(''Act''),[1] notice is hereby given that on August 19, 1999, the Government Securities Clearing Corporation (''GSCC'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II and III below, which items have been prepared primarily by GSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

Under the proposed rule change, GSCC will reduce the clearance fee that it charges to its netting members.

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

In its filing with the Commission, GSCC 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. GSCC has prepared summaries, set forth in sections (A), (B) and (C) below, of the most significant aspects of these statements.[2]

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

GSCC passes through to its netting members (with the exception of category 1 interdealer broker netting members engaged in blind broker repo activity) the cost to GSCC of obtaining and providing clearance services. Currently, the fee charged by GSCC to netting members to recoup its own external and internal clearance costs is $2.90 per deliver and receive obligation. The level of this fee is periodically reviewed to ensure that it equates sufficiently close to GSCC's actual expense.

Recently, the Board of Governors of the Federal Reserve System (''Federal Reserve'') lowered its Fedwire funds and securities transfer fees.[3] GSCC's clearance fee is a blended combination of the clearance charges levied upon GSCC by both its clearing banks and by the Federal Reserve Bank of New York for transfers made through the Fedwire book entry system. Internalized settlements at the clearing banks (*i.e.*, those settlements occurring between GSCC and dealers within the same clearing bank) substantially reduce the amount of Federal Reserve fees included in GSCC's blended rate. As a result, there is not a direct correlation between Federal Reserve clearance fees and GSCC's clearance fee. Nonetheless, GSCC's processing costs were lowered because of the Federal Reserve's action, and a reduction in GSCC's clearance fee is therefore warranted.

GSCC has determined that the clearance fee level now needed to offset its own clearance costs is roughly $2.75 per settlement. Thus, GSCC has determined it appropriate, effective as of October 1, 1999, to reduce GSCC's unit fee for clearance from $2.90 to $2.75. This adjusted fee reflects GSCC's ongoing commitment to effectively translate reductions in GSCC's processing costs into membership savings. The level of clearance fee will continue to be periodically monitored for appropriateness.

GSCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act[4] and the rules and regulations thereunder applicable to GSCC because it involves a fee change which fairly reflects the costs incurred by GSCC in providing services to its members.

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

GSCC does not believe that the proposed rule change will have any impact or impose any burden on competition.

*(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from members, Participants or Others*

Written comments relating to the proposed rule change have not yet been solicited or received. GSCC will notify the Commission of any written comments received by GSCC.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

The foregoing rule change has become effective pursuant to section 19(b)(3)(A)(ii)[5] of the Act and Rule 19b–4(f)(2)[6] promulgated thereunder because the proposal establishes or changes a due, fee, or other charge imposed by GSCC. At any time within sixty days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing also will be available for inspection and copying at the principal office of GSCC. All submissions should refer to File No. SR–GSCC–99–04 and should be submitted by December 27, 1999.

For the Commission by the Division of Market regulation, pursuant to delegated authority.[7]

**Jonathan G. Katz,**

*Secretary.*

[FR Doc. 99–31529 Filed 12–3–99 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–42166; File No. SR–NASD–99–53]**

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. and Amendment Nos. 1 and 2 Thereto Relating to the Establishment of the Nasdaq Order Display Facility and Modifications of the Nasdaq Trading Platform

November 22, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'' or ''Exchange Act''),[1] and Rule 19b–4

[1] 15 U.S.C. 78s(b)(1).

[2] The Commission has modified the text of the summaries prepared by GSCC.

[3] 63 FR 63552 (November 13, 1998) (notice of schedule of fees for Federal Reserve Bank Services).

[4] 15 U.S.C. 78q–1.

[5] 15 U.S.C. 78s(b)(3)(A)(ii).

[6] 17 CFR 240.19b-4(f)(2).

[7] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

thereunder,[2] notice is hereby given that on October 1, 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. On October 26, 1999, Nasdaq filed Amendment No. 1 to the proposal.[3] On October 29, 1999, Nasdaq filed Amendment No. 2 to the proposal.[4] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

Nasdaq proposes to enhance its quotation montage by creating a new venue for the display of trading interest, called the Nasdaq Order Display Facility. Additionally, this proposed rule change would substantially modify the proposed Nasdaq National Market System (''NNMS'').[5]

**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 my be examined at the places specified in Item IV below. Nasdaq has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

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

1. Purpose

Nasdaq proposes to enhance its quotation montage and current trading platforms, SelectNet and SOES. This proposed rule change is contingent, and would expand upon Nasdaq's proposals to (1) establish agency quotations;[6] and (2) functionally integrate SOES and SelectNet that are currently pending before the Commission.[7] In particular, Nasdaq proposes the following changes.

*A. New Nasdaq Order Display Facility*

Under the proposal, Nasdaq will add a new display to the Nasdaq Workstation II (''NWII'') called the Nasdaq Order Display Facility, which would show the best bid/best offer in Nasdaq and two price levels away, accompanied by the aggregate size at each price level of the ''displayed'' trading interest of market makers, electronic communication networks (''ECN''), and Unlisted Trading Privilege (''UTP'') Exchanges.[8] As explained in greater detail below, Nasdaq market makers and ECN's that are NASD members (''Nasdaq Quoting Market Participants'') will be able to display their quotes/orders anonymously at these price levels in the Nasdaq Order Display Facility, which should encourage the display of greater trading interest.

*B. Enhanced Electronic Access to the Best Price in Nasdaq*

Under the proposal, market participants would be able to electronically access the best prices in the Nasdaq Order Display Facility using a substantially modified and enhanced version of Nasdaq's proposed NNMS trading platform. Specifically, Nasdaq would provide order delivery or automatic execution against the best prices displayed in the Nasdaq Order Display Facility based on the manner in which the market participant receiving the order participates in Nasdaq. Nasdaq would continue to offer market participants the ability to electronically negotiate transactions with specific market makers.

*C. Delivery of Multiple Quotes/Orders to Nasdaq*

Under the proposal, Nasdaq would allow (but not require) Nasdaq Quoting Market Participants to give the Nasdaq system multiple quotes/orders at single as well as multiple price levels. These markets participants may submit multiple agency and principal quotes/orders at multiple price levels, instead of a single quote at one price level. The proposed system will be able to accommodate the Agency Quote concept proposed in SR–NASD–99–09.[9] Nasdaq would display such trading interest on the NWII consistent with the parameters (price, anonymity/attribution) of the quotes/orders and the current market. Although Nasdaq would accept multiple quotes/orders at various price levels which may be displayed on a non-attributed basis in the Nasdaq Order Display Facility if within the top three price levels in Nasdaq, the Nasdaq Quotation Montage would display one MMID per ECN and market maker.[10] This functionality should allow Nasdaq to assist market participants with the management of their back book. Nasdaq believes that this functionality should, in turn, make it easier for ECNs to participate in automatic execution, and will assist Nasdaq Quoting Market Participants in complying with the SEC's Order Handling Rules (''Order Handling Rules'' or ''OHR''). Nasdaq also believes that this functionality will reduce the potential for the market to trade through orders that a market maker or ECN is holding in its back book.

*D. Order Collector Facility*

Under the proposal, Nasdaq will create an Order Collector Facility (''OCF''), which would serve as a single

[2] 17 CFR 240.19b–4.

[3] *See* letter from Thomas P. Moran, Assistant General Counsel, NASD Regulation, to Richard Strasser, Assistant Director, Division of Market Regulation (''Division''), Commission (October 26, 1999) (''Amendment No. 1''). In Amendment No. 1, the NASD makes technical and clarifying amendments to the proposed which are incorporated in this notice. Additionally, the NASD amended the proposed rule language to clarify that certain provisions of the proposal are contingent upon other proposals that are pending before the Commission.

[4] *See* letter from John F. Malitzis, Assistant General Council, NASD Regulation, to Richard Strasser, Assistant Director, Division, Commission (October 29, 1999) (''Amendment No. 2''). Amendment No. 2 clarifies that the Nasdaq staff has consulted the NASD Regulation staff with respect to the proposal rule change pursuant to the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries.

[5] *See* Exchange Act Release No. 41296 (April 15, 1999), 64 FR 19844 (April 22, 1999) (Notice for File No. SR–NASD–99–11 proposing to functionally integrate the Small Order Execution System (''SOES'') and SelectNet to become the foundation of the NNMS.) (hereafter ''SR–NASD–99–11'' or ''SOES/SelectNet Integration'').

[6] *See* Exchange Act Release No. 41128 (March 2, 1999), 64 FR 12198 (March 11, 1999) (Notice for SR–NASD–99–09 proposing to permit market makers to have a second market maker ID (''MMID'') for the purpose of separately displaying agency and proprietary quotes.) (Hereafter ''SR–NASD–99–09'' or ''Agency Quote Proposal'').

