Commission, and recording secretaries will attend the closed meeting. Certain staff members who have an interest in the matters may also be present.

The General Counsel of the Commission, or his designee has certified that, in his opinion, one or more of the exemptions set forth in 5 U.S.C. 552b(c)(4), (8), (9)(A) and (10) and 17 CFR 200.402(a)(4), (8), (9)(A) and (10), permit consideration for the scheduled matters at the closed meeting.

Commissioner Hunt, as duty officer, voted to consider the items listed for the closed meeting in a closed session.

The subject matters of the closed meeting scheduled for Tuesday, January 25, 2000, will be:

A litigation matter;

Institution and settlement of injunctive actions; and

Institution and settlement of administrative proceedings of an enforcement nature.

At times, changes in Commission priorities require alterations in the scheduling of meeting items. For further information and to ascertain what, if any, matters have been added, deleted or postponed, please contact:

The Office of the Secretary at (202) 942–7070.

Dated: January 20, 2000.

Jonathan G. Katz,
Secretary.

[FR Doc. 00–1806 Filed 1–21–00; 2:40 pm]

BILLING CODE 8010–01–M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–42344; File No. SR–NASD–99–11]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 1, 2, and 3 to the Proposed Rule Change by the National Association of Securities Dealers, Inc., To Modify the NASD's Small Order Execution System and SelectNet Service

January 14, 2000.

I. Introduction

On February 5, 1999, the National Association of Securities Dealers, Inc. (''NASD''), through its wholly-owned subsidiary, The Nasdaq Stock Market, Inc. (''Nasdaq''), filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934

(''Act'') [1] and Rule 19b–4 thereunder [2] to amend the rules governing Nasdaq's Small Order Execution System (''SOES'') and SelectNet Service (''SelectNet''). Notice of the proposed rule change was published for comment in the **Federal Register** on April 22, 1999.[3] The Commission received 79 comment letters regarding the proposal.[4] On August 24, 1999, December 8, 1999, and January 4, 2000, Nasdaq filed Amendment Nos. 1, 2, and 3 to the proposal.[5] This order approves the proposed rule change, as amended.

II. Description of the Proposal

A. Background

The NASD implemented SOES in 1984 to provide for the automatic execution of small retail agency orders at the best bid or offer (the ''inside

---

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

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 41296 (April 15, 1999), 64 FR 19844. In addition to providing notice of the current proposal, Securities Exchange Act Release No. 41296 also re-opened the comment period for File No. SR–NASD–98–17, regarding Nasdaq's proposal to establish an integrated order delivery and execution system (''IODES Proposal''). The IODES Proposal was published for comment in the **Federal Register** on March 12, 1998. *See* Securities Exchange Act Release No. 39718 (March 4, 1998), 63 FR 12124. Subsequently, the Commission extended the comment period for the IODES Proposal through May 8, 1998. *See* Securities Exchange Act Release No. 39794 (March 25, 1998), 63 FR 15471 (March 31, 1998).

[4] A list of the commenters appears in Appendix A.

[5] *See* letter from Robert E. Aber, General Counsel, Nasdaq, to Belinda Blaine, Associate Director, Division of Market Regulation (''Division''), Commission, dated August 24, 1999 (''Amendment No. 1''); letter from Thomas P. Moran, Assistant General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission, dated December 8, 1999 (''Amendment No. 2''); and letter from Thomas P. Moran, Assistant General Counsel, Nasdaq, to Richard Strasser, Assistant Director, Division, Commission, dated January 4, 2000 (''Amendment No. 3''). Amendment Nos. 1 and 2 responded to concerns raised by the commenters. Specifically, Amendment No. 1 discussed electronic communication network (''ECN'') participation in the proposed Nasdaq National Market System (''NNMS''); ECN reserve size interaction with NNMS; unlisted trading privilege (''UTP'') exchange participation in NNMS; the elimination of SelectNet preferencing; NNMS fees; order entry firm participation in NNMS; the timeframe for implementing NNMS; and the continuation of SelectNet. Amendment No. 2 discussed the five-second interval delay between automatic executions; the elimination of SelectNet liability orders; SelectNet preferencing away from the inside market; technology concerns; the potential for manipulative order entry strategies; the reserve size feature; the maximum order size for NNMS; and the elimination of the No Decrementation functionality. Amendment No. 3 revised NASD Rule 4730 (to be renumbered as NASD Rule 4753) to provide that the delay between SOES executions during locked and crossed markets for market makers in SmallCap securities will remain at five seconds.

---

market'').[6] Orders entered into SOES generally are routed automatically on a rotating basis to the SOES market makers displaying the best bid or ask price. SOES also allows market participants to ''preference'' (*i.e.*, direct) an order to a designated market maker.[7] SOES currently provides for ''tiered'' maximum order sizes in Nasdaq National Market (''NNM'') securities of 1000, 500, or 200 shares, depending on the trading characteristics of a security.[8] The maximum SOES order size for Nasdaq SmallCap securities is 500 shares.[9] SOES participation is mandatory for all market makers in NNM securities [10] and voluntary for market makers in Nasdaq SmallCap securities. SOES reports trades for public dissemination and sends both sides of a transaction to the applicable clearing corporations designated for clearance and settlement.

SelectNet is an electronic, screen-based order routing system that allows market makers and order entry firms (referred to collectively as ''participants'') to negotiate securities transactions in Nasdaq securities through computer communications rather than by telephone.[11] Unlike SOES, SelectNet does not provide automatic executions. SelectNet allows participants to negotiate for a larger size or a price superior to the current inside quote. In addition, SelectNet participants may indicate that an order or counter-offer will be in effect from between three and 99 minutes, specify a day order, and indicate whether price or size are negotiable or whether a specific minimum quantity is acceptable. Participants may accept, price improve, counter, or decline a

---

[6] *See* Securities Exchange Act Release Nos. 21433 (October 29, 1984), 49 FR 44042 (November 1, 1984) (File No. SR–NASD–84–26) (notice of proposal to implement SOES); and 21743 (February 12, 1985), 50 FR 7432 (February 22, 1985) (order approving File No. SR–NASD–84–26).

[7] *See* Securities Exchange Act Release No. 25791 (June 9, 1988), 53 FR 22594 (June 16, 1988) (order approving File No. SR–NASD–88–1) (''1988 Order'').

