB within 30 days of this notice.

Dated: April 18, 2000.

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42713; Form Type 34-36 MR; File No. 79-9]

### Notice of Application and Order Temporarily Granting Application for a Conditional Exemption by the National Association of Securities Dealers, Inc. Relating to the Acquisition and Operation of a Software Development Company by the Nasdaq Stock Market, Inc

April 24, 2000

Pursuant to Rule 0-12<sup>1</sup> under the Securities Exchange Act of 1934 ("Exchange Act"), notice is hereby given that on March 3, 2000, the National Association of Securities Dealers, Inc. ("NASD") and the Nasdaq Stock Market, Inc. ("Nasdaq") filed with the Securities and Exchange Commission ("Commission") an application for a conditional exemption under Section 36(a)(1) of the Exchange Act<sup>2</sup> relating to Nasdaq's acquisition and operation of a software development company. In addition, the NASD requested that, if the Commission determined to solicit comment on the application for a permanent exemption, the Commission grant a temporary conditional exemption for a period of one year.

The Commission is publishing this notice to solicit comments from interested persons on the NASD's application for a permanent exemption. For the reasons discussed below, the Commission also is issuing an order at this time approving the NASD's request for a temporary conditional exemption for a period of one year from the date of this release. The Commission will make a final determination concerning the request for a permanent exemption after reviewing the comments submitted in response to this notice and prior to the expiration of the temporary exemption.

The text of the NASD's application is set forth in section 1 below,<sup>3</sup> followed by the Commission's solicitation of comments on the NASD's request for a permanent exemption in section II and the Commission's order granting the NASD's request for a temporary exemption in section III.

#### I. NASD's Application for Exemption

On behalf of the NASD and Nasdaq, pursuant to Section 36 of the Securities Exchange Act of 1934 and Rule 0-12

thereunder, we are writing to apply for an exemption from Section 19(b) of the Exchange Act, to (1) permit Nasdaq to acquire and operate a software development company, Financial Systemware, Inc. ("FSI"), to market certain financial services software, "OTC Tools" and related software ("Software"), and to expand the products and services offered by FSI to include service bureau and back-office functions for NASD broker-dealers, without filing proposed rule changes pursuant to Rule 19b-4 under the Exchange Act of before making or implementing any modifications to the Software, or with respect to each new software product or service offered by FSI (provided those new software products and services are offered in a manner that is not inconsistent with the presentation contained in this letter), and (2) permit FSI to determine prices for such software products and services based on competitive market factors without filing proposed rule changes pursuant to Rule 19b-4 under the Exchange Act.

#### A. Background

The NASD is a national securities association registered under Section 15A of the Exchange Act. As a national securities association, the NASD is a self-regulatory organization ("SRO") as defined by Section 3(a)(26) of the Exchange Act. Though its subsidiaries, NASD Regulation, Inc., the American Stock Exchange, Inc. and Nasdaq, the NASD develops rules and regulations, conducts regulatory review of its members' business activities, and designs and operates marketplace facilities and services.

The NASD also has three other subsidiaries: (1) Nasdaq International, Ltd., which provides services to domestic and foreign companies, (2) Securities Dealers Insurance Co., Inc., which provides reinsurance services in connection with a fidelity bond program for NASD members, and (3) Securities Dealers Risk Purchasing Group, which provides professional liability insurance to NASD members.

The NASD sets the overall strategic direction and policy agenda of the whole organization, oversees the effectiveness of its subsidiaries and ensures that the organization's statutory and self-regulatory obligations are fulfilled.

Subject to receiving the exemptive relief requested herein, Nasdaq plans to acquire the assets of FSI, whose primary line of business is the development and distribution of a financial services software product called "OTC Tools." OTC Tools is designed for and marketed

<sup>1</sup> 17 CFR 240.0-12.

<sup>2</sup> 15 U.S.C. 78mm(a)(1).

<sup>3</sup> The NASD filed its application on March 3, 2000. Subsequently, Nasdaq completed its acquisition of the assets of the software development company.

to NASD broker-dealers that use Nasdaq Workstation II terminals. OTC Tools is a Microsoft Windows-based software product that enhances and simplifies a user's interactions with, and use of, the Nasdaq Workstation II terminal, but does not change or alter the current features of Nasdaq, SelectNet or SOES (*i.e.*, required to publish notice of it and provide an opportunity for public comment. The proposed rule change may not take effect unless approved by the Commission by order, or unless the rule change is within the class of rule changes that are effective upon filing pursuant to Section 19(b)(3)(a).<sup>6</sup>

Currently, the Software which is being commercially marketed to NASD broker-dealers, offers a variety of features to assist them in efficiently managing their quotes, monitoring and executing incoming orders, continually checking for closed, locked or crossed markets, and monitoring the depth of the market. There is a high level of effective competition in providing these types of software products and services to market participants. For example, Automatic Securities Clearance, through its BRASS service, provides order-management services and software to a large number of NASD member firms that are in many respects similar to the Software. Other firms, such as Eagle Trading, ADP, TCAM and Royal Blue, offer order handling packages that compete with those offered by FSL. Similarly, many NASD member firms have developed internal order management and order-routing software that provides independent functions comparable to those provided by the Software.

Given the NASD's complex infrastructure and the dramatic acceleration of technological changes that are impacting the securities markets, the NASD and Nasdaq believe that they must have the capability to respond quickly to the technological needs of NASD members. The NASD and Nasdaq believe that the acquisition of FSI will greatly improve Nasdaq's ability to provide such rapid solutions to its members' technological needs. Nasdaq also plans to expand the products and services offered by FSI to include service bureau and back-office functions<sup>4</sup> for NASD broker-dealers.