[7] *See* note 5, *above.*

[8] A ''UTP Exchange'' is 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 (''UTP Plan'' or ''Nasdaq UTP Plan''). As of September 1, 1999, there were four members of the Nasdaq UTP Plan. In addition to the NASD, the UTP Plan participants included the Boston Stock Exchange, the Chicago Stock Exchange (''CHX''), and the Philadelphia Stock Exchange. Of these, only the CHX has established an interface with the NASD/Nasdaq. The Cincinnati Stock Exchange is currently in the process of becoming a member of the UTP Plan and the Pacific Exchange has indicated its intent to commence this process.

[9] *See* note 6, *above.*

[10] If SR–NASD–99–09 is approved, however, a market maker would also be able to display one Agency Quote MMID in the Nasdaq Quotation Montage. UTP Exchanges would continue to transmit to, and display in, Nasdaq a single, two-sided quotation.

point of order entry and single point of delivery of Liability Orders and executions.[11] Specifically, to access the best-priced quotes/orders, a market participant would be required to enter an order into the OCF, which would deliver either an automatic execution or a Liability Order to the next market maker, ECN, or UTP Exchange (''Quoting Market Participant'') in the queue. The OCF would determine whether to deliver an order or an execution based on the manner in which the market participant receiving the order participates in the Nasdaq market (*e.g.,* automatic execution for market makers, automatic execution for ECNs that agree to participate in the automatic-execution functionality of the system, order delivery for ECNs that choose to take order delivery, and order delivery for UTP Exchanges). Nasdaq believes that this should ensure efficient and expeditious routing of orders and executions, while eliminating the potential for dual liability that market markers currently face in Nasdaq. The proposed changes described herein build upon those proposed in SR–NASD–99–11 and would create the next generation Nasdaq trading platform.[12] By creating the OCF as the single point of order entry and the single point of delivery of executions and orders, Nasdaq believes that the proposal should fully integrate its two current trading systems, SelectNet and SOES, from the end user's perspective.

*E. Other Enhancements/Rule Changes*

Other enhancements that Nasdaq is proposing to its current trading environment include the addition of an odd-lot processing facility, and the modification of current procedures that apply to a market maker's failure to update its quote after being decremented to zero (commonly referred to as ''SOESed-out-of-the-Box'' in the present system architecture).

1. Background

As an equity market, Nasdaq collects, aggregates and displays pre-trade information simultaneously to all market participants. This pre-trade information currently takes the form of a quote, which represents a single (or an aggregate of same-priced) agency or principal order(s). Nasdaq also provides trading platforms through which market participants may access the liquidity displayed in the Nasdaq marketplace.

Nasdaq believes that the manner in which it currently collects, aggregates and displays pre-trade information is not functionally optimized presently, thus limiting the efficiency of Nasdaq's execution services and increasing the relative cost of using those services. This is due, in part, to the way market participants transmit pre-trade information to Nasdaq. Presently, Nasdaq Quoting Market Participants (*i.e.,* ECNs and market makers who are NASD members) transmit quotation information to Nasdaq, which may represent multiple agency or principal orders that the participant has aggregated into a single quote, or may represent only a single agency order or principal order. When Nasdaq receives a quote, it cannot discern whether that quote represents a single order or multiple orders at one price. Also, Nasdaq Quoting Market Participants can only send Nasdaq a single, two-sided principal quote (although in the future market makers may also be able to send a single, one or two-sided Agency Quote to Nasdaq). Nasdaq believes that the current inability of Nasdaq Quoting Market Participants to submit to Nasdaq quotes or orders at multiple price levels has made compliance with the OHR[13] difficult, because participants cannot leave their limit orders with Nasdaq for display when required by SEC rules.[14] Nasdaq also believes that during fast market conditions this inability to display a customer limit order without adjusting the Nasdaq Quoting Market Participant's quote has resulted in limit orders being traded through because the Nasdaq Quoting Market Participant cannot transmit to Nasdaq quickly enough a revised quote representing such limit order.

Nasdaq believes that these developments, in turn, have led to the proliferation of ECNs, which accept multiple price levels of orders and display those orders when they become the best market in the ECN. Nasdaq believes that while this has assisted market makers in meeting their quotation and limit order display obligations under the OHR,[15] it has led to increased fragmentation of pre-trade information. Moreover, with the recent adoption of Rule 3b–16 under the Act[16] and the implementation of Regulation ATS,[17] alternative trading systems (''ATS'') that currently participate as ECNs in Nasdaq and are NASD members/broker-dealers, may now register as exchanges and directly compete for Nasdaq market share, as well as company listings. In short, Nasdaq believes that the revolutionary changes in U.S. equity markets spurred by dramatic shifts in the regulatory landscape and plummeting technology costs have introduced novel challenges to Nasdaq. Nasdaq believes that it is critical that Nasdaq be able to compete on the same terms and offer the same services as it competitors. Nasdaq believes that to do otherwise would render meaningless the concepts of fair competition among markets and equal regulation, which would be contrary to the clear mandates and proscriptions of the Exchange Act.

To address the issue of fragmentation as well as the competitive concerns, Nasdaq proposes to modify the display in the NWII and Nasdaq's trading platforms. This proposed rule change builds upon, and is contingent on the functional integration of SOES/SelectNet proposed in SR–NASD–99–11 and should result in a substantially enhanced NNMS trading platform. This proposed rule change also incorporates the concept of a market maker agency quote proposed in SR–NASD–99–09.

2. Nasdaq Order Display Facility

Today, the NWII presentation is split into two primary display components. The top portion of the NWII contains, among other things: (1) the Market Minder Window, which allows market participants to monitor price activity (inside bid/offer and last sale) of selected stocks; and (2) the Dynamic Quote Window, which shows for a particular stock the inside bid and offer, the last sale, change in price from previous close, daily high and low, volume, and the short sale arrow indicator. The bottom portion of the NWII contains the ''Nasdaq Quotation Montage.'' The Nasdaq Quotation Montage shows for a particular stock two columns (one for bid, one for offer), under which is listed the MMIDs for each registered market maker, ECN, and UTP Exchange in the stock and the corresponding quote (price and size) next to the related MMID. Nasdaq ranks the bids and offers along with the corresponding MMID in price/time priority. Accordingly, the market participant at the best bid who is first in time appears first in the montage, the

[11] For purposes of this filing, the term ''Liability Order'' shall mean an order to which an ECN, market maker, or UTP Exchange Specialist, owes a firm quote obligation under Exchange Act Rule 11Ac1–1 (''Liability Order''). *See* 17 CFR 240.11Ac1–1.

[12] *See* note 5, *above.*

[13] *See* Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996).

[14] *See* Exchange Act Rules 11Ac1–1, 17 CFR 240.11Ac1–1 (''Firm Quote Rule'') and 11Ac1–4, 17 CFR 240.11Ac1–4 (''Limit Order Display Rule'').

[15] *See id.*

[16] 17 CFR 240.3b–16.

[17] *See* Exchange Act Release No. 40760 (Dec. 8, 1998), 63 FR 70844 (Dec. 22, 1998) (''Regulation ATS'').

market participant at the best bid (or the next best bid) who is next in time is ranked second, and so forth.

Market makers are required to submit a two-sided principal quote,[18] and ECNs that participate in Nasdaq may submit a one or two-sided quote.[19] UTP Exchanges that have an interface with Nasdaq are required under the UTP Plan to submit to Nasdaq to two-sided quote, which represents the exchange specialist's best quote in the stock at issue. While a market maker's quoted price and size is attributed to the market maker by the corresponding MMID, this may not represent the market maker's best price if the market maker has placed a better priced order into an ECN that complies with the Display Alternative in Exchange Act Rule 11Ac1–4.[20] Accordingly, market maker may be displaying in the Nasdaq Quotation Montage a proprietary bid of $20 when the market is $20 1/8 to 20 1/4, but the market maker may be displaying in a qualifying ECN a bid of $20 1/16. The $20 1/16 quote may only be seen by subscribers of the ECN in which the market maker has placed the order and is not visible to the Nasdaq system or Nasdaq market participants unless and until $20 1/16 becomes the best bid in the ECN or the best bid price moves in Nasdaq to $20 1/16.

a. *Enhanced Display of Trading Interest.* Nasdaq proposes to add the Nasdaq Order Display Facility, which would be displayed in the top portion of the NWII. Nasdaq would retain the Nasdaq Quotation Montage and the functionality it currently provides—the display of market maker, ECN and UTP Exchange attributable quotes ranked in price/time priority. The Nasdaq Order Display Facility would display the three best price levels in Nasdaq on both the bid and offer side of the market. Each price level will be updated and will display the aggregate size of ''displayed'' trading interest (''attributable'' and ''non-attributable,'' as explained below) at each price level.