[8] *See* 1988 Order and NASD Rule 4710(g).

[9] *See* NASD Rule 4710(g).

[10] *See* 1988 Order and NASD Rule 4611(f).

[11] The Commission approved SelectNet, which originally was referred to as the Order Confirmation Transaction Service, on a permanent basis in 1988. *See* Securities Exchange Act Release No. 25690 (May 11, 1988), 53 FR 17523 (May 17, 1988) (order approving File No. SR–NASD–88–11). *See also* Securities Exchange Act Release Nos. 28636 (November 21, 1990), 55 FR 49732 (November 30, 1990) (order approving File No. SR–NASD–90–51) (implementing enhancements to SelectNet); and 30581 (April 14, 1992), 57 FR 14596 (April 21, 1992) (order approving File No. SR–NASD–91–51) (expanding SelectNet's hours of operation to include a pre-opening session from 9:00 a.m. to 9:30 a.m. Eastern Time and an after-hours session from 4:00 p.m. until 5:15 p.m. Eastern Time).

SelectNet order. If a participant elects to counter an offer, SelectNet allows the participants to negotiate by exchanging counter-offers until they reach an agreement. After the participants reach an agreement, the execution is ''locked in,'' reported to the tape for public dissemination, and sent to the clearing organization for comparison and settlement.

SelectNet currently allows participants to broadcast orders to all market participants or to preference an order to a designated market maker. Although SelectNet is an order delivery service rather than an order execution service, Nasdaq believes that a preferenced SelectNet order presented to a market maker at its displayed quote generally gives rise to liability under Exchange Act Rule 11Ac1–1 (''Firm Quote Rule'') for the market maker to execute the transaction at that price.[12] As discussed more fully below, Nasdaq proposes to eliminate most SelectNet liability orders.

Nasdaq has designated SelectNet as the link to the electronic communications networks (''ECNs'') pursuant to the Commission's Order Handling Rules.[13] SelectNet also allows exchanges that trade Nasdaq securities on an unlisted trading privilege (''UTP'') basis to access Nasdaq market makers.[14] As discussed more fully below, SelectNet will continue to perform both of these functions under the current proposal.

Nasdaq maintains that although SOES and SelectNet provide valuable services to market participants, the operation of two separate and independent execution systems has resulted in the long-standing problem of potential dual liability for market makers. According to Nasdaq, multiple access points to a market maker's quote, through SOES and SelectNet as well as a firm's internal order delivery and telephone facilities, can routinely subject market makers to unintended double liability for orders that reach a market maker's quote at or near the same time through

different systems. Nasdaq asserts that the potential for unexpected and increased order liability reduces market maker incentives to commit capital and display larger quote sizes, thereby depriving the Nasdaq market of valuable liquidity.

Nasdaq proposes to implement a new trading environment to address these problems. Specifically, Nasdaq proposes to modify SOES and SelectNet to (1) Re-establish SelectNet as a non-liability order delivery and execution system for NNM securities; and (2) Recast SOES as it is used to trade NNM securities.[15] The recast SOES will be called the Nasdaq National Market Execution System (''NNMS''). Nasdaq believes that the proposed changes will reduce instances of dual liability in the most active Nasdaq securities while improving the speed of executions and increasing the access of all market participants to the full depth of a security's trading interest.

B. NNMS

As proposed, NNMS would: (1) Increase the maximum order size for NNM securities that are eligible for automatic execution to 9,900 shares;[16] (2) Allow market makers and order entry firms to enter proprietary orders into NNMS and obtain automatic executions for proprietary and agency orders in NNM securities; (3) Reduce the current 17-second delay between executions against the same market maker to five seconds;[17] (4) Enable NNM orders to interact automatically with a market maker's displayed size and reserve size, including, if approved by the Commission in a separate pending proposal, a market maker's agency quotes,[18] after yielding priority to displayed quotations at the same

price; (5) Eliminate the No Decrementation (''No Dec'') feature for NNM securities, which currently allows continuous executions against a market maker's quote at the same price without decrementing the quoted size; and (6) Eliminate the SOES preferencing feature for NNM securities. Several of these changes are discussed in more detail below.

1. Automatic Executions for Orders of up to 9,900 Shares in NNM Securities

SOES currently permits the automatic execution of retail agency orders of 200, 500, or 1,000 shares at the inside market. NNMS will provide automatic executions at the inside market for orders of up to 9,900 shares in NNM securities. Automatic executions through NNMS will be available not only for retail agency orders, but also for market makers' proprietary orders and for the orders of order entry firms.

2. Reserve Size

The NNMS reserve size functionality would allow a market maker or its customer to display publicly part of the full size of its order or interest with the remainder of its order or interest held in undisplayed reserve. The undisplayed portion of the order or interest would be displayed in whole or in part as the displayed portion of the order or interest is executed. To use the reserve size function, a market maker must initially display a minimum of 1,000 shares in its quotation, or in its agency quotation, if the Commission approves the display of separate agency quotes, and it must refresh its proprietary or agency quote to a minimum of 1,000 shares. After a market maker's or its customer's displayed quotation was decremented to zero due to NNMS executions, Nasdaq would refresh the market maker's or its customer's displayed size from reserve size to a level designated by the market maker or its customer or, in the absence of such a designation, to the automatic refresh size (*i.e.,* 1,000 shares).[19] A market maker that wished to refresh a displayed proprietary or agency quote at the inside market at the same price level would be required to refresh his proprietary or agency quotation at the level of 1,000 shares or more to continue using reserve size. A market maker that wished to refresh and display his proprietary or agency quote at the same inside price at

---

[12] Nasdaq notes that the Firm Quote Rule does not apply if: (1) prior to the receipt of an order in a security, a broker or dealer has communicated to its exchange or association a revised quotation size or a revised bid or offer; or (2) at the time an order in a security is presented, a broker or dealer is in the process of effecting a transaction in that security, and immediately after the completion of that transaction, the broker or dealer communicates to its exchange or association a revised quotation size or a revised bid or offer for the security.

[13] *See* Securities Exchange Act Release No. 38156 (January 10, 1997), 62 FR 2415 (January 16, 1997) (order approving File No. SR–NASD–96–43).