#### *B. Basis for Relief Sought and Anticipated Benefits to Investors*

Section 19(b)(1) of the Exchange Act requires an SRO,<sup>5</sup> including the NASD (as a registered securities association

<sup>4</sup> For example, FSI may perform for its customers, service bureau and back-office functions, including ACT trade reporting, trade comparison, and position and account management functions (*e.g.*, profit and loss calculations).

<sup>5</sup> Section 3(a)(26) of the Exchange Act defines the term "self-regulatory organization" to mean "any national securities exchange, registered securities association, registered clearing agency, and, for purposes of Section 19(b) and other limited purposes, the Municipal Securities Rulemaking Board ("MSRB")."

under Section 15A of the Exchange Act), to file with the Commission its proposed rule changes accompanied by a concise general statement of the basis and purpose of the proposed rule change. Once a proposed rule change has been filed, the Commission is required to publish notice of it and provide an opportunity for public comment. The proposed rule change may not take effect unless approved by the Commission by order, or unless the rule change is within the class of rule changes that are effective upon filing pursuant to Section 19(b)(3)(a).<sup>6</sup>

Section 19(b)(1) of the Exchange Act defines the term "proposed rule change" to mean "any proposed rule or rule change in, addition to, or deletion from the rules of [a] self-regulatory organization." Pursuant to Section 3(a)(27) and 3(a)(28) of the Exchange Act, the term "rules of a self-regulatory organization" means (1) the constitution, articles of incorporation, bylaws and rules, or instruments corresponding to the foregoing, of an SRO, and (2) such stated policies, practices and interpretations of an SRO (other than the MSRB) as the Commission, by rule, may determine to be necessary or appropriate in the public interest or for the protection of investors to be deemed to be rules. The Commission has exercised this rulemaking authority by adopting Rule 19b-4(b) under the Exchange Act, which defines the term "stated policy, practice, or interpretation."

Rule 19b-4(b) defines the term "stated policy, practice, or interpretation" to mean generally "any *material aspect of the operation of the facilities of the self-regulatory organization*<sup>7</sup> or any

<sup>6</sup> Under Section 19(b)(3)(A) of the Exchange Act and rule 19b-4(e) thereunder, a proposed rule change may take effect upon filing without the notice and approval procedures required by Section 19(b)(2) if the proposed rule change comes within prescribed statutory categories, including rule changes that (1) constitute a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the SRO, (2) establish or change a due, fee, or other charge imposed by the SRO, (3) are concerned solely with the administration of the SRO, or (4) are matters which the Commission may, consistent with the public interest and the purposes of this subsection, specify by rule.

<sup>7</sup> The term "facilities of the self-regulatory organization" is not defined in the Exchange Act. The term "facility" is defined in Section 3(a)(2) of the Exchange Act, but only with respect to an exchange (as defined in Section 3(a)(1), to "include \* \* \* its premises, tangible or intangible property whether on the premises or not, any right to use such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service."

*statement made available to the membership, participants, or specified persons thereof that establishes or changes any standard, limit, or guideline with respect to rights and obligations of specified persons or the meaning, administration, or enforcement of an existing rule."* (Emphasis added.)

To the extent that the software or related services (or portions thereof) offered by FSI to Nasdaq member firms would be a "facility" of an SRO, Section 19(b) of the Exchange Act, and rule 19b-4, would, absent an exemption, require the NASD to file proposed rule changes with the Commission in certain instances where FSI seeks to modify the Software or the fees it charges for providing it. Technology applications for broker-dealers and market makers develop and change very rapidly, and FSI needs to be able to move quickly to modify existing products and develop new software products. If FSI were required to follow the procedures for rule filings and approvals each time the Software is modified or enhanced, the delays and administrative difficulties associated with the rule filing process would put FSI at a significant competitive disadvantage relative to other software developers that are not affiliated with an SRO. Moreover, the NASD and Nasdaq would not be able to provide NASD broker-dealers with the type of timely and effective software development that users desire and have indicated they need. Thus, in this competitive software market, the delays and administrative difficulties associated with the rule filing process would, in the NASD's view, put FSI at such a competitive disadvantage so as to render the acquisition of FSI or the rights to the software impracticable.

As noted above, because of the NASD's complex infrastructure and the dramatic acceleration of technological changes that are impacting the securities markets, the NASD believes that it must have the capability to respond quickly to the technological needs of its members. The NASD believes that the acquisition of FSI by Nasdaq will greatly improve Nasdaq's ability to provide such rapid solutions to its members' technological needs. If, however, the NASD and Nasdaq cannot as a practical matter compete in the software market, the result would be the inhibition of the development of more efficient and effective market operations and economically efficient execution of securities transactions—each a stated Congressional goal under Section 11A of the Exchange Act, which directs the Commission to facilitate the development of a national market

system. Furthermore, as more efficient means are developed for NASD broker-dealers to manage and monitor their quotations, order flow, executions and positions, the cost savings derived from these efficiencies can be passed on to investors through reduced spreads and transactions costs, as well as through increased liquidity in the over-the-counter market. Absent full and effective competition in the software market, the incentive to develop new and beneficial software for market maker use is reduced, thereby reducing the opportunity to pass along the benefits to investors.