Nasdaq Quoting Market Participants would be required to designate a quote/order as ''attributable'' or ''non-attributable,'' [21] and would be able to indicate a reserve size for the quote/order.[22] If an order is ''attributable,'' the price and size of the order would be displayed next to the Nasdaq Quoting Market Participant's MMID in the Nasdaq Quotation Montage (assuming this is the Quoting Market Participant's best-priced attributable order). Attributable orders or quotes would be displayed in the Nasdaq Order Display Facility as part of the aggregate trading interest when the price of the quote/order is within the best three price levels (on either side of the market) in Nasdaq.

Alternatively, if a Nasdaq Quoting Market Participant designates a quote/order as ''non-attributable,'' it will be displayed in the Nasdaq Order Display Facility as part of the aggregate trading interest when the price of the quote/order is within the best three price levels. That order or quote would not, however, be displayed in the Nasdaq Quotation Montage next to the Quoting Market Participant's MMID. Thus, Nasdaq believes that Nasdaq Quoting Market Participants would be able to use a Nasdaq facility to display trading interest to the market anonymously, without attribution to its MMID, and still be in compliance with Exchange Act Rules 11Ac1–1 and 11Ac1–4.[23]

Market markers be required to publish in the Nasdaq Quotation Montage a two-sided quote that is attributed to its MMID. [24] Nasdaq believes, however, that the Nasdaq Order Display Facility meets the requirements of Exchange Act Rule 11Ac1–4. [25] Thus, Nasdaq believes it would be consistent with Exchange Act Rule 11Ac1–4 [26] for a Nasdaq market marker to give the system a non-attributable principal quote/order that is priced better than its attributable quote/order displayed in the Nasdaq Quotation Montage and display that non-attributable quote/order only in the Nasdaq Order Display Facility without updating its attributable quote/order in the Nasdaq Quotation Montage.[27] Nasdaq also believes it would also be consistent with Exchange Act Rules 11 Ac1–1 and 11Ac1–4 [28] for a market maker that receives a customer limit order that is priced better than the market marker's attributable quote/order in the Nasdaq Quotation Montage, to designate that limit order as non-attributable and display it only in the Nasdaq Order Display Facility. Nasdaq notes that this arrangement and treatment of the limit order must be consistent with the market maker's best execution obligations and understanding with the customer.

b. *Reserve Size.* This proposal also would permit Nasdaq market makers and ECNs to use reserve size. Reserve size, under the proposal, would work in virtually the same manner as proposed in SR–NASD–99–11.[29] Specifically, reserve size could apply to a market maker's principal or agency quote, and the market maker would be required to display (either as attributable or non-attributable) 1,000 shares. Reserve size would replenish displayed size (attributable or non-attributable) by at least 1,000 shares (or a greater default amount) once displayed size is decremented to zero. Reserve size along with displayed (both attributable and non-attributable) size would be accessible through Nasdaq's trading

[18] *See* NASD Rule 4613.

[19] *See* NASD Rule 4623.

[20] Exchange Act Rule 11Ac1–4 requires an OTC market maker to make publicly available any superior prices that the market maker privately quotes through an ECN. A market maker may comply with this requirement by changing its quote to reflect the superior price or, in the alternative, may deliver better priced orders to an ECN provided that the ECN meets the ''Display Alternative'' in Exchange Act Rule 11Ac1–4(c)(5). The Display Alternative states that a market maker is not required to update its quote in Nasdaq if it is displaying a better-priced order in an ECN if the ECN disseminates these priced orders to the public quotation system and provides broker-dealers equivalent access to these orders. Nasdaq market makers currently utilize SelectNet to access ECN quotes. Additionally, other investor protection rules, such as the *Manning* Rule, will continue to apply to this facility.

[21] A Nasdaq Quoting Market Participant must designate a quote/order as either attributable or non-attributable. For purposes of this filing, both attributable and non-attributable quotes/orders are considered ''displayed orders'' since they are displayed in the Nasdaq system and have the potential for being viewed in the NWII by market participants.

[22] The ''reserve size'' feature allows a Nasdaq market maker on ECN, or a customer of either to display publicly part of the full size of its order or interest with the remainder held in reserve on an undisplayed basis to be displayed in whole or in part as the displayed part is executed.

[23] 17 CFR 240.11Ac1–1 and 17 CFR 11Ac1–4.

[24] *See* proposed NASD Rule 4613(d). Additionally, Nasdaq will display in the Nasdaq Quotation Montage only one MMID (two sided) and one Agency MMID (one or two sided) for each market maker and one MMID per ECN. *See* proposed NASD Rule 4707.

[25] 17 CFR 240.11Ac1–4.

[26] *Id.*

[27] Nasdaq believes that the Nasdaq Order Display Facility meets the requirements of the Display Alternative, Exchange Act Rule 11Ac1–4(c)(5). That is, if a market maker displays in the Nasdaq Order Display Facility a non-attributable principal or agency interest that is priced better than its attributable quote/order in Nasdaq Quotation Montage, this would be consistent with Exchange Act Rule 11Ac1–4(c)(5) because the better-priced non-attributable quote/order will be displayed in Nasdaq once it is at the best bid/best offer or two price levels away. Additionally, the prices in the Nasdaq Order Display Facility will be accessible through Nasdaq's traditional execution systems, thus providing equivalent access to the quote. Nasdaq notes that if a market marker were to place an order into a qualifying ECN, that order would not be displayed in Nasdaq until it was at the top of the ECN's file. In the proposed Nasdaq system, however, the market maker's order in the Nasdaq order Display Facility will be displayed when it is within the best three price levels on either side of the market.

The NASD believes that the Nasdaq Order Display Facility reduces fragmentation and increases transparency in that quotes/orders that might not be displayed to the market because they are in an ECN and not at the top of the ECN's book, may now be displayed in Nasdaq.

[28] 17*CFR 240.11Ac1–1 and 17 CFR 240.11Ac1–4.*

[29] *See* proposed NASD Rule 4710. Also *see* note 5, *above.*

platform. Reserve size, however, would not be displayed in either the Nasdaq Order Display Facility or the Nasdaq Quotation Montage. As described in the Order Execution Algorithm section of this filing, Nasdaq would access reserve size after all displayed size at a given price in the Nasdaq market is exhausted.

Next, a special MMID (to be named in the future, but for purposes of this filing ''SIZE'') that represents the aggregate size of the best-priced non-attributable bid quotes/orders and separately the best-priced non-attributable offer quotes/orders in the system would be displayed in the Nasdaq Quotation Montage, along with the other MMIDs for the Quoting Market Participants displaying attributable size. There would be one ''SIZE'' MMID for the bid and the offer side of the market.[30] Nasdaq believes that the ''SIZE'' MMID is necessary to properly calculate and disseminate the Nasdaq best bid and best offer (''BBO'') along with the accompanying market center over Nasdaq Level 1 Service and National Quotation Data Service (''NQDS'').[31]

Nasdaq would also provide a ''Summary Scan'' functionality as part of the Nasdaq Order Display Facility. The Summary Scan feature would be a query-only functionality that would provide a look at the total displayed size (attributable and non-attributable) for all levels below the three price levels in the Nasdaq Order Display Facility. The Summary Scan would anonymously display interest (attributable and non-attributable) at each price level on both sides of the market, but would not be dynamically updated.