[14] *See* Securities Exchange Act Release No. 38191 (January 22, 1997), 62 FR 4562 (January 30, 1997) (notice of filing and immediate effectiveness of File No. SR–NASD–97–02).

[15] For Nasdaq SmallCap securities, SOES generally will remain unchanged.

[16] The current order size maximums for NNM securities through SOES are 1,000, 500, or 200 shares.

[17] After SOES executes an unpreferenced market order or marketable limit order against a SOES market maker, the market maker currently is not required to execute another unpreferenced SOES order in that security at the same bid or offer until 17 seconds have elapsed, absent a quotation update by the market maker within the 17-second period. *See* Securities Exchange Act Release No. 39490 (December 24, 1997), 63 FR 897 (January 7, 1998) (order approving File No. SR–NASD–97–50).

[18] Nasdaq filed a proposal with the Commission that would permit the separate display of customer orders by market makers in Nasdaq through a market maker agency identification symbol (''agency quote''). *See* Securities Exchange Act Release No. 41128 (March 2, 1999), 64 FR 12198 (March 11, 1999) (notice of filing of SR–NASD–99–09) (''Agency Quote Proposal''). The Commission subsequently extended the comment period for the Agency Quote Proposal. *See* Securities Exchange Act Release No. 41243 (April 1, 1999), 64 FR 17428 (April 9, 1999). The Agency Quote Proposal currently is pending with the Commission.

[19] In addition, NNMS's autoquote refresh function would allow a market maker whose displayed proprietary quotation and reserve size have been decremented to zero due to NNMS executions to elect to have Nasdaq refresh the market maker's quotation (1) at a price interval designated by the market maker; and (2) to the size level designated by the market maker or, in the absence of such a size level designation, to the automatic refresh size.

a size less than 1,000 shares would be permitted to do so, but would not be permitted to use NNMS's reserve size feature.[20]

Orders entered in NNMS would be executed automatically against displayed quotations and reserve size (including agency quotes, if the Commission approves the display of separate agency quotes), in price/time priority. For quotations at the same price level, NNMS would yield priority to all displayed quotations over reserve size, so that NNMS would execute against displayed quotations in time priority and then against reserve size in time priority.

3. Elimination of the No Dec Feature for NNM Securities

The No Dec feature allows continuous executions against a market maker's quotation at the same price without decrementing the quoted size. Nasdaq proposes to eliminate the No Dec feature for NNM securities. Nasdaq believes that the No Dec feature has become less important because market makers now are able to manage their quotations by displaying their actual size. In addition, Nasdaq believes that the No Dec feature will become less important in a market where market makers will have the ability to refresh their quotations at a size they determine. Nasdaq also believes that the No Dec feature inhibits quote competition among market participants and discourages the full display of trading interest.

4. Elimination of SOES Preferencing

Nasdaq proposes to eliminate the existing SOES preferencing feature for NNM securities because it is inconsistent with the processing of orders in time priority as contemplated in Nasdaq's new trading environment. Nasdaq also believes that preferencing in an automatic execution system reduces incentives for market makers to compete aggressively for orders by showing the full size and true price of their trading interest. Moreover, Nasdaq believes that the preferencing feature

---

[20] This restriction would not apply for interim executions against a market maker's non-updated proprietary or agency quote. For example, if a market maker displaying an initial proprietary or agency quotation of 1,000 shares with 5,000 shares in reserve were accessed automatically by NNMS for 300 shares in displayed size, the market maker or its customer would be allowed to continue to display its remaining 700 shares and keep 5,000 shares available in reserve size. If the market maker or its customer subsequently updated either its displayed or reserve size, or its quoted price, the market maker would be obligated to increase the displayed size of its proprietary or agency quote to 1,000 shares to continue to use NNMS's reserve size feature.

might place the agency quotes of public customers at a disadvantage.

5. Execution Fees

NNMS would impose a $0.50 per side fee for each execution. To reduce user cost and facilitate the use of NNMS's reserve size functionality, a simultaneous and instantaneous execution against an NNMS participant's displayed size and reserve size would be treated for billing purposes as a single execution.

6. Penalties for Withdrawals

Like today, under the proposal, a market maker's failure to update a fully exhausted quote would result in the system placing the market maker's quote in a ''closed'' state that, if not updated within five minutes, would be cause for suspension of the market maker's quote for 20 business days.[21]

C. Modifications to SelectNet

Through rule changes requiring the use of ''oversized'' preferenced SelectNet orders, Nasdaq proposes to eliminate the use of most SelectNet liability orders and thereby re-establish SelectNet as an order delivery and negotiation system. Specifically, subject to the exceptions discussed below, Nasdaq proposes to revise its rules to implement an ''oversized order requirement,'' which will prohibit members from directing a SelectNet preferenced order to an NNMS market maker, including the market maker's agency quote, if the Commission approves the display of separate agency quotes, unless the preferenced order is

---

[21] Market makers will continue to have the ability, through Nasdaq's automatic quote update facility, to pre-select a tick value and have Nasdaq refresh the market maker's proprietary quote away from the inside market. This capability will not apply to a market maker's agency quote because that quotation would represent agency interest. If a market maker's quote is refreshed to a different price or size level, another order will not be delivered to that market maker for five seconds after that quote is refreshed at the new price or size level. Nasdaq recently proposed an order display facility (''Order Display Facility Proposal'') that would eliminate the 20-day suspension. *See* Securities Exchange Act Release No. 42166 (November 22, 1999), 64 FR 69125 (December 6, 1999) (notice of filing of File No. SR–NASD–99–53). Under the Order Display Facility Proposal, if a market maker's quote/order decremented to zero, and the market maker did not update its principal quote/order, transmit an attributable revised 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 did not voluntarily update or withdraw 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 being displayed in that security at that time and reopen the market maker's quote.

designated as either (1) ''All-or-None'' (''AON'') of a size that is at least 100 shares greater than the displayed amount of the NNMS market maker's quote to which the order is directed; or (2) ''Minimum Acceptable Quantity'' (''MAQ'') with a MAQ value of at least 100 shares greater than the displayed amount of the NNMS market maker's quote to which the order is directed. SelectNet will be programmed to reject preferenced messages that fail to satisfy these requirements.[22] In Nasdaq's view, the oversized order requirement will ensure that market makers are not subject to liability under the Firm Quote Rule for SelectNet preferenced orders directed to them. Accordingly, Nasdaq believes that the proposal will reduce instances of dual liability resulting from the receipt of orders through asynchronous systems. Nasdaq notes that the recipient of an oversized NNM SelectNet order may choose to execute the incoming order or initiate an electronic negotiation in response to the message.[23]

As discussed below, the oversized order requirement will not apply to UTP exchanges, which will be able to send and receive SelectNet liability orders. In addition, market participants will continue to use SelectNet liability orders to access ECNs that choose to participate in Nasdaq's new trading environment as order entry ECNs.