### C. Discussion

The Commission has general exemptive authority pursuant to Section 36 of the Exchange Act, and Rule 0-12 thereunder, in pertinent part, to exempt any person from any Exchange Act provision or rule, to the extent that such exemption is necessary or appropriate, in the public interest, and is consistent with the protection of investors. In order for the NASD and Nasdaq to compete effectively in providing software and service bureau functions to NASD broker-dealers, the NASD respectfully requests that the Commission exercise its general exemptive authority and exempt the NASD from the requirements of Sections 19(b) to (1) permit it to operate FIS and offer software to market makers (and other NASD member firms) without filing proposed rule changes with respect to making or implementing any modifications to the Software, or with respect to each new software product or service offered by FSI to (provided those new software products and services are offered in a manner that is not inconsistent with the representations contained in this letter), and (2) permit FSI determine prices for such software products and services based on competitive market factors without filing proposed rule changes. In particular, the NASD requests an exemption from Section 19(b) of the Exchange Act with respect to any rule filings that would otherwise be required under that Section and the rules and regulations thereunder.

Given the rapid advances in technology, the increasing reliance of the financial industry on automation and the degree of competition in the supply of technological solutions, we believe that in certain circumstances, including those presented in this request, a policy distinction can be made between essential or core SRO services and ancillary non-essential or optional services such as those offered by FSI to permit the latter category of

services to be offered by an SRO on a fully competitive basis without compliance with the notice and comment process while at the same time ensuring that those services are offered in a way that is consistent with the goals and requirements of the Exchange Act.

As noted above, OTC Tools offers a variety of features to assist NASD broker-dealers in efficiently managing their quotes, monitoring and executing incoming orders, continually checking of closed, locked or crossed markets, and monitoring the depth of the market. These functions to be performed by OTC Tools are not central to the core functionality of Nasdaq's marketplace. Rather the functions involved are supplemental to, and independent of, the primary functions of Nasdaq.

Moreover, the NASD and Nasdaq believe that the exemption requested is consistent with the purposes of the Exchange Act, particularly the protection of investors, the maintenance of fair and orderly markets, and the fostering of competition. This segment of the financial software market is highly competitive. As discussed above, there are a number of other firms that offer competing products to OTC Tools. The NASD and Nasdaq purpose that Nasdaq will operate FSI as a stand-alone business, capitalized separately and not subsidized by NASD members or other revenues of the NASD or Nasdaq.<sup>8</sup>

In addition, the NASD and Nasdaq would take appropriate steps to ensure that FSI would not have any information advantage regarding planned developments and changes to Nasdaq that would not also be available to other competing vendors. Finally, the core functions of Nasdaq would not be altered as a result of the acquisition, and the NASD and Nasdaq will take all reasonable steps necessary to ensure that market makers and order-entry firms will continue to have the ability to trade effectively through Nasdaq's essential facilities without using the Software.

### D. Conditions

As described in Exchange Act Rule 0-12, in connection with a request for exemption from any provision of the Exchange Act, the applicant is required to state any conditions or limitations it believes would be appropriate for the protection of investors. As a general matter, the NASD and Nasdaq believe the request submitted herein is appropriate because it deals with

<sup>8</sup>The NASD, of course, reserves the right to provide capital to FSI adequate for it to compete effectively in the market place and to develop and market new products and services.

nonessential services of the NASD and provides the benefit of optional technological innovation designed to improve the productivity of NASD member firms. The following limitations on the exemptive relief requested are, in the view of NASD and Nasdaq, not objectionable to further this objective and to ensure that the operation of FSI is generally consistent with the requirements of the Exchange Act applicable to SROs.

*Continued Presence of Competition*—As indicated above, at the time of this application, there is a high level of effective competition in providing software to market makers. Automatic Securities Clearance, through its BRASS service, for example, provides order-management services and software that are in many respects similar to the Software to a large number of NASD member firms. Other firms, such as Eagle Trading, ADP, TCAM and Royal Blue, offer order handling packages that compete with those offered by FSI. Similarly, many NASD member firms have developed internal order management and order management and order-routing software that provides independent functions comparable to those provided by the Software. Moreover, the software industry in general, and the financial software industry in particular, have low barriers to entry, so that, as the markets evolve and technology is increasingly brought to bear on securities trading, new entrants can, in our view, emerge. NASD and Nasdaq understand that the Commission may reconsider at a later date its decision to grant the exemptive relief requested herein in the event that effective competition for these software products and services no longer exists.

*Independent Functionally of Nasdaq and Other NASD-Sponsored Services*—NASD and Nasdaq believe that providing the Software to NASD member firms does not, and will not, affect the basic functionality of the Nasdaq system. In acquiring FSI and providing the software to NASD member firms, the core functions of Nasdaq (currently provided through the Nasdaq Workstation II terminal system) will not be changed. Nasdaq and other NASD-sponsored systems (such as the Automated Confirmation Transaction Service) operate and will continue to operate independently of the Software. Use of the Software is not, and will not in the future, be necessary to access Nasdaq or any other NASD market-related facility, and NASD members that do not use the Software will be able to enter and change quotes, route orders, effect transactions and perform all market functions in Nasdaq. The NASD

and Nasdaq believe that requiring full Nasdaq core functionality without use of the Software is an appropriate condition to the grant of the exemptive relief requested.

*Full Public Access to Nasdaq through the Application Programming Interface ("API")<sup>9</sup> will Continue*—As the Commission is aware, the Nasdaq system is an open architecture system and Nasdaq has provided an API that enables firms to have access to the Nasdaq system through their own software or computer system. The NASD and Nasdaq are fully committed to maintaining the API to provide for fair and equitable access to the system and to encourage the development of software by NASD member firms and competing software vendors. Thus, we believe that conditioning the exemptive relief on continued free and open access to Nasdaq through the API is appropriate in light of the commitment of the NASD and Nasdaq to maximum competition in offering services to NASD members.

