

### Applicants' Legal Analysis

1. Section 15(a) of the Act provides, in relevant part, that it is unlawful for any person to serve as an investment adviser to a registered investment company, except pursuant to a written contract that has been approved by the vote of a majority of the outstanding voting securities of the investment company. Section 15(a) further requires the written contract to provide for its automatic termination in the event of its assignment. Section 2(a)(4) of the Act defines "assignment" to include any direct or indirect transfer of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor. Applicants state that the Merger may result in an assignment of the Existing Advisory Agreements and that such agreements will terminate according to their terms.

2. Rule 15a-4 under the Act provides, in relevant part, that if an investment advisory contract with a registered investment company is terminated due to its assignment, an investment adviser may act as such for the company for 120 days under a written contract that has not been approved by the company's shareholders, provided that: (i) The new contract is approved by that company's board of directors, including a majority of the non-interested directors; (ii) the compensation to be paid under the new contract does not exceed the compensation that would have been paid under the contract most recently approved by the company's shareholders; and (iii) neither the adviser nor any controlling person of the adviser "directly or indirectly receive[s] money or other benefit" in connection with the assignment. Applicants state that they may not rely on rule 15a-4 because BT Corp will receive benefits in connection with the Merger.

3. Section 6(c) of the Act provides that the Commission may exempt any person, security, or transaction from any provision of the Act or any rule thereunder if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with both the protection of investors and the purposes fairly intended by the policy and provisions of the Act. Applicants state that the requested relief meets this standard.

4. Applicants state that the terms and timing of the Merger were determined in response to a number of factors beyond the scope of the Act and substantially unrelated to the Funds. Applicants assert that there is insufficient time to obtain shareholder approval of the New

Advisory Agreements before the Merger is consummated. Applicants further assert that the requested relief would prevent any disruption in the delivery of investment advisory services to the Funds during the period after the Merger.

5. Applicants represent that, under the New Advisory Agreements during the Interim Period, the Funds will receive the same scope and quality of investment advisory services, provided in the same manner, as they receive under the Existing Advisory Agreements. Applicants state that, in the event of any material change in investment management personnel providing services to the Funds, the applicable Adviser will apprise and consult with the relevant Fund's Board to ensure that the Board, including a majority of the non-interested directors, is satisfied that the services provided by the Adviser will not be diminished in scope and quality. Applicants note that the fees payable to the Advisers under the New Advisory Agreements during the Interim Period will be at the same rate as the fees paid under the Existing Advisory Agreements.

### Applicants' Conditions

Applicants agree as conditions to the issuance of the exemptive order requested by the application that:

1. The New Advisory Agreements will contain substantially the same terms and conditions as the Existing Advisory Agreements, except for the date of commencement and termination.

2. The portion of the advisory fees earned by the Advisers during the Interim Period will be maintained in interest-bearing escrow accounts, and amounts in the accounts chargeable to the Funds (including interest earned on such amounts) will be paid to the applicable Adviser only upon approval of each New Advisory Agreement by the relevant Fund's shareholders or, in the absence of such approval, to the Fund.<sup>10</sup>

3. Each fund will schedule a meeting of its shareholders to vote on approval of the New Advisory Agreements, which will be held within 150 days following the commencement of the Interim Period (but in no event later than November 30, 1999).

4. The BT Advisers, or entities controlling them, will pay the costs of

<sup>10</sup> As described in representation 11 in this notice, if the Commission declines to extend the Temporary Order or denies the BT Advisers' request for a permanent section 9(c) order, the BT Advisers may only receive the fees payable to them that were escrowed up to the date on which the Temporary Order or an extension of the Temporary Order expires if the permanent order has not been granted.

preparing and filing the application and the costs relating to the solicitation and approval of Fund Shareholders of the New Advisory Agreements necessitated by the Merger.

5. BT Corp, Deutsche Bank, and applicants will take all appropriate actions to ensure that the scope and quality of investment advisory and other services to be provided to the Funds by the advisers during the Interim Period will be least equivalent, in the judgment of the Boards, including a majority of the non-interested directors, to the scope and quality of services currently provided under the Existing Advisory Agreements. In the event of any material change in investment management personnel providing advisory services pursuant to the New Advisory Agreements, the applicable Adviser will apprise and consult with the relevant Fund's Board to ensure that the Board, including a majority of the non-interested directors, is satisfied that the services provided by the Adviser during the Interim Period will not be diminished in scope or quality.