D. UTP Exchange Participation

Under the proposal, SelectNet will continue to serve as the primary linkage between UTP exchanges and Nasdaq. UTP exchanges will continue to receive and be obligated to execute preferenced SelectNet liability orders, and they will retain their ability to send SelectNet preferenced liability orders to Nasdaq market makers. Although a market maker may be subject to dual liability if a UTP exchange accesses the market maker with a SelectNet liability order and, at the same time, an NNMS market maker or order entry firm accesses the market maker via NNMS, Nasdaq believes that the potential dual liability will be manageable.

E. ECN Participation

An ECN will be able to participate in NNMS as either an order entry ECN or as a full participant ECN. The manner in which an ECN chooses to participate in NNMS will be governed by an

---

[22] SelectNet will continue to accept orders of any size (subject to the current 999,999-share system limit) for Nasdaq SmallCap securities.

[23] Nasdaq notes that this is not to be understood to prohibit liability for each of potentially two quotes displayed by market makers under the Agency Quote Proposal.

addendum to the Nasdaq Workstation II Subscriber Agreement for ECNs.[24]

An order entry ECN will participate in Nasdaq in substantially the same manner as ECNs participate in Nasdaq today. Market participants will continue to access order entry ECNs via the SelectNet linkage and will be able to send preferenced SelectNet messages (*i.e.,* liability orders) of up to 999,999 shares to order entry ECNs. Unlike a full participant ECN, an order entry ECN will not provide automatic executions for orders received from NNMS participants. An order entry ECN will be able to send oversized SelectNet orders to NNMS market makers and other ECNs. In addition, an order entry ECN may request order entry capability in NNMS, which will allow the ECN to obtain automatic executions against the quotations of NNMS market makers, including agency quotations, if the Commission approves the display of separate agency quotes.

A full participant ECN will agree to provide automatic executions for orders the ECN receives from other NNMS participants through NNMS. A full participant ECN will not receive SelectNet preferenced liability orders.[25] Like an order entry ECN, a full participant ECN may request order entry capability in NNMS, which will allow the ECN to obtain automatic executions against the quotations of NNMS market makers, including agency quotations, if the Commission approves the display of separate agency quotes.

Due to the time and the technology constraints affecting some ECNs, Nasdaq believes that, on an interim basis, ECNs should have an option regarding their manner of participation in Nasdaq's new system. Accordingly, Nasdaq does not propose at this time to require all ECNs to register as full participant ECNs, although Nasdaq will reconsider this issue in the future.

F. Nasdaq SmallCap Securities

For Nasdaq SmallCap securities, the trading rules for automatic execution through SOES will remain unchanged. Accordingly, participation in the automatic execution system for SmallCap securities will continue to be voluntary, and automatic executions will be available only for the small orders of public customers. The current maximum order size limits also will remain in effect. After Nasdaq has had experience with NNMS, it will consider whether the functionality of the NNMS

system should be made available for the trading of SmallCap securities.

Nasdaq originally proposed to revise NASD Rule 4730(b)(3) (to be renumbered as NASD Rule 4753(b)(3)) to provide that during locked and crossed markets, SOES will execute orders against the quotations of market makers in SmallCap securities that are locked or crossed at 17-second intervals, rather than five-second intervals, as currently required. Nasdaq amended its proposal to maintain the current five-second delay between SOES executions during locked and crossed markets.[26]

G. Technical Amendments

Nasdaq proposes technical, non-substantive changes to several rules in the NASD Rule 4600 Series and throughout the NASD Manual. In particular, Nasdaq proposes to revise NASD Rule 4613, ''Character of Quotations,'' to eliminate the references to SOES tier sizes for the NNM quotations of market makers. In addition, Nasdaq will rescind or conform other rules that refer to SOES, including NASD Rule 4611(f), ''Registration as a Nasdaq Market Maker,'' NASD Rule 4619, ''Withdrawal of Quotations and Passive Market Making,'' NASD Rule 4620, ''Voluntary Termination of Registration,'' NASD Rule 4632, ''Trade Reporting,'' NASD Rule 4618(c), ''Clearance and Settlement,'' and the NASD Rule 4700 Series (SOES).

III. Summary of Comments

The Commission received 79 comment letters regarding the proposed rule change. The commenters included broker-dealers, registered representatives, ECNs, academics, professional associations, and a registered national securities exchange.[27] Nineteen commenters, including the Trading Committee of the Securities Industry Association (''SIA''),[28] the Investment Company Institute (''ICI''),[29] and Charles

Schwab,[30] supported the proposal.[31] The Trading Committee of the SIA, for example, believed that the proposal would reduce the problem of dual liability for market makers and improve the speed of executions.[32] Similarly, the ICI maintained that the proposal would increase the speed of executions and enhance access to the full depth of a security's trading interest by all market participants.[33] One trader and investor believed that the proposal would result in a more liquid and more transparent Nasdaq market.[34]

Fourteen commenters supported the proposal but voiced concerns with some aspects of the proposed changes. Morgan Stanley Dean Witter (''Morgan Stanley''), for example, generally supported the proposed rule change because it will reduce instances of double liability for market makers, but recommended several modifications to the proposal.[35] Similarly, the Electronic Traders Association (''ETA'') supported the proposal but expressed reservations regarding, among other things, the operation of the fee system for NNMS.[36] Donaldson, Lufkin & Jenrette (''DLJ'') believed that the proposal ''can bring substantial benefits'' to Nasdaq but noted that the proposal fails to eliminate all instances of dual liability.[37] The

---

[24] *See* NASD Rule 4623(b)(3).

[25] Telephone conversation between Thomas P. Moran, Assistant General Counsel, Nasdaq, and Yvonne Fraticelli, Special Counsel, Division, Commission, on October 5, 1999.