*Fair Access to Information on Nasdaq Developments*—As a fourth condition consistent with the statutory objective and our stated objective of maintaining a competitive software market, the NASD and Nasdaq, as noted above, agree not to provide FSI an information advantage concerning Nasdaq core facilities, particularly changes and improvements to the system, that is not available to the industry generally or to vendors of financial software for market makers and order entry firms, and will prevent FSI from having any advance knowledge of proposed changes or modifications to core Nasdaq facilities. This is appropriate to avoid giving FSI any informational advantage in the development and enhancement of software products for the Nasdaq market.

In this regard, FSI will not share employees with the NASD, Nasdaq or any other NASD affiliate, and will be housed in office space from that of the

<sup>9</sup> API provides an electronic interface between a subscriber's computer system and the Nasdaq Workstation II system. Through the use of the API, a subscriber may build its own workstation presentation software to integrate the Nasdaq Workstation II service into the subscriber's existing presentation facilities. The API allows a subscriber to emulate the Nasdaq Workstation II presentation software with equivalent functionality, capacity utilization and through-put capability, in addition to providing enhanced capability to develop customized internal presentations for use in support of a subscriber's activities. API also allows a subscriber to operate a quote-update facility to assist solely in complying with the Commission's Order Handling Rules. Generally, a subscriber establishes an API "linkage," such as Nasdaq Workstation II substitute or quote update facility, which in turn connects to a service delivery platform via an API server.

NASD or Nasdaq. In addition, FSI will be notified of any change or improvements to the Nasdaq system in the same manner that other competing vendors are notified of such changes or improvements. For example, in addition to mailings and Web site disclosure of changes to Nasdaq or to Nasdaq technical specifications, Nasdaq currently meets at least quarterly with all vendors to discuss proposed modifications to the System and changes that are in the pipeline (subject to Commission approval, where needed). FSI will be treated, for purposes of these mailings, disclosures and meetings, the same as any third party vendor and will not receive any information regarding planned or actual changes to Nasdaq in advance of other vendors. Conversely, FSI will not disclose any system or design specifications, or any other information to any employees with the NASD, Nasdaq or any other NASD affiliate that would give FSI and unfair advantage over its competitors.

#### *E. Conclusion*

For the reason set forth above, the NASD hereby requests that the Commission grant an exemption from Sections 19(b), and the rules and regulations thereunder, to (1) permit the Nasdaq to operate FSI and offer software to market makers (and other NASD member firms) without filing proposed rule changes with respect to making or implementing any modifications to the Software, or with respect to each new software product or service offered by FSI (provided those new software products services are offered in a manner that is not inconsistent with the representations contained in this letter), and (2) permit FSI to determine prices for such software products and services based on competitive market factors without filing proposed rule changes. If the Commission believes that notice of this request and an opportunity for public comment is necessary, the NASD requests that the Commission grant the relief requested, on a temporary basis, for a period of one year, and that thereafter, following the conclusion of any such notice and comment period, the Commission grant the requested relief on a permanent basis.

#### **II. Solicitation of Comments**

Section 36(b) of the Exchange Act provides that the Commission shall, by rule or regulation, determine the procedures under which an exemptive order shall be granted. Exchange Act Rule 0-12(g) provides that the Commission, in its sole discretion, may choose to publish in the **Federal**

**Register** a notice of an application for an exemption under Section 36 and to allow any person to submit information that relates to the action requested in the application. The Commission has determined that, prior to taking final action on the NASD's application for a permanent exemption, it would be helpful to offer the public an opportunity to submit information concerning the permanent exemption and the conditions on which the exemption is based. Accordingly, interested persons are invited to submit written data, views, and arguments concerning the NASD's application for an exemption. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington DC 20549-0609. All submissions should refer to Form Type 34-36 MR; File No. 79-9 and should be submitted by July 31, 2000. Comment letters received will be available for public inspection and copying in the Commission's Public Reference Room.

#### **III. Order Granting Temporary Conditional Exemption**

The Commission has determined to grant the NASD's request for a temporary conditional exemption for a period of one year from the date of this release. The Commission finds that the temporary conditional exemption from the provisions of Section 19(b) is necessary or appropriate in the public interest and is consistent with the protection of investors. In particular, the exemption could help promote efficiency and competition in the market to provide enhanced software services to broker-dealers who interact with the NASD's facilities, while upholding the regulatory objectives of the Exchange Act. After the end of the public comment period set forth in section II above and prior to expiration of the temporary exemption, the Commission will make a final determination concerning the NASD's application for a permanent exemption.<sup>10</sup>

As discussed further below, the NASD, as a registered self-regulatory organization, operates a number of facilities used by broker-dealers that effect transactions in securities in the over-the-counter market, particularly securities that are qualified for inclusion in Nasdaq. These facilities, which

<sup>10</sup> The Commission's approval of the NASD's request for a temporary conditional exemption should not be interpreted as suggesting that the Commission is predisposed to approving the NASD's application for a permanent exemption subject to the same conditions.

include the automated quotations network that is the heart of Nasdaq, order delivery and execution systems, and a transaction reporting system, are made available to broker-dealer subscribers primarily through the Nasdaq Workstation II ("NWII") service. The NASD has adopted an open architecture system that provides an API between the NWII system and a subscriber's computer system. The API allows broker-dealers to employ specialized software that supplements the NWII service and enhances their interaction with the NASD's facilities, thereby facilitating their trading and other proprietary activities. Currently, a number of companies independent of the NASD offer this type of software product for sale to broker-dealers. Nasdaq has acquired one of these companies—FSI.