6. The application and any exemption issued will be without prejudice to, and will not limit the Commission's rights in any manner with respect to, any Commission investigations or enforcement actions pursuant to the federal securities laws, or the consideration by the Commission of any application for exemption from statutory requirements, including without limitation, the consideration of a request for a permanent exemption pursuant to sections 9(c) of the Act, or the revocation, removal, or extension of the Temporary Order.

For the Commission, by the Division of Investment Management, under delegated authority.

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

[FR Doc. 99-11363 Filed 5-5-99; 8:45 am]

BILLING CODE 8010-01-M

### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41343; File No. SR-NASD-99-16]

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. and Amendment No. 1 Thereto Relating to Agency Quotations and Access Fees**

April 28, 1999.

On April 15, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its

wholly owned subsidiary the Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq.<sup>1</sup> On April 22, 1999, the NASD amended the filing.<sup>2</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

Nasdaq is proposing to: (1) amend certain NASD quotation rules to remove any arguable prohibitions that could prevent market makers from charging a fee when their agency quote is accessed; and (2) require market makers and electronic communications networks ("ECNs") to round their quotations to the next minimum quotation increment when the market maker or ECN charges another market participant a fee in excess of one-half of one cent to access its quote. Proposed new language is italicized; proposed deletions are in brackets.

\* \* \* \* \*

#### **3320. Offers at Stated Prices**

No member shall make an offer to buy from or sell to any person any security at a stated price unless such member is prepared to purchase or sell, as the case may be, at such price and under such conditions as are stated at the time of such offer to buy or sell. *It shall be consistent with this rule for a Nasdaq market maker to charge a fee to a market participant that accesses the market maker's Agency Quote (as defined in NASD Rule 4613(b)) so long as the market maker meets all NASD*

*requirements for displaying the Agency Quote.*

#### **IM-3320. Firmness of Quotations**

Members and persons associated with members in the over-the-counter market make trading decisions and set prices for customers upon the basis of telephone and wire quotations as well as quotations in the National Quotation Bureau sheets. In some instances a dealer's quotations, purportedly firm, are, in fact, so qualified upon further inquiry as to constitute "backing away" by the quoting dealer. Further, dealers who place quotations in the sheets have been found to be unwilling to make firm bids or offers upon inquiry in such a way as to pose a question as to the validity of the quotations originally inserted. Such "backing away" from quotations disrupts the normal operation of the over-the-counter market.

Members, of course, change interdealer quotations constantly in the course of trading, but under normal circumstances where the member is making a "firm trading market" in any security, it is expected at least to buy or sell a normal unit of trading in the quoted stock at its then prevailing quotations unless clearly designated as not firm or firm for less than a normal unit of trading when supplied by the member. It should be realized, however, that at times contemporaneous transactions or substantial changes in inventory might well require dealers to quote a "subject market" temporarily.

In order to insure the integrity of quotations, every member has an obligation to correctly identify the nature of its quotations when they are supplied to others. In addition, each member furnishing quotations must insure that it is adequately staffed to respond to inquiries during the normal business hours of such member.

It shall be deemed conduct inconsistent with high standards of commercial honor and just and equitable principles of trade if a member fails to fulfill its obligations as outlined above. *It shall not be a violation of this rule or be deemed conduct inconsistent with high standards of commercial honor and just and equitable principles of trade if a Nasdaq market maker charges a fee for accessing its Agency Quote so long as the market maker meets all NASD requirements for displaying the Agency Quote.*

#### **Rule 4613. Character of Quotations**

(a)-(b) No Change.<sup>3</sup>

<sup>3</sup> In pending File No. SR-NASD-99-11, Nasdaq proposed amendments to NASD Rule 4613(a) which

(c) Firm Quotations.