[26] *See* Amendment No. 3, *supra* note 5. The proposal, as amended, retains proposed changes to the rule text of renumbered NASD Rule 4753(b)(3) to clarify that the interval for execution of orders against the quotations of market makers that have locked or crossed the market applies to SmallCap securities as well as NNM securities. Telephone conversation between Thomas P. Moran, Assistant General Counsel, Nasdaq, and Ira L. Brandriss, Division, Commission, on January 14, 2000.

[27] A list of the commenters appears in Appendix A.

[28] The SIA is comprised of over 740 North American securities firms.

[29] 29 The ICI is an association of 7,576 mutual fund companies, 479 closed-end investment companies, and 8 sponsors of unit investment trusts.

[30] *See* Schwab Letter, Appendix A.

[31] Thirteen commenters who supported the proposal are persons associated with a Nasdaq market maker, the Security Investment Company of Kansas City. These commenters submitted identical letters which maintained that the proposal will provide prompt access to the best prices in the Nasdaq market, reduce the potential dual liability of market makers, and improve the speed of executions. *See* Halford Letter, Cave Letter, Gaines Letter, Hook Letter, Kitzmiller Letter, Frankel Letter, Schmidt Letter, Mytinger Letter, McCann Letter, Turpin Letter, Malmstrom Letter, Boyle Letter, Means Letter, and Weisenborn Letter, Appendix A. The Kansas City Securities Association (''KCSA'') submitted a similar letter. *See* KCSA Letter, Appendix A.

[32] *See* SIA Letter, Appendix A.

[33] *See* ICI Letter, Appendix A.

[34] *See* Mktmaven Letter, Appendix A.

[35] *See* Morgan Stanley Letter, Appendix A. Morgan Stanley believed that the proposal should be modified to (1) retain the existing 17-second delay in executions against a market maker; (2) retain the No Dec feature for market makers' proprietary quotations; (3) provide a firm quote compliance facility that would allow a market maker to indicate that it has received a telephone order to trade at its displayed quotation; and (4) modify the availability of the 9,900-share NNMS maximum order size.

[36] *See* ETA Letter, Appendix A. The ETA is an association of order entry and other related firms.

[37] *See* DLJ Letter, Appendix A. DLJ believed that Nasdaq should not implement the proposed changes to SOES and SelectNet prior to the year 2000. In addition, DLJ stated that it would require at least six months from the time Nasdaq publishes its changes to the Application Programming Interface (''API'') for DLJ to program, test, and install new systems. As discussed more fully below, other commenters also expressed concern regarding the time for implementing the proposed changes.

Electronic Trading Group ("ETG"), a proprietary trading firm that makes markets in listed and Nasdaq securities, "strongly support[ed]" the proposal but maintained that the proposed changes fail to create a level playing field for all market participants.[38]

Forty-one commenters opposed or noted concerns with the proposal without expressing general support for the proposed changes.[39] One commenter stated that it did not support any of the features in the proposed system and recommended that Nasdaq instead adopt its previously proposed IODES system, excluding the proposed limit order book.[40] Another commenter urged the Commission to reject the current proposal.[41]

Nasdaq responded to the commenters in Amendment Nos. 1 and 2 to the proposal.[42] The views of the commenters are discussed below.

A. Elimination of SelectNet Liability Orders

Thirty-two commenters objected to the elimination of most preferred SelectNet liability orders for NNM securities. Many of the commenters asserted that the elimination of SelectNet liability orders will limit their ability to obtain executions at quotes outside the current inside market (*i.e.,* the best bid or offer), a capability that the commenters believed is crucial for investors.[43] In this regard, several commenters maintained that investors are willing to forego the inside price for the ability to access the liquidity outside the inside market, or to obtain an execution when a stock's price is moving rapidly.[44] One commenter maintained that an order might not be executable at the current inside price if

a market maker at the inside is slow to update its 100-share quotation.[45] Accordingly, the commenter found it "imperative that investors be able to enter orders at prices outside the current inside market."[46]

Other commenters maintained that the oversized order requirement might fail to provide an effective means for accessing a quotation because, in some instances, it would require an investor to assume an unwanted short position. For example, an investor seeking to sell 500 shares would be required to assume an 800-share short position to SelectNet preference a market maker quoting 1200 shares.[47]

Other commenters believed that the proposed changes could undermine the integrity of the Nasdaq market. For example, one commenter feared that the elimination of SelectNet liability orders would produce a market that could permit market makers to refuse to fill an order and not move their quote.[48] The commenter also asserted that a market maker would be able to "hold" the market by repeatedly entering 100-share quotations at five-second intervals.[49] Another commenter stated that market makers would be able to "ignore" oversized orders preferenced to them through SelectNet.[50] Similarly, another commenter, asserting that the oversized order requirement "opens up numerous possibilities for [market maker] manipulation," maintained that market makers might post artificially inflated quotes because they will not be required to trade at their quotations.[51]

One commenter recommended that the proposed system be designed to

require a market maker to honor all orders in a manner consistent with the Firm Quote Rule at the price and up to the size the market maker elects to display until the market maker exhausts or changes his quotation.[52] In addition, the commenter asserted that the elimination of SelectNet liability orders is unnecessary because the existing exceptions to the Firm Quote Rule adequately address the issue of potential double liability when a market maker is in the process of effecting an execution, after which he will update his quote.[53]

Other commenters suggested that Nasdaq address the issue of dual liability by retaining SelectNet liability orders only for quotations outside the current inside market.[54] Because automatic executions through NNMS will be available only for quotations at the inside market, these commenters believed that retaining SelectNet liability orders solely for quotations outside the current inside market would eliminate the potential for dual liability while allowing market participants to continue using the existing SelectNet preferencing feature for quotations outside the current inside market.

Other commenters expressed concern that market makers will continue to be exposed to potential double liability through SelectNet liability orders from UTP exchanges.[55]

B. ECN Participation

As noted above, the proposal will allow ECNs to participate in NNMS either as full participants or as order entry participants. Several ECNs criticized both alternatives. One commenter, for example, asserted that full participation would disadvantage an ECN because (1) The ECN's reserve quotations would not participate in the NNMS sweep of the ECN's top-of-the-file orders; [56] (2) The ECN would be subject to potential double executions; [57] and (3) The ECN would be required to provide access through NNMS to brokers that pay no ECN

[38] *See* ETG Letter, Appendix A. Among other things, ETG supported the implementation of a consolidated order book to provide price protection and time priority of orders. *See also* Sierra Nevada Letter (supporting the proposed changes as an interim measure).