Certain of the functions offered through FSI's products, when considered together with the other services offered by the NASD and its affiliates,<sup>11</sup> could cause such products to be considered part of the NASD's facilities. Consequently, changes to the products or the fees charged for the products could trigger the proposed rule change requirements of Section 19(b), which includes filings with the Commission, public notice and comment on those filings, and Commission review and approval of the proposed rule change. These requirements could significantly hamper the ability of FSI to compete effectively in a rapidly changing technology market to provide specialized software to broker-dealers. The requested temporary conditional exemption would allow FSI to modify its products, offer new products, and set fees for its products without going through the proposed rule change procedures of Section 19(b).

In granting the Commission broad exemptive authority in Section 36, Congress intended to incorporate flexibility into the Exchange Act regulatory scheme to reflect a rapidly changing marketplace. Congress particularly intended for the Commission to use this flexibility to promote efficiency and competition. The Commission believes that the NASD's requested temporary conditional exemption will help achieve these goals, while upholding the regulatory objectives of the Exchange

Act. In particular, the exemption could facilitate vigorous competition in the market to provide enhanced software services to broker-dealers by allowing FSI to compete on a more equal footing with companies that are not subject to the regulatory requirements applicable to an SRO. The exemption is subject to four principal conditions to help assure that FSI will not obtain an unfair competitive advantage because of its ownership by Nasdaq.

The Commission believes that granting a temporary conditional exemption is warranted because (1) the products of FSI will not be required for broker-dealers to access the NASD's fundamentally important or core services, including quotation collection and dissemination, order routing and execution, and transaction reporting, and (2) the opportunity for fair competition will be preserved in the market to provide enhanced software services to broker-dealers who use the NASD's facilities. Under these circumstances, the Commission believes that competitive forces, rather than the regulatory protections provided by the proposed rule change process, can be relied on to uphold the objectives of the Exchange Act in an efficient manner during the one-year period of the temporary exemption. Fair and vigorous competition, by creating incentives for companies to provide superior software products at fair prices, can serve the interests of broker-dealers, and ultimately those of their investor customers.

#### *A. The NASD's Facilities and Its Open Architecture System*

The NASD currently operates a number of facilities for broker-dealers that effect transactions in securities traded in the OTC markets. These facilities include (1) an automated quotations system, (2) the SelectNet order delivery system,<sup>12</sup> (3) the Small Order Execution System ("SOES"), and (4) the Automated Confirmation Transaction Service ("ACT").

At its heart, Nasdaq is a telecommunications network for the centralized collection and dissemination of quotations from market makers and electronic communications networks ("ECNs"). This service allows broker-dealers to enter, retrieve,

monitor, and adjust quotations throughout the trading day. The NASD's SelectNet facility offers broker-dealers the ability to automate the negotiation and execution of trades and eliminates the need for verbal contact between trading desks. It allows Nasdaq subscribers to direct orders for the purchase and sale of Nasdaq stocks to specified market makers or ECNs, or to broadcast orders for Nasdaq stocks to all market makers and ECNs. SelectNet also identifies incoming and outgoing orders and allows traders to see subsequent messages and negotiation results. The NASD's SOES facility automatically executes small agency orders routed to market makers, reports completed trades for public dissemination, and sends information with respect to those trades to clearing corporations for comparison and settlement. Finally, the NASD's ACT facility is an automated service that speeds the post-execution steps of price and volume reporting and the comparison and clearing of securities transactions.

Access to the NASD's facilities is made available primarily through the NASD's NWII service. In addition, the NASD has adopted an open architecture system that provides full public access to its facilities through API. The API provides an electronic interface between a subscriber's computer system and the NWII system. Through the use of the API, a subscriber may employ its own workstation presentation software to integrate the NWII services into its presentation capabilities. The API thereby allows a subscriber to develop customized internal presentations for use in support of the subscriber's activities. In sum, fundamentally important or core NASD services are provided through the NWII system, while subscribers also are able to develop or purchase customized software that enhances the NWII services and responds to their individual needs.

Many broker-dealers have taken advantage of the API and employ software to enhance the NASD services provided through the NWII system. Some broker-dealers have developed such software internally. In addition, a number of companies independent of the NASD have developed this type of software and offered it for sale to broker-dealers. For example, the promotional materials of one company states that its product "provides fully integrated and enhanced Nasdaq Workstation II features," including automated management of quotations, automated ACT reporting, and automated SelectNet order entry and order acceptance. Other competing companies make similar

<sup>11</sup> The companies that currently offer the enhanced software products for broker-dealers are not owned by an SRO. When considered alone, their activities do not fall within the definition of a facility of an SRO, and they therefore are not subject to the proposed rule change requirements of Section 19(b).

<sup>12</sup> The Commission recently approved a proposed rule change by the NASD to establish a revised order delivery and execution system—the Nasdaq National Market Execution System. Securities Exchange Act Release No. 42344 (Jan. 18, 2000), 65 FR 3987. After implementation of the system, SelectNet will be re-established as a non-liability system for purposes for order delivery and negotiation only.

assertions concerning the ability of their products to enhance the interaction of broker-dealers with the NASD's facilities, as well as to facilitate a wide array of other broker-dealer proprietary activities.

The Nasdaq has acquired one of these companies—FSI. FSI is a software development company that offers a product called OTC Tools. OTC Tools includes a variety of features to assist NASD members in conducting their proprietary activities, including efficiently managing their quotes, monitoring and executing incoming orders, continually checking for closed, locked, or crossed markets, and monitoring the depth of the market.<sup>13</sup> To enable FSI to modify its products, offer new products, and set fees for its products as freely and quickly as its competitors that are not owned by an SRO, the NASD has requested a temporary conditional exemption from the proposed rule change provisions of Section 19(b).