A market maker that receives an offer to buy or sell from another member of the Association shall execute a transaction for at least a normal unit of trading at its displayed quotations as disseminated in The Nasdaq Stock Market at the time of receipt of any such offer. If a market maker displays a quotation for a size greater than a normal unit of trading, it shall, upon receipt of an offer to buy or sell from another member of the Association, execute a transaction at least at the size displayed. *It shall be consistent with this rule for a Nasdaq market maker to charge a fee to a market participant that accesses through a Nasdaq-provided facility or telephone the market maker's Agency Quote (as defined in NASD Rule 4613(b)), so long as the market maker meets all NASD requirements for displaying the Agency Quote; provided however, a market maker may not charge a UTP Specialist a fee for accessing its quote when the UTP Specialist accesses the Agency Quote by telephone from the floor of the UTP exchange. For purposes of this rule a "UTP Specialist" shall mean a broker/dealer registered as a specialist in Nasdaq securities pursuant to the rules of an exchange that is a signatory 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/NMS/UTP Plan").*

(d)-(e) No Change.<sup>4</sup>

#### **4615. Quotation Rounding and Other Requirements for Agency Quotations and ECNs**

(a) *An electronic communications network ("ECN") included in Nasdaq pursuant to Rule 4623 or a Nasdaq market maker that displays an Agency*

would functionally integrate Nasdaq's SOES and SelectNet system. See Exchange Act Release No. 41296 (April 15, 1999), 64 FR 19844 (April 22, 1999).

<sup>4</sup> Nasdaq recently filed a proposed rule change, SR-NASD-99-09, to permit the separate display of customer orders by market makers in Nasdaq through a market maker agency identification symbol ("Agency Quote"). Under that proposal, the Agency Quote rule would be designated as NASD Rule 4613(b). The current NASD Rule 4613(b), regarding Firm Quotations, would be redesignated as NASD Rule 4613(c), and current NASD rule 4613(c) would be redesignated as NASD Rule 4613(d). That proposal would also eliminate current NASD Rule 4613(d), regarding Reasonably Competitive Quotations, as the requirements of this subparagraph were eliminated as of October 13, 1997 by Exchange Act Release No. 39120 (Sept. 23, 1997), 62 FR 51170 (Sept. 30, 1997). See note 2, above. This filing reflects the proposed redesignations.

<sup>1</sup> This proposal was filed pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), and Rule 19b-4, 17 CFR 240.19b-4, thereunder.

<sup>2</sup> See letter from Robert E. Aber, Senior Vice President and General Counsel, Office of the General Counsel, Nasdaq, to Richard Strasser, Assistant Director, Division of Market Regulation ("Division"), Commission, dated April 22, 1999 ("Amendment No. 1"). In Amendment No. 1, the NASD made various technical and clarifying amendments which are reflected in the notice. Also in Amendment No. 1, the text of proposed NASD Rule 4615 and the accompanying explanatory text in the filing is amended to clarify that if the access fee that an ECN or market maker charges is greater than one minimum quotation increment, the market maker or ECN must round its bid down (or offer up) to the next minimum increment that is equal to or greater than the access fee. Finally, the NASD also explained that the instant proposed rule change is contingent upon the Commission's approval of its pending Agency Quote proposal (Exchange Act Release No. 41128 (March 2, 1999), 64 FR 41128 (March 11, 1999) (File No. SR-NASD-99-09)).

*Quote (as defined in NASD Rule 4613) must round its bid down and/or its offer up by the next minimum quotation increment permitted by Nasdaq's system (or if the access fee, as described below, is larger than one minimum quotation increment, the market maker or ECN must round its bid(offer) down(up) to the next minimum increment that is equal to or greater than the access fee) if:*

*(1) the ECN charges non-subscribers that access its quote a fee in excess of one-half of one cent per share; or*  
*(2) the Nasdaq market maker charges any participant that accesses the market maker's Agency Quote (as defined in NASD Rule 4613) a fee in excess of one-half of one cent per share.*

*(b) Prior to commencing to charge for a fee for accessing its Agency Quote, a Nasdaq market maker shall inform Nasdaq Market Operations in writing of the maximum fee it intends to charge any market participant that accesses its Agency Quote (Initial Notification Requirement). Additionally, the market maker shall immediately inform Nasdaq Market Operations in writing of any change in the maximum fee it charges any market participant (Continuous Notification Requirement). The Initial Notification and Continuous Notification requirements shall also apply to ECNs included in Nasdaq.*

*(c) It shall be deemed conduct inconsistent with high standards of commercial honor and just and equitable principles of trade if a member fails to fulfill its obligations as outlined above.*

#### 4623. Electronic Communications Networks

(a) No change.

(b) An ECN that seeks to utilize the Nasdaq-provided means to comply with the ECN display alternative shall:

(1)-(3) No Change.