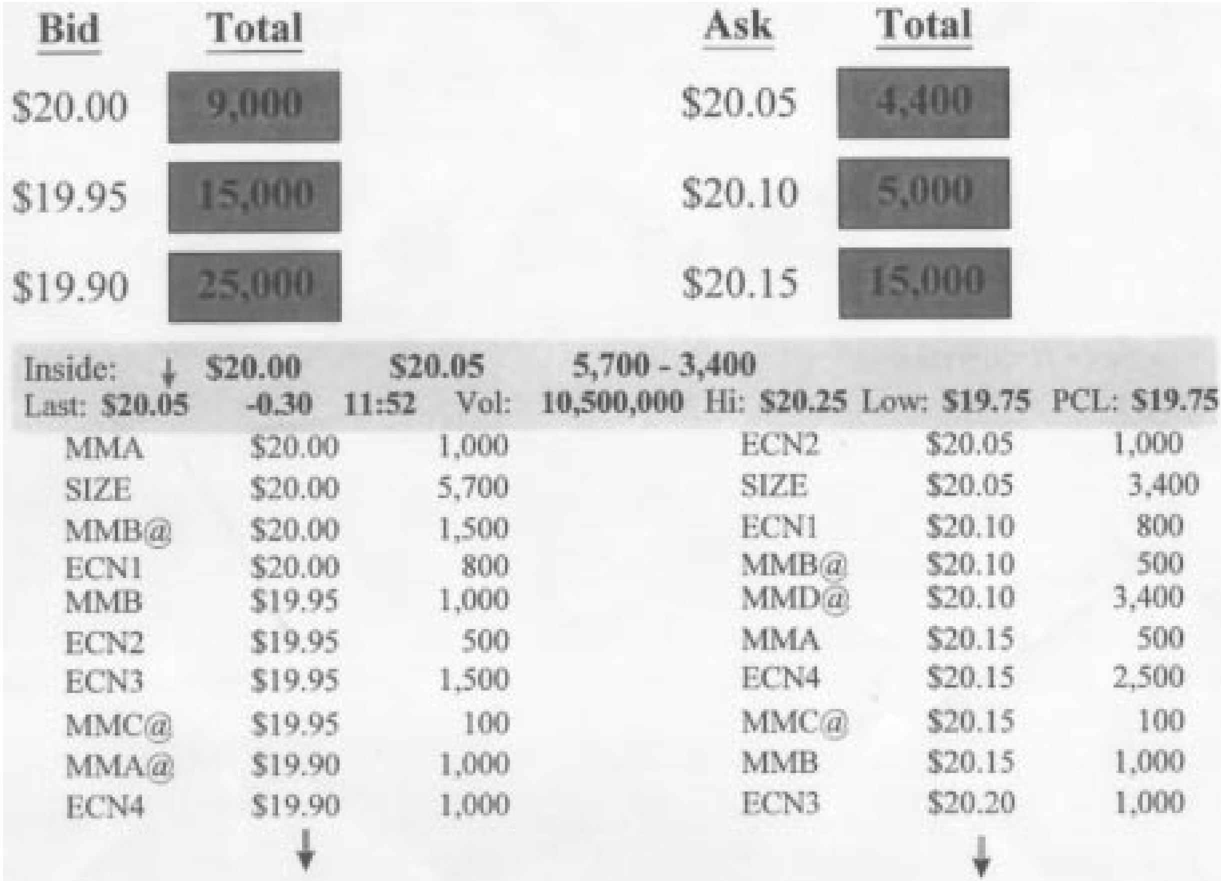
In essence, under the proposal the Nasdaq Quotation Montage would represent all trading interest that a Quoting Market Participant wishes to attribute to its MMID. This section may be viewed as a way for Quoting Market Participants to advertise their trading interests, which may be at the inside market or one or more ticks away. This section should be useful for market participants who wish to trade a block or large size at a price that is one or more ticks away from the market. The Nasdaq Order Display Facility would allow Nasdaq Quoting Market Participants to display size to the market anonymously, which should minimize certain risks that a market participant encounters when large size is attributable to its MMID. By allowing for the anonymous display of size to the market and by providing a facility that Nasdaq believes complies with the OHR, Nasdaq believes that the Nasdaq Order Display Facility should encourage Nasdaq Quoting Market Participants to show greater size and thereby increase transparency. Finally, Nasdaq believes that reserve size should benefit the market by allowing Nasdaq Quoting Market Participants to show the Nasdaq system back-book trading interest, but not the market in general. This feature should minimize potential market impact of displaying very large size, while enhancing liquidity since reserve size will be electronically accessible.

Below is a schematic of the proposed modified display of the NWII.[32]

[30] The aggregate size of the best bid/best offer displayed in the Nasdaq Order Display Facility will equal the sum of the individual sizes of the MMIDs at the best bid/best offer displayed in the Nasdaq Quotation Montage and the size of the SIZE MMID when that MMID is at the best bid/best offer.

[31] Nasdaq Level 1 Service provides the inside bid/offer quotations and identifies the market center at the best bid/best offer based on an algorithm set out in the Nasdaq UTP Plan. *See* NASD Rule 7010 and Nasdaq UTP Plan, Section VI, Paragraph C, Subparagraph 1. NQDS provides individual market maker quotes, Level 1 Service, and last sale information. *See id.* The SIZE MMID will be used in determining the best bid/best offer and corresponding market center for purposes of Level 1 and UTP.

[32] The description of the proposed modified display of the NWII that follows was submitted by the NASD pursuant to a telephone conversation between John F. Malitzis, Assistant General Counsel, NASD Regulation and Marc McKayle, Attorney, Division, Commission on November 19, 1999.



| Bid | Total | Ask | Total |
|---|---|---|---|
| $20.00 | 9,000 | $20.05 | 4,400 |
| $19.95 | 15,000 | $20.10 | 5,000 |
| $19.90 | 25,000 | $20.15 | 15,000 |

Inside: ↓ $20.00 $20.05 5,700 - 3,400
Last: $20.05 -0.30 11:52 Vol: 10,500,000 Hi: $20.25 Low: $19.75 PCL: $19.75

| | | | | | |
|---|---|---|---|---|---|
| MMA | $20.00 | 1,000 | ECN2 | $20.05 | 1,000 |
| SIZE | $20.00 | 5,700 | SIZE | $20.05 | 3,400 |
| MMB@ | $20.00 | 1,500 | ECN1 | $20.10 | 800 |
| ECN1 | $20.00 | 800 | MMB@ | $20.10 | 500 |
| MMB | $19.95 | 1,000 | MMD@ | $20.10 | 3,400 |
| ECN2 | $19.95 | 500 | MMA | $20.15 | 500 |
| ECN3 | $19.95 | 1,500 | ECN4 | $20.15 | 2,500 |
| MMC@ | $19.95 | 100 | MMC@ | $20.15 | 100 |
| MMA@ | $19.90 | 1,000 | MMB | $20.15 | 1,000 |
| ECN4 | $19.90 | 1,000 | ECN3 | $20.20 | 1,000 |

In the above schematic, there are 9,000 shares at the inside bid of $20. The Nasdaq Quotation Montage shows three Nasdaq Quoting Market Participants—MMA, showing market maker A's proprietary quote, MMB@, showing market maker B's agency quote, and ECN1—with *attributable* orders/quotes having a total size of 3,300 shares. The Nasdaq Quotation Montage also shows the SIZE MMID, which is displaying *non-attributable* orders/quote with a total size of 5,700 shares. Thus, the total number of attributable and non-attributable orders/quotes at the inside bid is 9,000 shares. The system rolls up into the Nasdaq Order Display Facility (in the top portion of the NWII) the total number of attributable and non-attributable orders, and shows in the top box an aggregate of 9,000 shares at $20 (the inside bid).

At the $19.95 level on the bid side of the market, the Nasdaq Quotation Montage shows four Nasdaq Quoting Market Participants—MMB, ECN2, ECN3, and MMC@—displaying *attributable* orders/quotes having a total size of 3,100 shares. The Nasdaq Order Display Facility in the top portion of the NWII shows that there are a total of 15,000 shares at the $19.95 level, of which 3,100 are attributable orders/quotes (which are identified in the Nasdaq Quotation Montage by MMID). The remaining 11,900 shares represent non-attributable orders/quotes at the $19.95 level which are not displayed in the Nasdaq Quotation Montage; and/or attributable orders/quotes residing in the system for Nasdaq Quoting Market Participants who are displaying a superior priced attributable order/quote (*e.g.*, MMA, who is at the inside bid of $20, could also have an attributable order/quote at the $19.95 level, which is aggregated into the second box in the Nasdaq Order Display Facility, but is not displayed next to MMA's MMID unit MMA's $20 attributable order/quote is filled). There is no SIZE MMID at $19.95 because such an MMID would only display the best priced non-attributable orders/quotes, which on the bid side of the market in the above schematic are currently priced at $20 (*i.e.*, there is only one SIZE MMID for each side of the market, and it displays the best priced non-attributable orders on each side). If $19.95 became the best bid, the SIZE MMID would be displayed in the Nasdaq Quotation Montage and would show all *non-attributable* orders/quotes at that price level.

3. Order Collector Facility

To further enhance the Nasdaq trading platform, Nasdaq proposes to implement an OCF which would do the following: (1) transmit to Nasdaq multiple quotes/orders and/or quotes/orders at multiple price levels by Nasdaq Quoting Market Participants; (2) provide a unified point of entry of orders into the Nasdaq system to access quotes/orders displayed (as either attributable or non-attributable) in both the Nasdaq Order Display Facility and the Nasdaq Quotation Montage; and (3) provide a single point of delivery to Quoting Market Participants of Liability Orders, which should eliminate all potential for dual liability. Nasdaq believes that this proposed provision should substantially enhance and modify its current architectures as well as the NNMS trading platform proposed in SR–NASD–99–11, by overlaying the OCF with the enhanced architecture to create a single point of order entry and delivery for the end user.

a. *Entry of Quotes/Orders.* Nasdaq proposes to allow Nasdaq Quoting Market Participants to transmit multiple quotes/orders and quotes/orders at multiple price levels, which the system would manage and display in Nasdaq (in the Nasdaq Order Display Facility and/or in the Nasdaq Quotation Montage) consistent with an order's/quote's parameters.