#### *B. Proposed Rule Change Provisions of Section 19(b)*

Section 10(b) requires that every SRO file with the Commission copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such SRO, accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission is required to publish notice of the filing of a proposed rule change and to give interested persons an opportunity to submit written data, views, and arguments. Section 19(b) provides that the Commission shall approve an SRO's proposed rule change if it is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the SRO.

The term "rules of a self-regulatory organization" is defined in Section 3(a)(28) of the Exchange Act to include the rules of an association of broker-dealers that is a registered securities association, and the term "rules of an association" is defined in Section 3(a)(27) to include such of the stated policies, practices, and interpretations of the association as the Commission

determines by rule to be necessary or appropriate in the public interest or for the protection of investors. In Exchange Act Rule 19b-4,<sup>14</sup> the Commission has defined "stated policy, practice, or interpretation" to include any material aspect of the operation of the facilities of a self-regulatory organization. The term "facility" when used with respect to an exchange<sup>15</sup> is defined very broadly in Section 3(a)(2) to include, among other things, any tangible or intangible property of the exchange and any right to the use of such property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including any system of communication to or from the exchange).

Certain aspects of the software products that enhance a broker-dealer's interaction with the NASD's facilities could, when considered together with the other services offered by the NASD and its affiliates, fall within the Exchange Act definition of a facility and therefore require the filing of a proposed rule change for material changes in the software and the fees charged for the software. The NASD has requested a temporary conditional exemption from this requirement under Section 36 of the Exchange Act.

#### *C. Commission's Exemptive Authority Under Section 36*

Section 36(a)(1) of the Exchange Act grants the Commission broad authority to exempt any person from any provision of the Act to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors. In enacting Section 36, Congress indicated that it expected that "the Commission will use this authority to promote efficiency, competition and capital formation."<sup>16</sup> It particularly intended to give the Commission sufficient flexibility to respond to changing market and competitive conditions.

The Committee recognizes that the rapidly changing marketplace dictates that effective regulation requires a certain amount of flexibility. Accordingly, the bill grants the SEC general exemptive authority under both the Securities Act and the Securities Exchange Act. This exemptive authority will allow the Commission the flexibility to explore and adopt new approaches to registration and disclosure. It will also enable

the Commission to address issues relating to the securities markets more generally. For example, the SEC could deal with the regulatory concerns raised by the recent proliferation of electronic trading systems, which do not fit neatly into the existing regulatory framework.<sup>17</sup>

At the same time that it added Section 36 to the Exchange Act, Congress enacted Section 3(f), which charges the Commission, when it is engaged in rulemaking itself or reviewing an SRO rule and is required to consider whether an action is necessary or appropriate in the public interest, also to consider whether the action will promote efficiency, competition, and capital formation.

Section 36 and Section 3(f) reaffirm a fundamental and long-established principle of the Exchange Act—investor interests are best served by a regulatory structure that facilitates fair and vigorous competition among market participants. Congress emphasized this principle, for example, when it amended the Exchange Act in 1975:

In 1936, this Committee pointed out that a major responsibility of the SEC in the administration of the securities laws is to 'create a fair field of competition.' This responsibility continues today. \* \* \* The objective would be to enhance competition and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations in practices and services. It would obviously be contrary to this purpose to compel elimination of differences between types of markets or types of firms that might be competition-enhancing.<sup>18</sup>

In recent years, the Commission has exercised its Section 36 exemptive authority by seeking to enhance competition as a means to meet the objectives of the Exchange Act. For example, it exempted alternative trading systems from many of the requirements that otherwise would apply to an "exchange," including registration and the filing of proposed rule changes, when such requirements were not necessary or appropriate to further the Exchange Act's objectives. In adopting this exemption, the Commission stated that it "believes that its regulation of markets should both accommodate traditional market structures and provide sufficient flexibility to ensure that new markets promote fairness, efficiency, and transparency."<sup>19</sup>

In addition, the Commission has used its exemptive authority to revise the proposed rule change requirements of

<sup>13</sup> For example, the current version of OTC Tools enables a user (1) to maintain a pre-configured maximum market spread in specific securities when making adjustments in a quotation at one side of the market; (2) to capture and execute incoming SelectNet orders in several different fashions by combining multiple keystroke or mouse functions; (3) to send, with a single point-and-click feature, multiple SelectNet preferenced orders to preset market makers or ECNs; and (4) to monitor SelectNet broadcast orders for electronic execution based on the user's pre-configured order selection file.

<sup>14</sup> 17 CFR 240.19b-4

<sup>15</sup> The Commission has found that Nasdaq falls within the definition of "exchange" under Section 3(a)(1) of the Act. Securities Exchange Act Release No. 40760 (Dec. 8, 1998), 63 FR 70844 ("ATS Release"), at nn. 58-61 and accompanying text.

<sup>16</sup> H.R. Rep. No. 104-622, 104th Cong., 2nd Sess. 38 (1996).

<sup>17</sup> S. Rep. No. 104-293, 104th Cong., 2nd Sess. 15 (1996).

<sup>18</sup> S. Rep. No. 94-75, 94th Cong., 1st Sess. 8 (1975).

<sup>19</sup> ATS Release, note 15 above, section I.