[39] In addition, six comment letters related solely to Nasdaq's IODES Proposal. *See* Lek Letter, USCC Trading I and II, Hill Letter, and Knight I and II, Appendix A. As noted above, the notice of filing for the current proposal also re-opened the comment period for Nasdaq's IODES Proposal. *See* note 3, supra.

[40] *See* A.G. Edwards Letter, Appendix A.

[41] *See* Weil Letter I and Weil Letter II, Appendix A.

[42] *See* note 5, *supra.*

[43] *See, e.g.,* Chung Letter, Deeney Letter, Erman Letter, Fennell Letter, King Letter, Lin Letter, Mt. Pleasant Letter, Mack Letter, Nemcic Letter, Norman Letter, O'Reilly Letter, Rudd Letter, Schiller Letter, Swenson Letter, Teitelman Letter, Vercellone Letter, Wolverton Letter, and Zucker Letter, Appendix A.

[44] *See e.g.,* Weintraub Letter, Swenson Letter, Haber Letter, Deeney Letter, King Letter, Nemcic Letter, Schiller Letter, Vercellone Letter, Snell Letter, and Teitelman Letter, Appendix A.

[45] *See* Atreya Letter, Appendix A.

[46] *See* Atreya Letter, Appendix A.

[47] *See* Catrina Letter, Appendix A. Similarly, the commenters expressed concern that the proposed rule may require an investor to purchase or sell more shares than the investor intended to purchase or sell. *See* Mack Letter, Lin Letter, and Catrina Letter, Appendix A. Moreover, the commenters noted that a short sale on a downtick would violate the short sale rule. *See, e.g.,* Atreya Letter, Vercellone Letter, Deeney Letter, Lin Letter, and Schiller Letter, Appendix A.

[48] *See* Whitcomb Letter, Appendix A. Similarly, the ETA asserted that the failure of market makers to honor their quotations in a manner consistent with the Firm Quote Rule would result in misleading and inaccurate quotations that would reduce the efficiency of the Nasdaq market and undermine investor confidence. *See* ETA Letter, Appendix A.

[49] *See* Whitcomb Letter, Appendix A.

[50] One commenter asserted, for example, that market makers "can and will ignore" non-liability SelectNet orders. *See* Mount Pleasant Letter, Appendix A. Another commenter maintained that it would have no recourse when non-liability SelectNet orders go unfilled. *See* ACIM Letter, Appendix A.

[51] *See* Haber Letter, Appendix A. The commenter noted that a market maker could withdraw its quotation when the inside market approached the market maker's quotation.

[52] *See* ETA Letter, Appendix A.

[53] *See* ETA Letter, Appendix A.

[54] *See* Norman Letter and O'Reilly Letter, Appendix A.

[55] *See, e.g.,* DLJ Letter, A.G. Edwards Letter, and STA Letter, Appendix A. The STA asserted that any possibility of dual liability must be eliminated.

[56] *See* Bloomberg Letter, Appendix A.

[57] Double liability could arise due to the time lag between the execution of an order on the ECN's own system and the subsequent receipt of an execution for the same order from Nasdaq. *See* Bloomberg Letter, Appendix A. Other ECNs also criticized the potential for double liability. *See* Instinet Letter and BRUT Letter, Appendix A (asserting that dual liability is inappropriate for ECNs because ECNs act solely as agents).

fees.[58] On the other hand, the commenter maintained that order entry participation would ''marginalize'' an ECN by omitting the ECN's orders from the NNMS sweep.[59]

Similarly, another commenter asserted that an order entry ECN would be able to execute transactions against preferenced SelectNet orders but, unlike market makers and full participant ECNs, would not be able to interact automatically with other NNMS orders on the basis of strict price/time priority.[60] A third commenter believed that order entry participation is not a viable alternative because an ECN must be accessible by widely used order delivery and execution systems to remain competitive.[61] Several ECNs recommended that Nasdaq implement an order delivery system, rather than a system that provides for automatic executions.[62]

On the other hand, other commenters criticized the proposal for providing two levels of participation for ECNs. One commenter asserted that because the proposal allows ECNs, but not other market participants, to choose between two levels of participation in NNMS, the proposal fails to promote fair competition between market participants and therefore is inconsistent with the Congressional finding in Section 11A(a)(1)(C) under the Act.[63] In addition, the commenter expressed concern that lack of uniform access to ECN quotes would provide opportunities for manipulative and fraudulent quotation and order entry strategies similar to those noted in Nasdaq's IODES proposal.[64] The

commenter believed that Nasdaq should revise its proposal to require the full participation of ECNs and UTP exchanges in NNMS.[65]

Other commenters also believed that Nasdaq should require ECNs to become full participants in NNMS, and, accordingly, subject to automatic executions.[66] One commenter expressed concern that a market maker might post its quotes in an order entry ECN to avoid automatic executions,[67] and other commenters asserted that automatic executions against an ECN's quotes are ''essential to provide equal access to all market participants.''[68]

C. UTP Exchange Participation

The Chicago Stock Exchange (''CHX'') asserted that the proposal improperly excludes the UTP exchanges, including the CHX, from full participation in NNMS.[69] The CHX noted that the proposal will allow UTP specialists to send preferenced orders through SelectNet but will not permit them to use NNMS, which, unlike SelectNet, provides for automatic executions. The CHX maintained that the inability of its specialists to participate in NNMS will ''cripple the CHX's UTP program.''[70]

D. Technology Concerns

Several commenters raised technology issues in connection with the proposal, including concerns regarding the capability of Nasdaq's systems to promptly deliver messages relating to the trading process. In this regard, one commenter recommended that Nasdaq ''demonstrate that it has the capability to deliver immediately to market makers

and executing broker-dealers executions, quote updates, size decrements, and other message traffic that is critical to the trading process.''[71] The commenter maintained that prompt message delivery is crucial in light of the proposed reduction in time delays between executions against a market maker from 17 seconds to five seconds.[72] Noting that there can be a time delay of five seconds or more between the entry of a SOES order and the market maker's receipt of notice of the execution, another commenter expressed concern that an increase in messaging traffic resulting from the proposed changes will increase the delay in providing notice of an execution and, accordingly, will increase the potential for double liability.[73]

Two commenters expressed concern that SOES, which uses technology inferior to that used by SelectNet, will replace SelectNet as the primary means of inter-participant trading.[74] One commenter feared that the impact of existing problems associated with SOES technology would be exacerbated by the increased use of SOES.[75]

In addition, several commenters noted that firms must have sufficient time to modify their computer systems to implement the proposed changes. In

---

[58] *See* Bloomberg Letter, Appendix A.