As noted previously, Nasdaq believes that Nasdaq Quoting Market Participants encounter certain difficulties in managing their books, because participants currently may only transmit a single quote (which may represent a single order or an aggregate of principal/agency interest at a single price). Nasdaq believes that, in addition to the problems Nasdaq Quoting Market Participants ace, this limitation also raises competitive concerns and limitations for Nasdaq and the services it provides.

To remedy this situation, Nasdaq proposes to allow certain Nasdaq Quoting Market Participant to give Nasdaq multiple principal and agency orders or quotes at single as well as multiple price levels.[33] Nasdaq would time stamp each quote/order upon receipt, and the time stamp will determine the quote's/order's ranking for automated execution purposes. Additionally, as noted above, a Nasdaq Quoting Market Participant would designate a quote/order as either attributable or non-attributable, and could designate a reserve size. Nasdaq will aggregate in its system all of a Nasdaq Quoting Market Participant's attributable and non-attributable quotes/orders at a particular price level, which would thereafter be disseminated into the Nasdaq Order Display Facility and/or the Nasdaq Quotation Montage. For no-attributable quotes/orders, Nasdaq would display the aggregate size of such quotes/orders in the Nasdaq Order Display Facility when the quotes/orders fall within the three top price levels (on either side of the market) in Nasdaq. For attributable quotes/orders, Nasdaq would display the aggregate size of such quotes/orders in the Nasdaq Quotation Montage, once the quote(s)/order(s) at a particular price level becomes the market maker's best attributable bid or offer in the bottom portion of the montage. (As noted previously, market makers would still only display one MMID, and possibly an agency MMID, in the Nasdaq Quotation Montage.)[34] Nasdaq Quoting Market Participants would have the option to forward their ''top of file'' as a single quote, instead of multiple quotes/orders at multiple price levels, as they do today. That is, a market maker could continue to send only its best bid/best offer to Nasdaq, and an ECN could continue to send Nasdaq only its top of file and be accessed via order delivery.

For example, assume if MMA sends Nasdaq five 1,000 share attributable buy orders at $20 and two 1,000 share non-attributable buy odes at $20, for total interest of 7,000 shares to buy at $20. Assume further than $20 becomes the best bid and MMA is alone at the inside bid. Nasdaq would aggregate all of the orders in the system and display them as follows: 7,000 shares in the Nasdaq Order Display Facility; 5,000 shares (the attributable portion) in the Nasdaq Quotation Montage next to MMA's MMID; and 2,000 (the non-attributable portion) in the ''SIZE'' MMID.

Nasdaq believes that the ability to transmit to Nasdaq multiple orders at varying prices (instead of displaying interest under a single quote) should provide many benefits to Nasdaq market makers and ECNs. First, it should ensure compliance with the OHR, and in particular the Limit Order Display and Firm Quote Rules.[35] Additionally, Nasdaq believes that it prevents any chance that a Nasdaq Quoting Market Participant, because of system delays and/or fast moving markets will miss a market because the participant is unable to quickly transmit to Nasdaq a revised quote (which may represent a limit order). Additionally, Nasdaq intends to include in the new system a ''request a cancel'' functionality. Under this feature where a Nasdaq Quoting market Participant will be required to request Nasdaq to cancel an order before the order is removed from the Nasdaq system.[36] The request to cancel feature, along with the ability to leave orders with Nasdaq, should benefit ECNs by allowing them to participate in automatic execution while minimizing the potential for double liability or taking on a proprietary position.[37]

As another benefit, when an Nasdaq Quoting Market Participant is at the best bid/best offer, Nasdaq would provide for internal matching of a Nasdaq Quoting market Participant's agency (or principal) orders against the participant's quotes/order before the order is sent into the Nasdaq system. For example, if MMA sends all of its quotes/orders to Nasdaq and is at the best bid of $20 showing (attributable and non-attributable) 4,000 shares, and the MMA sends Nasdaq a 1,000 share market sell order from one of its customers, Nasdaq would execute the market sell order against the market maker's bid, instead of sending the order to the Quoting Market Participant that otherwise would be next in the queue to receive the market sell order.

b. *Access to Displayed Quotes/Orders.* 1. *Order Entry Parameters.* Currently, to access quotes via automatic execution, a market participant may enter an order into SOES if the order is for a public customer and meets maximum order size requirements.[38] If an order is not SOES-eligible, a market participant may use SelectNet if the market participant wishes to access a quote of an ECN or UTP Exchange, or if the market participant wishes to use the negotiation features of SelectNet. Presently, SOES and SelectNet are not integrated and operate asynchronously. Notwithstanding, Nasdaq's proposal to integrate SelectNet and SOES, those systems would continue to operate on separate platforms.[39] From an end-user's perspective, a market participant would still have to operate and manage two separate systems. For example, market participants would have to first determine the type of order they wish to enter (liability versus non-liability) and/or to whom they wish to send the order (market maker, ECN, or UTP Exchange), and then decide which system (NNMS, the automated execution system, or SelectNet) into which to enter the order. In addition, the proposal to integrate the functionality of SOES and SelectNet (SR–NASD–99–11) does not entirely eliminate the potential for dual

[33] This functionality will not be available to Quoting Market Participants who are not NASD members (*e.g.,* UTP Exchanges/Non-NASD member ATSs).

[34] If a market participant has an Agency Quote, attributable quote/order or quotes/orders will be displayed once the quotes/orders at a particular price level become the market participant's best Agency Quote.

[35] *See* Exchange Act Rules 11Ac1–1, 17 CFR 240.11Ac1–1, (''Firm Quote Rule'') and 11Ac1–4, 17 CFR 240.11Ac1–4, (''Limit Order Display Rule'').

[36] If the order has already been executed or is in the process of being executed, the request to cancel may be declined.

[37] Nasdaq represents that ECNs do not currently participate in SOES because of the potential for dual liability and assuming proprietary positions. For example, if an ECN were to match orders between two subscribers and contemporaneously receive an execution from SOES against its quote, the ECN would be required to honor both the internal execution and the SOES execution, effectively requiring the ECN to take on a proprietary position. Dual liability does not arise in SelectNet because that system delivers an order (message) which can be declined if the ECN, after scanning its book, determines that the quote in Nasdaq was taken out by an internal execution. (An ECN cannot decline a SOES execution because the system delivers an execution, as opposed to an order.) Under this proposal, an ECN has the ability to give quotes/orders to Nasdaq. If an internal subscriber wanted to access an order in an ECN that is also being displayed in Nasdaq, the ECN could request a cancel before effecting the internal match. If the request to cancel were declined because the order was already executed in Nasdaq, the ECN could decline his/her internal customer and avoid dual liability.

[38] *See* NASD Rule 4730(c).

[39] *See* note 5, *above.*

liability.[40] Specifically, because UTP Exchanges needed a method of delivering Liability Orders to Nasdaq market makers, Nasdaq proposed in the SOES/SelectNet Integration to permit UTP Exchanges to send SelectNet Liability Orders to market participants that participate in the NNMS on an automatic execution basis. The OCF should eliminate all potential for double liability because it would serve as the single point of order entry and the single point of delivery of all Liability Orders (as well as Non-Liability Orders) and executions.

To access quotes in Nasdaq, order entry firms, market makers, ECNs, or UTP Exchanges, would enter either a directed or non-directed order into the OCF. The order could be of any size, up to 999,999 shares (there would be a separate odd-lot process), and would be required to indicate whether it is a buy, sell, sell short, or sell short exempt order.[40] The order would be required to be priced or be a market order.