(4) agree to provide for Nasdaq's dissemination in the quotation data made available to quotation vendors the prices and sizes of Nasdaq market maker orders (and other entities, if the ECN so chooses) at the highest buy price and the lowest sell price for each Nasdaq security entered in and widely disseminated by the ECN; and prior to entering such prices and sizes, register with Nasdaq Market Operations as an ECN; [and]

(5) provide an automated execution or, if the price is no longer available, an automated rejection of any order routed to the ECN through the Nasdaq-provided display alternative[.]; and

(6) comply with applicable requirements of NASD Rule 4615.

(c) No Change.

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

In its filing with the Commission, Nasdaq included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. Nasdaq has prepared summaries, set forth in Sections (A), (B) and (C) below, of the most significant aspects of such statements.

### (A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for the Proposed Rule Change

Nasdaq is proposing to amend NASD Rule 3320 regarding Offers at Stated Prices and NASD Rule 4613(c) regarding Firm Quotations, which arguably could be read to prohibit market makers from charging market participants fees when quotes are accessed. Nasdaq also is proposing to require market makers and ECNs to round their quotations to the next minimum quotation increment when: (1) the ECN charges non-subscribers a fee in excess of one-half of one cent to access its quote; and (2) the market maker charges another market participant a fee in excess of one-half of one cent to access its Agency Quote (as defined in NASD rule 4613).<sup>5</sup>

#### 1. Background

Recently, Nasdaq filed with the Commission a proposal to allow market makers in Nasdaq National Market Securities ("NNM") to display a second quotation separate from their proprietary quotation for the purpose of displaying customer interest ("Agency Quote Proposal").<sup>6</sup> As noted in the Agency Quote Proposal filing,<sup>7</sup> Nasdaq's intended purpose of the Agency Quote was to give market makers an alternative method to display agency interests to the market and to return "control" over their quotes that market makers argue they lost with the implementation of the SEC's Order Handling Rules ("OHR").<sup>8</sup>

<sup>5</sup> See *id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* As noted in the Agency Quote Proposal, market makers assert that they have "lost control" of their quotes because they must change their proprietary quote to reflect certain limit orders and must "advertise competing interests in their quotes." The original text in this footnote has been changed pursuant to a telephone conversation between John Malitzis, Assistant General Counsel, Office of the General Counsel, Nasdaq, and Marc McKayle, Attorney, Division, Commission (April 22, 1999).

<sup>8</sup> The OHR, comprised of amendments to Rule 11Ac1-1 ("Firm Quote Rule") and the adoption of

Additionally, the Agency Quote Proposal attempts to resolve the regulatory and administrative difficulties that market makers experience as a result of being required to display customer orders and other agency interests as well as market makers' proprietary interests in a single quote.

Also, as noted in the Agency Quote Proposal, many ECNs currently charge fees to market participants (and ECN subscribers) that execute against a customer order that is displayed in the ECN. Although market makers currently may not charge a similar fee when their public quotes are accessed, market makers have expressed a desire to do so, in particular since they often are acting as agent by displaying a customer's interest in their quote. Nasdaq believes that it is inequitable that ECNs are permitted to charge a fee when their quote is accessed, but market makers are prohibited from charging a fee in similar situations when they act as agent.

Nasdaq notes that concerns have been raised about this perceived inequity. Specifically, Nasdaq suggests that the present environment encourages market makers to send their customer limit orders to ECNs to comply with the OHR. Thus, market makers often must give up some of their business and incur ECN fees to process their customer's limit orders. Market makers argue that it is unfair that an ECN may charge a fee when its quote is accessed but they (market makers) are prohibited from charging a fee when they are representing an agency interest in their quote. Thus, there are strong incentives for market makers to register as ECNs to avoid some of the regulatory and other requirements imposed on market makers, as well as risk to capital that market makers assume. Additionally, market makers argue that they, like ECNs, should be able to charge an access fee when they are acting purely as agent. Similar to ECNs, the access fee charged would compensate market makers for costs incurred in representing orders in Nasdaq on an agency basis.