[59] *See* Bloomberg Letter, Appendix A.

[60] *See* Instinet Letter, Appendix A.

[61] *See* BRUT Letter, Appendix A.

[62] *See* Instinet Letter and Archipelago Letter, Appendix A. *See also* Bloomberg Letter, Appendix A.

[63] *See* Knight Letter II, Appendix A.

[64] *See* Knight Letter II, Appendix A. In the IODES Proposal, Nasdaq stated that the dichotomy between market makers, which provide automatic executions, and ECNs, which do not provide automatic executions, had resulted in anomalies in the processing of orders through SOES. Nasdaq noted that because ECNs and UTP exchanges do not provide automatic executions, Nasdaq had implemented systems changes designed to suspend executions in SOES whenever an ECN or UTP exchange was alone at the inside market. Nasdaq noted that because an ECN quote at the inside effectively halted SOES executions for a security, it might also cause SOES orders to be rejected back to the sending firm. Accordingly, Nasdaq stated that an ECN customer potentially could enter an order to control the inside price and create an advantage in SOES for the ECN customer or another order entry firm to jump ahead of orders that would have been executed if they had not been returned. The ECN customer could then change its quote before the quote could be accessed through SelectNet or the ECN's internal system. After a new dealer inside

price had been established, a new SOES order that entered the system would be executed as the first order against the first market maker at the new inside price. Under these circumstances, customer orders could be disadvantaged because orders entered earlier in time would be forced to go to the back of the queue. Nasdaq noted in the IODES Proposal that it had addressed this problem through a software modification that holds customer orders sent through SOES in queue for up to 90 seconds when an ECN or UTP participant is alone at the inside, instead of immediately rejecting the order. In addition, Nasdaq noted in the IODES Proposal Nasdaq that SOES users had alleged that some traders might be using ECNs to affect the way that SOES handles automatic executions. To avoid this potential problem, Nasdaq proposed to require all participants receiving orders through the proposed IODES system, including ECNs, to be subject to automatic executions. *See* IODES Proposal, *supra* note 3. *See also* Mack Letter, Appendix A (asserting that market makers should not be permitted to use an ECN to block or stop a stock).

[65] *See* Knight Letter II, Appendix A.

[66] *See, e.g.,* ACIM Letter, King Letter, Mack Letter, and Vercellone Letter, Appendix A.

[67] *See* King Letter, Appendix A.

[68] *See* ACIM Letter, Appendix A. *See also* Vercellone Letter, Appendix A.

[69] *See* CHX Letter, Appendix A.

[70] *See* CHX Letter, Appendix A.

---

[71] *See* STA Letter, Appendix A.

[72] *See* STA Letter, Appendix A. Another commenter stated that it is unclear whether Nasdaq's systems capacity will accommodate the greater speed of automatic execution. *See* Morgan Stanley Letter, Appendix A.

[73] *See* ASC Letter, Appendix A. *See also* BRUT Letter (noting that the issue of dual liability centers on Nasdaq's delay in communicating notices of SOES executions to market makers, and that the delay in notification may increase with an increase in SOES messages), and Archipelago Letter (maintaining that any Nasdaq routing system must route messages as quickly as possible), Appendix A.

[74] *See* Archipelago Letter, Appendix A. *See also* ASC Letter, Appendix A.

[75] *See* ASC Letter, Appendix A. The commenter noted several problems associated with SOES technology, including the following: (1) The Permanent Virtual Circuits connecting Nasdaq and market participants fail to indicate whether the opposite party is able to receive data, thereby permitting one party to send messages without realizing that the other party has not received the messages due to a malfunctioning application; (2) due to the lack of automatic re-route facilities, messages must be re-routed manually when a circuit is down, which may result in extended outages; (3) retransmitted messages may be unrecoverable due to the system's procedures for numbering missing messages; (4) the system's sequence number field is unable to fully represent numbers above 9999, so that an application cannot determine the correct sequence number of a retransmission once the total messages received exceeds 10,000; (5) execution messages do not include a unique identifier to prevent duplicate trade reports; and (6) due to delays in message processing, it may take up to 30 minutes to retransmit a message. *See also* Archipelago Letter, Appendix A.

this regard, one commenter estimated that it would require at least six months from the time Nasdaq publishes it changes to the Application Programming Interface (''API'') to program, test, and install new systems.[76]

E. NNMS System Features

1. Automatic Execution for Orders up to 9,900 Shares

Although many commenters supported Nasdaq's proposal to establish a maximum automatic execution order entry size of 9,900 shares for NNMS securities, one commenter maintained that the 9,900-share order entry size was arbitrary,[77] and another asserted that Nasdaq provided no basis for the 9,900-share maximum order size.[78]

Other commenters believed that allowing automatic executions for orders of up to 9,900 shares would drastically reduce small investors' access to executions[79] and prevent small investors from competing with market makers, a purpose inconsistent with the original purpose for establishing SOES.[80]

On the other hand, Charles Schwab maintained that increasing the availability of the automatic execution system would provide market makers with a crucial tool to access the best available prices in the market, and, consequently, to manage risk and obtain liquidity for customer orders.[81]

2. Availability of Automatic Execution

Several commenters believed that the proposed rule change would allow market makers, but not order entry firms, to engage in proprietary trading against market makers' quotes on NNMS.[82]

3. Reducing the Delay Between Automatic Executions From 17 Seconds to Five Seconds

Although many commenters supported the proposed reduction in the delay between automatic executions against a market maker from 17 seconds to five seconds, Morgan Stanley expressed concern that the reduction would provide market makers with insufficient time to react to virtually continuous executions against their quotations and would create significant difficulty for market makers in maintaining control over their positions and effectuating a coherent market making strategy.[83]