2. Non-Directed Orders

If a market participant wishes to immediately access the best prices in Nasdaq, the market participant would be required to enter a non-directed order into the OCF. A non-directed order, is one that the market participant entering the order into the system does not send/route to a particular Quoting Market Participant. A non-directed order must be designated as a market order or a marketable limit order and will be considered a ''Liability Order'' and treated as such by the receiving market participant.[42] Upon entry, the OCF would ascertain who the next Quoting Market Participant in the queue to receive an order is and, depending on how that receiving Quoting Market Participant participates in Nasdaq (*i.e.,* automatic execution versus order delivery), the OCF would deliver either an execution or a Liability Order.[43] While market makers will continue to be required to take automatic executions via the NNMS, the OCF will accommodate ECNs that have the option, but are not required, to participate in the system's automatic execution functionality.

a. *Quote Decrementation of Non-Directed Orders.* For a Nasdaq Quoting Market Participant accepting automatic executions (*i.e.,* a market makers and ECN choosing to participate in the system's automatic-execution functionality) the system would deliver an execution up to the size displayed by the participant and, if the order has not been filled by other displayed orders, to the participant's reserve size. The system would automatically decrement the aggregate quote in the Nasdaq Order Display Facility by the size of the delivered execution, and the Nasdaq Quoting Market Participant's quote in the Nasdaq Quotation Montage if the quote/order is attributable. Displayed (attributable or non-attributable) size would be replenished from reserve size for Nasdaq Quoting Market Participants accepting automatic executions, if the participant's displayed size is decremented to zero and the market participant has reserve size. If an ECN accepts automatic executions and has its attributable quote/order exhausted to zero without updating or transmitting of another attributable quote/order to Nasdaq, Nasdaq would zero out the one side of the quote that is exhausted. If both the bid and offer size of the ECN's market were reduced to zero without the ECN updating or transmitting another attributable quote/order, the ECN would be placed into an excused withdrawal state and restored once the ECN transmitted to Nasdaq revised attributable quotes/orders. Nasdaq believes that this is necessary to ensure that Quoting Market Participants that do not provide timely executions due to equipment or other failures do not hold up the market and cause queuing of orders within the Nasdaq system.[44]

For Quoting Market Participants not participating in automatic executions—ECNs that wish to accept order delivery and UTP Exchanges that only participate in order delivery—Nasdaq would deliver an order of a size up to the participant's displayed and reserve size (if applicable). Nasdaq would automatically decrement the participant's quote by the size of the delivered order, but Nasdaq would not deliver another order to such Quoting Market Participant until the Quoting Market Participant has processed the order by providing a complete or partial fill of the order. If the Quoting Market Participant declines or partially fills the order, Nasdaq would send the order (or remaining portion thereof) back into the system for immediate delivery to the next available Quoting Market Participant. In addition, if the Quoting Market Participant declines or partially fills the order without immediately transmitting a revised quote/order at an inferior price, or if the participant fails to respond in any manner within five seconds of order delivery, Nasdaq would immediately reroute the order to the next Quoting Market Participant in the queue. For ECNs, the system would zero out the ECN's quotes/orders at that price level on that side of the market, and the ECN's quote/order would remain at zero unless the ECN transmits to Nasdaq a revised attributable quote/order or the ECN has other attributable quotes/orders in the system.[45]

b. *Quote Refresh and Revised SOESed-Out-of-the-Box Procedures.* As noted previously, market makers will be required to maintain a two-sided, attributable principal quote (other than its Agency Quote) in Nasdaq at all times. To assist with this requirement, market makers would be able to use the Quote Refresh (''QR'') functionality

[40] To eliminate the potential for dual liability (*e.g.* receipt of a SelectNet Liability Order followed immediately by the delivery of a SOES execution against a market maker's quote), Nasdaq proposed to limit SelectNet so that only non-Liability Orders could be delivered to those market participants who participate in the NNMS and are subject to automatic execution (*i.e.,* market makers and ECNs that agree to accept automatic executions). *See* SR–NASD–99–11. To send a Liability Order to a market maker, a market participant would use the NNMS system, which would route the order to the next market maker in the queue. Market participants would still use SelectNet to access quotes of ECNs that do not participate in NNMS and to direct non-Liability Orders to a particular market maker. *See* NASD Rule 4730(c).

[41] Although Nasdaq is proposing to eliminate the rule limiting the size of orders that may be entered into the NNMS, the system in the short term would only be able to deliver an execution up to 9,900 shares. However, if a market participant enters an order into the system that is eligible for automatic execution and exceeds the system size limit of 9,900, the OCF would break the order up into multiples of 9,900 shares and execute the orders as such.

[42] If a non-directed limit order is marketable when entered into the system but subsequently becomes non-marketable because of a change in the inside market, the system will hold the order for 90 seconds rather than immediately returning the order to the participant who entered it. If within that 90 seconds the order once again becomes marketable, the system will send the order to the next Quoting Market Participant in the queue. At any time within that 90 seconds, the participant who entered the order can obtain the status of the order and request a cancel of such order.

If an order is a sell short that is not exempt from NASD Rule 3350 and the market moves from an up-bid to a down-bid after the order is entered but before delivery or execution, the system will return the order to the participant who entered it. Sell-short exempt orders (*i.e.*, those entered by primary market makers) may be entered into the system for execution.

[43] For example, if MMA and ECN1 (non-automatic execution participant) are at the inside bid each displaying 1,000 shares at $20, and OE Firm A enters a market order to sell 1,000 shares, assuming that MMA is first in time priority, the OCF will deliver an execution of 1,000 shares to MMA. If another market order to sell 1,000 shares is then entered into the system, the OCF will deliver a Liability Order to ECN1. If ECN1 had opted to take automatic executions, the OCF would have delivered an execution to ECN1.

[44] If an ECN's quote/order has been zeroed out and placed into an excused withdrawal state and the ECN has non-attributable quotes/orders in Nasdaq, the system will continue to provide access to those orders from non-directed orders as described in this filing.

[45] For UTP Exchanges, Nasdaq will place the side of the quote that was being accessed, at the lowest bid or highest offer price for 100 shares.

feature of the proposed NNMS.[46] QR allows a market maker to designate a refresh size (with a default refresh size of 1,000 shares) and price (*i.e.,* a tick amount away from the price of its decremented quote) to which it wishes to refresh if its quoted size is decremented to zero. If a market maker utilizing QR but has an attributable quote/order in the system that is priced at or better than the quote/order that would be created by the QR, Nasdaq would display the better-priced attributable quote/order, not the QR-produced quote/order.[47] If a market maker is not utilizing QR and the market maker has given Nasdaq multiple attributable quotes/orders, Nasdaq would display the market maker's next best-priced attributable quote/order when its attributable quote/order is decremented to zero.

If a market maker's quote/order is decremented to zero and does not update its principal quote/order via QR, transmit a revised attributable quote/order to Nasdaq, or have another principal (*i.e.,* non-Agency Quote) attributable quote/order in the system, Nasdaq would place the market maker's quote (both sides) in a closed state for three minutes. At the end of that time, if the market maker has not voluntarily updated or withdrawn its quote from the market, Nasdaq would refresh the market maker's quote/order to 100 shares at the lowest market maker bid and highest market maker offer currently being displayed in that security and reopen the market maker's quote. Nasdaq believes that in the proposed electronic environment, five minutes—the current grace period—is too long a period to have a quote closed on the Nasdaq screen. Nasdaq also believes that restoring the quote at the lowest ranked bid or highest ranked offer price will ensure that market makers maintain continued participation in the market and are available to provide liquidity in a manner consistent with their market making obligations.[48]

c. *Order Execution Algorithm.* In general, Nasdaq would execute non-directed orders against Quoting Market Participant's quotes/orders based on price/time priority. As noted above, each quote/order when entered into Nasdaq would receive a time stamp. Nasdaq would execute all orders at the best bid/best offer in general time priority based on the time stamp of the quote/order, subject to the following specific procedures.

First, the system would attempt to match orders entered by a Nasdaq Quoting Market Participant against its own quote/order if the Nasdaq Quoting Market Participant is at the best bid/bet offer. Thus, the system would try to match a Nasdaq Quoting Market Participant's orders and quotes/orders that are in the system if the participant is at the BBO and receives a market or marketable limit order on the other side of the market.

Second, after completing this process (when applicable), the proposed NNMS would first execute against displayed quotes/orders (attributable and non-attributable) of market makers and ECNs that participate in the automatic-execution functionality of the system, in time priority based on the entry time of the quotes/orders from these market makers and ECNs.[49] (There should be no interval delay between the delivery of executions against the quotes/orders of a market maker or ECN that participate in automatic execution (assuming the market maker or ECN has size to access), because all Nasdaq Quoting Market Participants may quote their actual size and may give Nasdaq multiple quotes/orders and price levels.)

Third, the NNMS would execute against the displayed quotes/orders (attributable and non-attributable) of ECNs that participate in the order-delivery functionality of the NNMS. This too would be based on time priority of quotes/orders entered by ECNs that accept order delivery. The system then will execute against reserve size of market makers and ECNs that participate in the automatic-execution functionality of the NNMS (in time priority), and then against the reserve size of ECNs that participate in the order-delivery functionality of the system.