In adopting the OHR, the Commission required that ECNs provide broker-dealers access to market maker orders reflected in the ECN's public quote that was equivalent to broker-dealer access to the market maker's own quotes. Currently, the Firm Quote Rules and NASD rules generally require market makers to trade at their displayed

Rule 11 Ac1-4 ("Display Rule"), were adopted by the Commission on August 28, 1996. See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996) ("OHR Adopting Release").

quotes, without any additional fees. Nonetheless, the OHR Adopting Release stated that an ECN could charge "for access to its system, similar to the communications and systems charges imposed by various markets, if not structured to discourage access by non-subscriber broker-dealers."<sup>9</sup> Subsequently, Commission staff no-action letters affirmed that individual ECNs could be used by market makers in compliance with the OHR. In these letters the ECNs represented, as a condition of receiving the no-action relief, that they would charge non-subscriber orders fees no greater than the lesser of the fees charged a substantial number of active broker-dealer subscribers, and one and one-half cents per share.

Regulation ATS extended the OHRs' equivalent access standard for alternative trading systems publishing public quotations.<sup>10</sup> In Regulation ATS, the Commission acknowledged that a self-regulatory organization ("SRO") has the authority to adopt rules limiting alternative trading systems fees, or requiring display of fees in the quote, to make alternative trading system quotes that are disseminated to the public comparable with other quotes in the SRO's market.<sup>11</sup>

The fees charged by ECNs to non-subscriber broker-dealers accessing ECN quotes have provoked much controversy. Market makers have argued that ECNs publishing quotes in Nasdaq should not be allowed to charge fees to trade with those quotes, on, in fairness, market makers should be allowed to charge ECNs and others that trade with the market maker's quotes. Broker-dealers say that while best execution principles compel them to trade with better-priced displayed ECN quotes to benefit their customers, these customers are generally unwilling to pay the fee charged by the ECN in that trade.

The ECNs say that their business model depends on charging both sides of a transaction an agency commission. They argue that they should still be able to charge these fees even when the OHR and Regulation ATS require them to display prices in the public quote.

The Nasdaq rule proposal would address these issues by allowing market makers, like ECNs, to charge fees to access their agency quotes. The proposal would, however, require both market makers and ECNs to round this quote to

the next inferior increment if the fee exceeded half-a-cent per share.<sup>12</sup>

## 2. Agency Fee Proposal

In light of the foregoing, Nasdaq is proposing to permit market makers to charge a fee when their Agency Quote is accessed, similar to that ECNs currently charge non-subscribers. Under this proposal, a market maker would be permitted to charge a fee but would be required to round its bid down or its offer up by the applicable minimum quotation increment in Nasdaq if the maximum fee the market maker charges any market participant exceeded one-half of the one cent. If the access fee the market maker charges is greater than a single minimum increment, then the market maker would have to round its Agency Quote to the next minimum increment that is equal to or greater than the access fee.<sup>13</sup> In effect, the market maker's fee would be included in the market maker's Agency Quote if the charge exceeded one-half of one cent. A virtually identical rounding requirement would apply to ECNs.<sup>14</sup> Nasdaq believes that when a quote-access fee exceeds a half-a-cent per share, the net execution price materially differs from the quoted price, and thus the fee should be rounded to account for such differential.

For example, a bid of 20 for a market participant that charges a fee of .006 cents per share would be rounded down to \$19<sup>15</sup>/<sub>16</sub>, while an offer of 20 with the same charge would be rounded up to 20<sup>1</sup>/<sub>16</sub>. As a second example, if a market participant charged a fee of twelve and a half cents per share (i.e., 1/8th point) on a \$20 buy limit order, the market participant would have to display that buy limit order at \$19<sup>7</sup>/<sub>8</sub> (or 1/8th down).

There would be no cap on the fee market participants could charge, nor is Nasdaq mandating that market participants charge the same rate to all market participants that access the market participant's quote (i.e., market makers and ECNs may vary access fees for different market participants).<sup>15</sup> Nasdaq notes, however, that it believes the Nasdaq UTP Plan would prohibit a market maker from charging a UTP

Specialist an access fee when the UTP Specialist accesses the market maker's Agency Quote by telephone.<sup>16</sup> The proposal, accordingly, prohibits market makers from charging when a UTP Specialist accesses a market maker's quote by phone. The UTP Plan does not, however, explicitly prohibit market makers from charging UTP Specialists a fee when a market maker's quote is accessed by a means other than the telephone, such as a Nasdaq order delivery system.