Section 19(b) to meet the changing needs of the SROs in a competitive international marketplace. For example, the Commission amended Rule 19b-4 in 1998 to streamline the requirements for introduction of new derivative securities products.<sup>20</sup> At the same time, the Commission adopted rule 19b-5 to help reduce impediments to competitive innovation by SROs by exempting them from the requirement to file proposed rule changes for pilot trading systems for a two-year period. In adopting this exemption, the Commission noted that "excessive regulation of traditional exchanges, alternating trading systems, or other markets hinders these exchanges' ability to compete and survive in the global arena" and found that the exemption from Section 19(b) for pilot trading programs "responds to the SROs' need for a more balanced competitive playing field."<sup>21</sup>

#### *D. Temporary Conditional Exemptions for FSI*

The NASD has requested a temporary conditional exemption that would allow FSI to modify its products, offer new products, and set fees for its products without filing proposed rule changes under Section 19(b). The exemption would be subject to four principal conditions: (1) the continued presence or effective competition in the market to provide software products that enhance a broker-dealer's interaction with the NASD's facilities; (2) the independent functionality of the NASD's facilities; (3) continued full public access to the NASD's facilities through the API; and (4) fair access to information concerning the NASD's facilities and systems.

The Commission believes that the requested temporary conditional exemption could help promote efficiency and competition, while upholding the regulatory objectives of the Exchange Act. Nasdaq's ownership of a software company whose products facilitate a broker-dealer's interaction with the NASD's facilities could promote efficiency and competition in at least two ways. First, Nasdaq's detailed knowledge of the needs of NASD members could lead FSI to develop products with features that more closely respond to those needs and that increase the efficiency of broker-dealer operations. Second, Nasdaq ownership could help assure that software is developed and made available that will meet the needs of the wide variety of broker-dealers that are NASD members, both large and small.

Thus, the existence of a Nasdaq-owned company offering enhanced software products could act as a spur to competition and thereby help generate better software products for broker-dealers.

Given the pace of change in software technology and market conditions, the Commission believes at this point that the procedural requirements of Section 19(b) could significantly hamper the ability of FSI to compete effectively with companies that are not subject to the same regulatory requirements. A software company needs to act rapidly and nimbly in developing and pricing its products. If FSI were required to comply with the proposed rule change requirements, it necessarily would be subject to greater expense, delay, and uncertainty in offering products and setting prices than its competitors. Although the requirements of Section 19(b) serve vital regulatory functions, particularly with respect to the fundamentally important or core services of an SRO, the Commission does not believe at this point that they are necessary to further the public interest in the context of the limited services to be provided by FSI.

In reviewing a proposed rule change under Section 19(b) the Commission focuses on the particular section of the Exchange Act that sets forth substantive requirements for the SRO's rules. For a national securities association such as the NASD, Section 15A of the Exchange Act requires, among other things, that its rules (1) provide for the equitable allocation of reasonable dues, fees, and other charges among members using any facility or system which the association operates or controls (subparagraph (b)(5)); (2) be designed to promote just and equitable principles of trade, 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, or broker-dealers (subparagraph (b)(7)); and (3) not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act (subparagraph (b)(9)).

The four principal conditions of the requested temporary exemption will help assure that these regulatory objectives are upheld during the one-year period of the exemption without requiring Commission review and approval of FSI's products and fees.<sup>22</sup>

First, the products of FSI will not be necessary for broker-dealers to access the NASD's fundamentally important or core services, including quotation collection and dissemination, order routing and execution, and trade reporting.<sup>23</sup> The NASD and Nasdaq have agreed to maintain an independent functionality for the NASD's market-related facilities—that is, FSI's products nor enhance software products of any kind will be necessary for a broker-dealer to obtain access to the NASD's fundamentally important or core services. The basic software products necessary to obtain such access (currently provided through the NWII service) will be provided separately from FSI.

In addition, for broker-dealers who wish to employ software products that enhance their interaction with the NASD's facilities, the exemption is conditioned on the continued existence of effective competition in the market to provide such type of products. This condition will assure that broker-dealers have a variety of viable software products from which to choose. To maintain an opportunity for fair competition, the NASD and Nasdaq have agreed to continue to provide open architecture systems that enable full public access to the NASD's facilities through the API. The NASD and Nasdaq also have agreed not to provide an unfair information advantage to FSI. FSI will not be given information that is not available to the industry generally or to other companies competing to provide enhanced software products to broker-dealers. In particular, the NASD and Nasdaq will prevent FSI from having any advance private knowledge of proposed changes or modifications to the NASD's facilities. To help meet this condition, FSI will not share employees with the NASD or any NASD affiliate and will be housed in office space separate from that of the NASD and Nasdaq.

Given these conditions, the Commission does not believe that the regulatory protections offered by Commission review and approval of

determines such modification is appropriate for the protection of investors or in the public interest.

<sup>23</sup>This approach is consistent with the Commission's decision in an administrative proceeding that included a denial of access claim under Section 19(d) of the Exchange Act. *In the Matter of the Application of Morgan Stanley & Co.*, Admin. Proc. File No. 3-9289 (Dec. 17, 1997) ("In those cases in which we have found a denial of access, an SRO had denied or limited the applicant's ability to utilize one of the fundamentally important services offered by the SRO. The services at issue were not merely important to the applicant but were central to the function of the SRO.")

<sup>20</sup> Securities Exchange Act Release No. 40761 (Dec. 8, 1998), 63 FR 70952.

<sup>21</sup> ATS Release, note 15 above, section VI.A.

<sup>22</sup> The Commission reserves the right to modify, by order, the terms and scope of the exemption from the proposed rule change requirements if it

proposed rule changes are necessary or appropriate to further the Exchange Act's regulatory objectives during the one-year period of the temporary exemption. Access to the NASD's fundamentally important and core services will be independently maintained by the NASD and fully subject to the Exchange Act's regulatory scheme, including the proposed rule change requirements of Section 19(b). Fair competition will be maintained in the market to provide enhanced software products to broker-dealers. Under these circumstances, the Commission believes at this point that competitive forces can be relied upon to produce software products at fair prices that meet the needs of broker-dealers. In sum, the Commission believes that FSI will neither be unnecessarily hampered in its competition to provide software services to broker-dealers nor given an unfair competitive advantage because of its ownership by Nasdaq.