Fourth, once displayed and reserve size in Nasdaq is exhausted, the system would attempt to access the quotes of UTP Exchanges, again in time priority based on the entry time of the UTP Exchanges' quotes (assuming there is more than one UTP Exchange in the stock at that price level). Similar to the Intermarket Trading System (''ITS''), the system would first attempt to probe and sweep the Nasdaq market before sending an order to another market center.[50]

Last, the system would then move to the next price level. There would be a five-second delay before the Nasdaq system would attempt to execute any orders in its system at that time. Orders held during this five-second period would then be executed in time priority, up to the available size, at that next price level. The five-second interval delay would not impact the processing of directed orders. Requests to cancel orders would also be accepted during the five-second delay. This delay will give market participants time to adjust their quotes and trading interests before the market moves precipitously through multiple price levels, which may occur when there is news, rumors, or significant market events. Nasdaq believes that the delay is a modest and reasonable attempt to limit volatility.

d. *Directed Orders.* The Nasdaq Quotation Montage would serve, in part, as a method for Quoting Market Participants to advertise their buying or selling interest. To access a specific quote/order in the Nasdaq Quotation Montage, a market participant would enter into the OCF a ''directed order'' to begin the negotiation process with a particular Quoting Market Participant. A directed order is one that is routed by the market participant entering the order to specific MMID. To limit the possibility for dual liability, a directed order would have to be designated as: (1) All-or-None (''AON'') and at least 100 shares greater than the size of the displayed quote/order of the market participant to which the order is directed; or (2) a Minimum Acceptable Quantity order (''MAQ'') with a MAQ value of at least 100 shares greater than the displayed amount of the quote/order of the participant to which the order is directed. If a Quoting Market Participant is at the inside or is displaying (attributable or non-attributable) interest

[46] The parameters for QR are the same as for the NNMS. Accordingly, when a market maker's principal attributable quote (both displayed and reserve) is exhausted to zero, the system will refresh the market maker's price on the bid or offer side of the market, whichever is decremented to zero, by an interval designated by the market maker and the market maker's size to a level designated by the market maker. When the market maker's quote is refreshed, the QR will refresh the market maker's attributable quote/order (not the non-attributable quote) to a default size of 1,000 shares or an amount designated by the market maker. *See* note 5, *above.*

[47] For example, MMA's $20 bid is decremented to zero and MMA has set an QR of 1/4 (meaning the quote will be updated to $19 3/4—1/4 point away from the decremented $20 bid price). If MMA has an attributable buy quote/order for 19 15/16, the system will display that order instead of the $19 3/4. Alternatively, if MMA has no other attributable quote/order in the system or it MMA's next best attributable quote/order is priced inferior to the QR price of $19 3/4 (*e.g.,* $19 1/2), the system will display the QR-produced quote of $19 3/4.

[48] Under current NASD Rule 4730, a market maker whose quote is decremented to zero and fails to restore its quote in the allotted time will be deemed to have withdrawn as a market maker (''SOESed-Out-of-the-Box''). Subject to certain specified exceptions, the market maker is prohibited from re-entering quotations in that security for twenty (20) business days. The NNMS Rules contain a virtually identical procedure, called ''Timed Out of the Box'' *See* note 5, *above.*

[49] Time priority would be based on the Nasdaq system time stamp for the individual quote/order.

[50] *See e.g.,* Section 8(a)(v) of the ITS Plan.

in the Nasdaq Quotation Montage and receives a directed, non-Liability Order that it wants to fill, to avoid double execution, it may request a cancel of its displayed quote/order in Nasdaq before it fills the non-Liability Order. Nasdaq will not decrement a quote/order upon the delivery of a directed, non-Liability Order.

e. *Locked/Crossed Markets.* Nasdaq believes with the implementation of the OCF, locked and crossed markets should be virtually eliminated. Specifically, if a Quoting Market Participant enters an order that would lock or cross the market, the OCF would not display the order as a quote/order, but instead the order would be treated as a marketable limit order and entered into the OCF as a non-directed Liability Order for execution in time priority. For locked market situations, the orders would be routed to the Quoting Market Participant(s) next in the queue who would be locked, and the order would be executed at the price of the locking quote/order. For crossed market situations, the crossing order would be entered into the system and routed to the next Quoting Market Participant(s) in queue, and the order would be executed at the price of the displayed quote/order that would have been crossed. Once the lock/cross is cleared, if the Quoting Market Participant's order is not completely filled, the OCF would reformat the order and display it as a quote/order on behalf of the entering Quoting Market Participant.[51]

Assuming, for example, that the inside market is \$20 to \$20 1⁄16, 1,000 by 1,000, and MMA is at the inside bid, if MMC attempts to enter into the system an offer quote/order of \$20 for 4,000 shares, the system would format MMC's quote/order as an order, route it to MMA (assuming MMA is first in the queue and there are no other marketable orders in the queue ahead of MMC's order), and execute MMC's order against MMA's quote/order at \$20 for 1,000 shares. Presuming the next market participant on the bid side is quoting at \$19 15⁄16 and since there are 3,000 shares remaining in MMC's order, the OCF would reformat the remaining portion of the order and display it as a quote/order (consistent with the order's parameters), thereby establishing a new inside of \$19 15⁄16 bid and \$20 offer.

As a second example, if MMC attempts to enter into the system an offer quote/order of \$19 15⁄16 for 1,000 shares when MMA is at the best bid of \$20, the system would format MMC's quote/order as an order, route it to MMA, and execute MMC's order against MMA's quote/order at \$20 for 1,000 shares, thus giving price improvement to MMC's order.

Finally, if the market is locked or crossed at 9:30 a.m., Nasdaq would clear out the locked and/or crossed quotes by executing the oldest bid (offer) against the oldest offer (bid) which it is marketable against, at the price of the oldest quote/order. Nasdaq would begin processing non-directed market and marketable limit orders that are in the queue.[52]

*F. UTP Exchange Participation*

National securities exchanges trading pursuant to grants of UTP would be able to enter orders into the OCF. Similar to today, UTP Exchanges would continue to receive, and be obligated to execute, Liability Orders. Specifically, when a UTP Exchange is next in queue to receive a non-directed Liability Order, Nasdaq would deliver the order to the UTP Exchange up to the size of the UTP Exchange's quote. The system would decrement the UTP Exchange's quote by an amount equal to the size of the delivered order. As described in the decrementation procedures above, if a UTP Exchange declines or partially fills the order, Nasdaq would send the order (or remaining portion thereof) back into the system for immediate delivery to the next available Quoting Market Participant. In addition, if the UTP Exchange declines or partially fills the order without immediately transmitting a revised quote/order at an inferior price, or if the UTP Exchange fails to respond in any manner within 5 seconds of order delivery, Nasdaq would presume equipment failure and immediately reroute the order to the next Quoting Market Participant in the queue. The system would then place the side of the UTP Exchange's quote that was being assessed, at the lowest bid or highest offer price for 100 shares.

UTP Exchanges would be free to provide automatic executions against their quotations. Additionally, if a UTP Exchange wishes to access the best Nasdaq market, the UTP Exchange could enter a non-directed Liability Order into the OCF. the OCF would be programmed to send the next Quoting Market Participant an order for delivery, not automatic execution, regardless of whether the receiving Quoting Market Participant participates in automatic execution. UTP Exchanges would also be able to direct non-Liability Orders for negotiation to particular market makers. Finally, as is the case today, UTP Exchanges would only be able to submit a single, two-sided attributable quote, and would not be able to utilize reserve size or QR.

*G. ECN Participation*

As is the case today, ECNs who are NASD members would have the choice of taking order delivery or participating in automatic execution. Regardless, ECNs in Nasdaq would have full access to the OCF for order entry and order delivery. Specifically, ECNs who are NASD members would be able to designate quotes/orders as attributable/non-attributable, and would be able to transmit multiple quotes/orders at multiple prices. ECNs would be able to utilize the system's reserve size feature for quotes/orders. ECN participation in Nasdaq would continue to be governed by rule and private contract.

*H. Odd-Lot Processing*

Under this provision of the proposal, Nasdaq would accept and execute orders less than one normal unit of trading, *i.e.,* odd-lot orders or orders less than one round lot (*i.e.* 100 shares for equities). The system would provide a separate mechanism for processing and executing these orders as distinct from normal units of trading. Nasdaq would hold odd-lot orders in a separate file and automatically execute such odd-lots against all registered market makers in round robin rotation whenever the odd-lot order becomes marketable.[53] For example, if a member enters a market order for 50 shares into the system, it would immediately and automatically execute the order at the inside price against the market maker that is first in rotation for execution of such orders, regardless of the market maker's quoted price. The automatic execution would not decrement the market maker's displayed size. Additionally, if a mixed lot is entered into the system, to ensure continuity of price, once the round-lot portion is executed, the odd-lot portion would be executed against the next market maker in rotation at the round-lot portion price.

*I. Nasdaq SmallCap*

Nasdaq proposes to use the expanded NNMS system and the Nasdaq Order Display Facility for all Nasdaq

[51] If the market moves and the order no longer is locking/crossing, the OCF will return the order and format it as a quote/order for display in Nasdaq.

[52] Prior to the opening, Nasdaq would continue to process ''trade or move'' messages, as proposed in SR–NASD–99–23. *See* Exchange Act Release No. 41473 (June 2, 1999), 64 FR 31335 (June 10, 1999).