The proposal would require all market makers and ECNs to inform the NASD of the maximum (or highest) fee the market maker or ECN intends to charge any single market participant, as well as any changes in previously established fees. The NASD intends to publish and widely distribute this fee information through a common facility, such as the Nasdaqtrader.com Web Site. Nasdaq is sensitive to the concerns that allowing market makers to charge the proposed fee could result in the imposition of administrative burdens and other costs on small firms, as firms would be required to calculate the fees they owe and are owed. To alleviate these concerns, Nasdaq intends to develop through a common facility (e.g., the Nasdaqtrader.com Web Site) reports and data that firms may use to calculate the fees. In addition, to implement the Agency Quote proposal, Nasdaq is proposing amendments to current NASD rules (e.g., NASD Rule 3320 regarding Offers at Stated Price and NASD Rule 4613 regarding Firm Quotations), which arguably could be read to prohibit market makers from charging market participants fees when their quotes are accessed.

Nasdaq believes that where a quote is subject to the rounding requirement, a market participant should make a number of disclosures to its customer to fulfill its best execution obligations. First, the market participant should disclose and explain that while rounding will result in price improvement by the amount rounded, the rounding may delay the execution of the order because the order will be reflected at a lower price, in the case of buy orders (or higher price, in the case of sell orders). Additionally, a market maker must disclose (if applicable) that when the quote is rounded down (up) the market maker will collect the access

<sup>12</sup> As explained in more detail below, the Commission is seeking comment not only on the NASD rule filing as currently proposed, but also on the broader questions raised by ECN and ATS fees for accessing quotes and possible ways of reconciling these fees with the existing Nasdaq market.

<sup>13</sup> Nasdaq notes that the half-a-cent level is equivalent to the average fee that most ECNs charge their professional customers.

<sup>14</sup> ECNs currently are not subject to a requirement that they round their quotes to reflect a fee.

<sup>15</sup> The proposed rule would not prevent market participants from rebating fees to a customer or customers.

<sup>16</sup> See Section IX ("Market Access"), 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/NMS/UTP Plan").

<sup>9</sup> *Id.* at n. 272.

<sup>10</sup> See Exchange Act Release No. 40760 (Dec. 8, 1998), 63 FR 70844 (December 22, 1998) ("Regulation ATS Adopting Release").

<sup>11</sup> *Id.*

fee from the customer, since the accessing market participant has already paid the fee with the implicit inclusion of the fee in the quote. (An example of this situation is illustrated below.)

The following is an example of how the proposal would work. Three market makers and an ECN (MNA, MMB, MMC and ECN1) are at the inside (*i.e.*, best) price of each displaying in their quotes (Agency Quotes for the market makers), customer orders to buy 1,000 shares at \$30. MMA charges no access fee, MMB charges a fee of .002 cents per share, MMC charges a fee of .007 cents per share, and ECN1 charges a fee of .015 cents per share. The following would be displayed in the Nasdaq montage:

MMID	Bid price	Shares
MMA@ .....	\$30	1,000
MMB@ .....	30	1,000
MMC@ .....	29 <sup>15</sup> / <sub>16</sub>	1,000
ECN1# .....	29 <sup>15</sup> / <sub>16</sub>	1,000

If two 1,000-share market orders to sell were entered into Nasdaq's Small Order Execution System ("SOES") (or its successor system),<sup>17</sup> both orders would be executed automatically and reported to the tape at 1,000 shares at \$30; to collect the access fee, MMB would directly bill the market participant who accessed its quote.

Next, assume that the best market moves to MMC's price, and a market order is delivered through SOES to MMC's bid, which represents a customer buy limit order for \$30 that is rounded down to 29<sup>15</sup>/<sub>16</sub>. In this case, the Nasdaq system would automatically execute and lock in the trade at 29<sup>15</sup>/<sub>16</sub> (not \$30), and report that price to the tape. The incoming market order would be executed at 29<sup>15</sup>/<sub>16</sub>, and the market maker would be required to give the customer buy limit order a fill of 29<sup>15</sup>/<sub>16</sub>. As noted above, MMC must disclose to its customer that, based on the access fee it charges other market participants, it is required to round the customer's limit order price down, and that while rounding will result in price improvement of 1/16th, the rounding may also delay the execution of the order. Additionally, MMC must disclose that because the incoming market order is implicitly paying a fee by selling to MMC's customer for 1/16th less, MMC will collect the .007 cents per share from its customer (*i.e.*, MMC deducts the .007 cents per share from the .0625 cents per share in price improvement that the customer received).<sup>18</sup>

\* \* \* \* \*

This proposal is contingent upon SEC approval of the Agency Quote Proposal, and would become effective concurrently with Nasdaq's implementation of the Agency Quote Proposal.<sup>19</sup> Nasdaq believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6)<sup>20</sup> and Section 11A of the Act.<sup>21</sup> Section 15A(b)(6)<sup>22</sup> 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. Moreover, under Section 15A(b)(6) of the Act,<sup>23</sup> the rules of a registered national securities association must not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. In Section 11A(a)(1)(C) of the Act,<sup>24</sup> Congress found that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly 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 investor's orders in the best market; and (5) an opportunity for investor's orders to be executed without the participation of a dealer.