For the reasons discussed above, the Commission finds that the temporary conditional exemption requested by the NASD is necessary or appropriate in the public interest and is consistent with the protection of investors.

*It Is Therefore Ordered*, pursuant to Section 36(a)(1) of the Act,<sup>24</sup> that the NASD's application for a temporary conditional exemption (Form Type 34-36 MR; File No. 79-9) is granted for a period of one year until April 24, 2001.

By the Commission.

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 00-10725 Filed 4-28-00; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-24402, 812-11650]

### The Pacific Corporate Group Private Equity Fund, et al., Notice of Application

April 24, 2000.

**AGENCY:** Securities and Exchange Commission ("SEC").

**ACTION:** Notice of application for an order under section 17(d) of the Investment Company Act of 1940 ("Act") and rule 17d-1 under the Act to permit certain joint transactions.

**SUMMARY OF APPLICATION:** The Pacific Corporate Group Private Equity Fund, formerly known as The Alternative Investment Fund (the "Fund"), and Pacific Corporate Group, Inc., formerly

known as Pacific Corporate Advisors, Inc. (the "Adviser"), seek to amend a prior order ("Prior Order") that permits the Fund to co-invest with other investment vehicles managed by the Adviser or its affiliates and/or, under certain circumstances, with the Adviser or its affiliates. The amended order ("Amended Order") would revise certain conditions of the Prior Order.

**Applicants:** The Fund and the Adviser.

**FILING DATES:** The application was filed on June 9, 1999, and amended on February 7, 2000. Applicants agree to file an amendment during the notice period, the substance of which is reflected in this notice.

**Hearing or Notification of Hearing:** An order granting the application will be issued unless the SEC orders a hearing. Interested persons may request a hearing by writing to the SEC's Secretary and serving applicants with a copy of the request, personally or by mail. Hearing requests should be received by the SEC by 5:30 p.m. on May 19, 2000, and should be accompanied by proof of service on applicants, in the form of an affidavit, or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the SEC's Secretary.

**ADDRESSES:** Secretary, SEC, 450 Fifth Street, NW., Washington, DC 20549-0609. Applicants, c/o Brown & Wood LLP, One World Trade Center, New York, New York 10048.

**FOR FURTHER INFORMATION CONTACT:** Paula L. Kashtan, Senior Counsel, at (202) 942-0615, or Mary Kay Frech, Branch Chief, at (202) 942-0564 (Division of Investment Management, Office of Investment Company Regulation).

**SUPPLEMENTARY INFORMATION:** The following is a summary of the application. The complete application may be obtained for a fee at the SEC's Public Reference Branch, 450 Fifth Street, NW., Washington, DC 20549-0102 (telephone (202) 942-8090).

#### Applicants' Representations

1. The Fund is a closed-end management investment company registered under the Act. The Adviser serves as investment adviser to the Fund and is registered under the Investment Advisers Act of 1940. The Fund invests in private equity investments either directly or indirectly through underlying partnerships managed by an adviser not affiliated with the Adviser.

2. On December 4, 1996, the SEC issued the Prior Order to applicants under section 6(c) of the Act exempting applicants from section 12(d)(1)(A) of the Act and pursuant to section 17(d) of the Act and rule 17d-1 under the Act.<sup>1</sup> The Prior Order permits the Fund and Subsequent Funds, as defined in the Prior Order (together with the Fund, the "Funds"), to: (i) invest in unaffiliated private investment companies exempt from the definition of an investment company by section 3(c)(1) of the Act; and (ii) co-invest with Private Funds, as defined in the Prior Order, managed by the Adviser or its affiliates and/or, under certain circumstances, with the Adviser or its affiliates ("Co-Investments").

3. Applicants state that, as a result of amendments to section 3(c)(1) of the Act that became effective in 1997, relief from the provisions of section 12(d)(1)(A) of the Act granted in the Prior Order is no longer required. Accordingly, applicants request that conditions 2 through 7 of the Prior Order be deleted. Applicants represent and understand that, except as requested in the application, the representation set forth in and the terms and provisions of the Prior Order remain unchanged.

#### Applicants' Conditions

Applicants agree that the Amended Order granting the requested relief shall be subject to the following conditions:

1. A majority of the trustees of each Fund ("Trustees") will not be "interested persons," as defined in section 2(a)(19) of the Act, of the Fund ("Non-Interested Trustees").

2. No Co-Investments (except for follow-on investments made pursuant to condition 9 below) will be made pursuant to the requested order with respect to portfolio companies in which the Adviser, any Fund or Private Fund, or any of their affiliates has previously acquired an interest.

3. The Trustees of each Fund participating in a Co-Investment, including a majority of the Non-Interested Trustees, will approve Co-Investments in advance. To facilitate the Trustees' determinations, the Adviser will provide the Trustees of a Fund with periodic information listing all investments made by the other Funds, the Private Funds, and/or the Adviser or its affiliate, as applicable, that would be suitable for investment by a Fund.

4. (a) Before making a Co-Investment, the Adviser will make a preliminary

<sup>1</sup> Investment Company Act Release Nos. 22324 (Nov. 6, 1996) (notice) and 22370 (Dec. 4, 1996) (order).

<sup>24</sup> 15 U.S.C. 78mm(a)(1).