[53] An odd-lot order becomes marketable when the best price in Nasdaq moves to the price of the odd-lot limit order. Odd-lot orders that are marketable at entry or become marketable will execute against the first market maker in rotation for odd-lot processing at the best price or at the odd-lot order's price.

securities, including SmallCap securities. Nasdaq sees no reason to continue to have separate systems for its listed securities. Additionally, from a technological perspective, it is very costly and difficult to run two separate platforms. As such, Nasdaq proposes to delete the current SOES rules that apply to SmallCap.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent, in general, with the provisions of Section 15A of the Act, and in particular, Sections 15A(b)(2),[54] 15A(b)(6),[55] and 15A(b)(11),[56] and Section 11A of the Act,[57] in that the proposed rule change is designed to enhance the protection of investors and provide for the fairest and most efficient mechanism for transactions in the market for Nasdaq securities. Section 15A(b)(2) [58] requires the Association to be organized to enforce compliance by its members and associated persons with the provisions of the Act, the rules thereunder, and the rules of the Association. Section 15A(b)(6) [59] requires that the rules of a registered national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. The proposed rule change represents a significant effort to provide for an integrated order delivery and execution system where all market participants and investors may be brought together in a signal system and where all orders are processed and distributed in a fair and orderly fashion to achieve immediate or rapid executions at the best available price.

Nasdaq believes that the system will provide many benefits to Nasdaq market makers, ECNs, and order entry firms. First, the system through the OCF should eliminate, in total, the potential for double execution and double liability that market makers currently face. Second, market makers' regulatory burdens should be reduced because the Nasdaq believes that Nasdaq Order Display Facility will comply with the display alternative in Rule 11Ac1–4 under the Act.[60] Thus, market makers should be able to display their principal and agency interest anonymously in the Nasdaq Order Display Facility without changing their attributable quote in Nasdaq and still comply with Rules 11Ac1–1 and 11Ac1–4 under the Act.[61] Moreover, the potential that a limit order on a Nasdaq Quoting Market Participant's back book would be traded through (or not be displayed as required by Rule 11Ac1–4 under the Act) should be minimized because Nasdaq market makers and ECNs would be able to give the system multiple orders. Thus, Nasdaq believes that the proposed rule change is consistent with Section 11A(a)(1)(B) of the Act, [62] and Rule 11A thereunder,[63] which sets forth findings of Congress that new data processing and communications techniques create the opportunity for more efficient and effective market operations.

In a similar vein, the Nasdaq believes that the Order Display Facility should reduce fragmentation and increase transparency. The Nasdaq believes that the Nasdaq Order Display Facility is consistent with Section 15A(b)(11),[64] which requires that the rules of a registered national securities association be designed to produce fair and informative quotations, prevent fictitious or misleading quotations and to promote orderly procedures for collecting, distributing, and publishing quotations. Specifically, Nasdaq market makers and ECNs would no longer be limited to displaying to the market their best bid and best offer quotes. If the proposal is approved, market makers and ECNs would be able to display in Nasdaq multiple levels of trading interest and varying prices. This interest would be electronically accessible if/when the trading interest falls within the best three prices on either side of the market. While a market maker or ECN currently can only display one level of trading interest (on either side of the market) to the market at any one point in time, the proposal would enable market makers and ECNs to display (and electronically access) three price levels of trading interest in the Nasdaq Order Display Facility. Order entry firms would benefit from the proposal because they would be able to view and electronically access these additional levels of trading interest. Thus, Nasdaq believes that the proposal should enhance liquidity and transparency, while reducing fragmentation.

Finally, the Nasdaq believes that the proposed rule change is consistent with Section 11A(a)(1)(C) of the Act,[65] which states that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and order markets to assure: (1) Economically efficient execution of securities transactions; (2) fair competition among brokers and dealers; (3) the availability to brokers, dealers and investors of information with respect to quotations and transactions in securities; (4) the practicability of brokers executing investors' orders in the best market; and (5) an opportunity for investors orders to be executed without the participation of a dealer. As noted above, the OCF should integrate Nasdaq's current trading systems from an end user's prospective, substantially enhance these systems, and provide a single point of entry and delivery of Liability Orders. The OCF should also encourage ECNs to participate in automatic execution because the potential for incurring a proprietary position due to double executions should be minimized by the proposed new functionality (*i.e.,* the ability to give Nasdaq multiple quotes/orders.) Nasdaq believes that this proposal advances all the goals of Section 11A of the Act [66] by providing an integrated order delivery and execution system, enhanced display of agency and principal trading interest via the Nasdaq Order Display Facility, and by increasing the opportunity for market participants to participate in, and investors to receive, automatic execution. Thus, the Nasdaq believes that the proposal is designed to provide maximum transparency and efficient executions at the best price for the benefit of all investors and market participants.

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

Nadaq 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.

[54] 15 U.S.C. 78*o*–3(b)(2).

[55] 15 U.S.C. 78*o*–3(b)(6).

[56] 15 U.S.C. 78*o*–3(b)(11).

[57] 15 U.S.C. 78k–1.

[58] 15 U.S.C. 78*o*–3(b)(6).

[59] 15 U.S.C. 78*o*–3(b)(6).

[60] *See* 17 CFR 240.11Ac1–4.

[61] *See* 17 CFR 240.11 Ac1–1 and 17 CFR 240.11 Ac1–4.

[62] 15 U.S.C. 78k–1(a)(1)(B).

[63] *See* 17 CFR 240.11A.

[64] 15 U.S.C. 78*o*–3(b)(11).

[65] 15 U.S.C. 78k–1(a)(1)(C).

[66] 15 U.S.C. 78k–1.

*(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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR–NASD–99–53 and should be submitted by December 27, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[67]

**Johathan G. Katz,**

*Secretary.*

[FR Doc. 99–31527 Filed 12–6–99; 8:45 am]

**BILLING CODE 8010–01–M**

[67] 17 CFR 20.30–3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–42178; File No. SR–PCX–99–39]**

## Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc. Creating PCX Equities, Inc.

November 24, 1999.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and rule 19b–4 thereunder,[2] notice is hereby given that on October 7, 1999, the Pacific Exchange, Inc. (''PCX'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The PCX proposes to create a Delaware stock corporation, to be called PCX Equities, Inc. (''PCX Equities''), which will be a wholly-owned subsidiary of the PCX, and to transfer to PCX Equities all of the assets and liabilities that solely support the equities trading business and/or equities clearing business of the PCX. The PCX also proposes to authorize PCX Equities to issue Equity Trading Permits (''ETPs'') and Equity Automated Systems Access Permits (''Equity ASAPs'') that will entitle holders of the permits to trade equity securities at the new PCX Equities. The proposed rule changes for implementing the restructuring, including (1) the Certificate of Incorporation for PCX Equities; (2) the Bylaws for PCX Equities; (2) the Rules for PCX Equities; (3) changes to the PCX Constitution; and (4) changes to the PCX rules, are available for inspection at the places specified in Item IV of this notice.

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

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

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

1. *Purpose*

*a. Purpose of the Proposed Restructuring.* The PCX proposes to create the PCX Equities subsidiary and the corresponding trading permits for two primary reasons. First, the PCX intends to separate the equities operation into a stand-alone subsidiary of the PCX that will continue to share certain corporate functions with the Exchange's options business and to operate pursuant to the PCX's self-regulatory organization (''SRO'') registration. The PCX believes that by restructuring the equities business as a private stock corporation with business control and management, the entity will have greater flexibility to develop and execute strategies designed to improve its competitive position than it has under the current membership-cooperative structure. Furthermore, the PCX anticipates that by restructuring as a private stock corporation, PCX Equities management will be better able to respond quickly to competitive pressures and to make changes to the operation as market conditions warrant.

Second, the PCX intends to increase the revenue of the equities business by conferring trading privileges on the basis of ETPs rather than requiring equities trading participants to bear the expense of a full PCX membership. The PCX believes these changes will ease existing limits on trading access and allow all interested traders to participate in programs offered, which will include competing and remote specialist platforms as contemplated by the proposed rule amendments filed with the SEC on February 26, 1999,[3] and September 3, 1998,[4] respectively.

As members of the PCX, PCX seat owners will retain ownership of the subsidiary and ultimately will benefit from any improvement in the financial health of that entity resulting from these changes.

*b. PCX Equities, Inc.* i. *Structure.* PCX proposes to create PCX Equities, a Delaware stock corporation, as a wholly-owned subsidiary. All of the issued shares of stock of PCX Equities will be

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Exchange Act Release No. 41327 (April 22, 1999), 64 FR 23370 (April 30, 1999).

[4] Exchange Act Release No. 41051 (February 12, 1999), 64 FR 8426 (February 19, 1999).