Nasdaq believes that by requiring market participants to round their quotes and in effect display the fee in their quotation when the fee exceeds a certain level, the proposal will avoid the dissemination of potentially misleading quotation information. Nasdaq believes that when quote-access fee exceed a half-a-cent per share, the net execution price materially differs from the quoted price. To the extent that this results in a market participant having to pass on the quoted price to the customer, it may

rounding the limit order price down 1/16th, Nasdaq believes that MMC should not charge the incoming market order an additional access fee; rather, Nasdaq believes that MMC should collect its .007 cents per share fee from its customer.

<sup>19</sup> See Amendment No. 1, note 3, *above*.

<sup>20</sup> 15 U.S.C. 78o-3(b)(6).

<sup>21</sup> 15 U.S.C. 78k-1.

<sup>22</sup> 15 U.S.C. 78o-3(b)(6).

<sup>23</sup> *Id.*

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

act to deter that market participant from acting as a market maker. On the other hand, if the market maker passes a fee on to its customer, this may result in dissatisfaction because the customer perceives that he or she did not obtain the best price in the market. In contrast, under Nasdaq's instant proposal, the firm will receive the quoted price, thus eliminating this concern. Finally, the proposal would address perceived inequities that currently exist between market makers and ECN's, as the proposal would allow market makers to charge a fee when they act as agent, similar to that which ECNs currently charge to non-subscribers.

Nasdaq notes that in the past the SEC staff has taken the position that it is inconsistent with the Firm Quote Rule, Rule 11Ac1-1 under the Act,<sup>25</sup> for market makers to charge a fee when their quotations are accessed.<sup>26</sup> Nasdaq believes that the SEC staff's position was, in part, premised on the fact that market makers would be charging when the market maker was acting as "principal" and in essence charging a mark-up customers it ordinarily would not levy such a charge on. Under the current proposal, market makers would be assessing a fee on customers (and

<sup>25</sup> See 17 CFR 240.11Ac1-1.

<sup>26</sup> Specifically, the SEC staff has stated in response to a request for "non-action relief" that the Exchange Act Firm Quote Rule does not permit a market maker posting a quote impose a fee on market participants that customarily trade with the market maker at its quote without a mark-up. See letter from Robert L.D. Colby, Deputy Director, Division, Commission, to M. Joseph Messina, Vice President, M.H. Meyerson & Co., Inc., dated June 12, 1998. In reaching this conclusion, the SEC staff noted that the Firm Quote Rule provides that each responsible broker or dealer shall be obligated to execute any order to buy or sell a subject security presented to it by another broker or dealer or any other person, such as a retail customer, with whom such responsible broker or dealer deals, at a price at least as favorable to such buyers or sellers as the responsible broker's or dealer's published bid or published offer (exclusive of commission or commission equivalent or differential customarily charged by such responsible broker or dealer in connection with execution of any such order) in an amount up to its published quotation size. *Id.* The SEC staff has interpreted the above parenthetical as addressing mark-ups that are customarily charged to retail customers by brokers. *Id.* Thus, according to the SEC staff, the Firm Quote Rule does not permit a market posting quotations in the public quote to impose a fee, such as a liquidity or access fee, on market participants that customarily trade with a market maker at its quote without a mark-up. *Id.*

The SEC staff also stated that it interpreted NASD Rule 4613(b) ("NASD Firm Quote Rule") as requiring market makers to include in their posted quote an access fee they may charge. *Id.* Nasdaq expresses no opinion as to whether it concurs with the SEC staff's prior interpretation of NASD Rule 4613, but notes that this filing would permit market makers to publish quotes without including the fee in its bid or offer, unless such fee exceeds a half-a-cent, in which case the fee would implicitly be included in the market maker's quote.

<sup>17</sup> See note 3, *above*.

<sup>18</sup> Since the market maker has already implicitly assessed a fee on the incoming market order by

others) that is in essence a commission solely when they are acting in an agency capacity. Similar to ECNs. While a market maker may not be able to charge a fee when it is acting in a principal's capacity for the reasons previously cited by the SEC staff, Nasdaq believes that it would be consistent with the Exchange Act Firm Quote Rule to permit market makers to charge a fee when they are acting as agent. Accordingly, Nasdaq believes that this rule proposal is consistent with Section 11A of the Act.<sup>27</sup>

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

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

#### *(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 the foregoing, including whether the proposed rule change is consistent with the Act. The Commission asks for comments in particular on the following questions:

1. Should market makers be permitted to charge a fee to trade with limit orders in their agency quote lines? In addition to charging for agency orders displayed in their agency quote lines, should market makers be permitted to charge a fee for proprietary orders displayed in their agency quote lines?
2. Should any fee charged by market makers for orders executed against their agency quote lines be included in the quoted price? Should ECN fees be included in an

ECN's quote? If ECN fees are required to be included in the quote, how should the fact that an ECN may have a range of fees it charges its broker-dealer subscribers be addressed?

3. Should there be a maximum permissible fee charged by market makers and ECNs, and if so, what should that fee be? Should market makers and ECNs be prohibited from charging a fee that is greater than one trading increment? Would disparate fees create confusion in the marketplace?

4. Will competition ensure that fees are not used as a barrier to access?

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 at the principal office of the NASD.

All submissions should refer to File No. SR-NASD-99-16 and should be submitted by June 1, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>28</sup>

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

[FR Doc. 99-11361 Filed 5-5-99; 8:45 am]

BILLING CODE 8010-01-M

### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-41346; File No. SR-NYSE-99-02]

#### **Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 to Proposed Rule Change Permanently Approving the Pilot Program for the Listing Eligibility Criteria for Closed-End Managed Investment Companies Registered Under The Investment Company Act of 1940**

April 29, 1999.

### **I. Introduction**

On January 26, 1999, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities

and Exchange Commission ("SEC" or "Commission") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 under the Act,<sup>2</sup> a proposed rule change creating a pilot program ("pilot") relating to the listing eligibility criteria for closed-end investment companies registered under the Investment Company Act of 1940 ("Funds").

Notice of the proposal was published in the **Federal Register** on February 3, 1999.<sup>3</sup> The Commission received one comment letter on the proposal. On April 21, 1999, the NYSE submitted Amendment No. 1 to the proposed rule change.<sup>4</sup> This notice and order approves the proposed rule change as amended and seeks comment from interested persons on Amendment No. 1.

### **II. Description of the Proposal**

The Exchange generally lists Funds either in connection with an initial public offering or shortly thereafter, when the fund does not have a three-year operating history and is thus considered newly formed. On January 26, 1999, the Exchange proposed to codify its policy regarding the listing of these newly organized Funds.<sup>5</sup> The same day, the Commission granted partial accelerated approval to the proposal as a three-month pilot, effective until April 29, 1999.

Under the pilot, if a Fund has at least \$60 million in net assets, as evidenced by a firm underwriting commitment, the Exchange will generally authorize the listing of the Fund. This requirement is the minimum net asset requirement for listing. Additionally, the Exchange retains the discretion to deny listing to a Fund if it determines that, based upon a comprehensive financial analysis, it is unlikely that the particular Fund will be able to maintain its financial status. Any Fund with less than \$60 million in net assets will not be considered for listing.

Lastly, Funds are subject to continued financial listing standards. The Exchange generates a monthly exception report to identify companies below the

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

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

<sup>3</sup> See Securities Exchange Act Release No. 40979 (January 26, 1999), 64 FR 5332 (February 3, 1999).

<sup>4</sup> See letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Jonathan G. Katz, Secretary, SEC, April 21, 1999 ("Amendment No. 1"). In Amendment No. 1, the NYSE added a requirement that an applicant Fund, which is a spin-off or carve-out, show that the new entity will satisfy the net assets test by submitting to the Exchange a letter from its parent company's investment banker or other financial advisor.

<sup>5</sup> The Exchange sought both accelerated approval to implement a three-month pilot program to amend its *Listed Company Manual* with respect to Funds and permanent approval of the rule change implemented in the pilot.

<sup>27</sup> 15 U.S.C. 78k-1.

<sup>28</sup> 17 CFR 200.30-3(a)(12).