4. Reserve Size Feature

Several commenters supported the reserve size feature, asserting that it would increase liquidity and facilitate more rapid executions of larger-sized orders.[84] Other commenters, however, expressed concern regarding Nasdaq's ability to monitor and ensure the proper use of the reserve size feature.[85] In addition, some commenters asserted that reserve size is inconsistent with market transparency. Morgan Stanley, for example, stated that ''[r]eserve size hides the true depth of trading interest from the marketplace and acts as a disincentive to display liquidity.''[86] Similarly, one market maker maintained that the reserve size feature would hinder proprietary trading by market makers, which make their proprietary trading decisions based upon the size of an order being offered.[87] Accordingly, the commenter believed that the proposal would diminish liquidity on Nasdaq.[88]

5. Elimination of the No Dec Feature

Archipelago asserted that Nasdaq should retain the No Dec feature because it reduces quote update traffic, thereby mitigating the capacity strain on Nasdaq's network. Morgan Stanley believed that the No Dec feature serves as a useful quote maintenance tool that

Nasdaq should retain in a modified form.[89] Another commenter asserted that the elimination of the No Dec feature would make it more difficult for market makers to provide orderly markets.[90]

However, two commenters favored the elimination of the No Dec feature.[91] One commenter asserted that the elimination of the No Dec feature would prevent a market maker at the inside from repeatedly renewing a 100-share quote.[92] The commenter believed that the elimination of the No Dec feature, combined with the reserve size feature, would improve the functioning of the market.[93]

F. NNMS Fees

One commenter expressed concern that the fee system for NNMS might operate in a discriminatory and anticompetitive manner.[94]

IV. Discussion

After carefully considering all of the comments, the Commission finds, for the reasons discussed below, that the proposed rule change is consistent with the Act and the rules and regulations applicable to the NASD. In particular, the Commission finds that the proposal is consistent with the requirements of Sections 15A(b)(6) and (11), and 11A(a)(1)(C) of the Act.[95] Section 15A(b)(6) 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. In Section 11A(a)(1)(C), Congress found that it is in the public interest and appropriate for the protection of investors and the

---

[76] *See* DLJ Letter, Appendix A. *See also* STA Letter, ASC Letter (noting that implementation of the proposed changes will require considerable effort by market participants), and BancBoston Letter (noting that Order Audit Trail System, extended trading hours, Year 2000, and decimalization have placed significant resource strains on BancBoston and other market participants), Appendix A.

[77] *See* ACIM Letter, Appendix A.

[78] *See* Archipelago Letter, Appendix A. The commenter maintained that wholesale market makers and ECNs, the market participants that most frequently post large quoted sizes, wish to make quotes fully accessible for the entire size, and, accordingly, the 9,900-share maximum size is an impediment to prompt access to liquidity.

[79] *See* O'Leary Letter, Appendix A. The commenter asserted that in fast market conditions, several 9,900-share orders would absorb the highest quality executions ahead of an individual investor's order.

[80] *See* Galchen Letter, Appendix A.

[81] *See* Schwab Letter, Appendix A.

[82] *See, e.g.,* Miller Letter, Whitcomb Letter, ETA Letter, Sierra Nevada Letter, Mount Pleasant Letter, and Sudit Letter, Appendix A.

[83] *See* Morgan Stanley Letter, Appendix A.

[84] *See, e.g.,* Samarasinghe Letter, Haber Letter, and Lin Letter. One commenter supported executions against a market maker's reserve size, but argued that reserve size feature may present misleading information. *See* Wilson Letter, Appendix A.

[85] *See, e.g.,* King Letter (asserting that the reserve size feature will foster manipulative and fraudulent practices), Snell Letter (questioning the enforcement of the reserve size feature), and Wolverton Letter (maintaining that the reserve size feature will permit market makers to ''hide'' shares behind their displayed quotes), Appendix A. *See* also Sievers Letter.

[86] *See* Morgan Stanley Letter, Appendix A. *See also* Mack Letter and Wilson Letter, Appendix A.

[87] *See* Sievers Letter, Appendix A.

[88] *See* Sievers Letter, Appendix A.

[89] *See* Morgan Stanley Letter, Appendix A. Morgan Stanley believed that Nasdaq should retain the No Dec feature, but that it should be available only to market makers displaying a size of at least 1,000 shares.

[90] *See* Caris Letter, Appendix A.

[91] *See* Wilson Letter and Lin Letter, Appendix A.

[92] *See* Lin Letter, Appendix A. The commenter asserted that a market maker at the inside might repeatedly renew a 100-share quote in an effort to sustain the price of a stock. The commenter noted that the repeated renewal of the quotation might hinder the efforts of other market participants to fill larger-sized orders in the stock.

[93] *See* Lin Letter, Appendix A.

[94] *See* ETA Letter, Appendix A.

[95] 15 U.S.C. 78o–3(b)(6) and (11), and 15 U.S.C. 78k–1(a)(1)(C).

maintenance of fair and orderly markets to assure: (1) The 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.[96]

Specifically, as discussed more fully below, the Commission finds that the proposed changes are designed to protect investors and the public interest and to assure the economically efficient execution of securities transactions by allowing market makers, public customers, and order entry firms to obtain automatic executions for orders of up to 9,900 shares in NNM securities. By reducing instances of double liability for market makers in NNM securities, the proposal potentially may encourage market makers in NNM securities to display larger sized quotations, thereby adding liquidity to the market for NNM securities and helping to assure the economically efficient execution of transactions in NNM securities. In addition, by reducing the delay between executions against a market maker from 17 seconds to five seconds, the proposal may facilitate the price discovery process and promote quote competition among market makers, thus helping to ensure the best execution of customer orders. The Commission believes that the proposed changes potentially may enhance the efficiency and increase the depth and liquidity of the market for NNM securities, to the benefit of all market participants.

A. Automatic Executions for Orders of up to 9,900 Shares in NNM Securities

SOES currently permits the automatic execution of retail agency orders of 200, 500, or 1,000 shares at the inside market. NNMS will provide automatic executions at the inside market for orders of up to 9,900 shares in NNM securities. Automatic executions through NNMS will be available not only for retail agency orders, but also for market makers' proprietary orders and for the orders of order entry firms.

Several commenters expressed concerns regarding the automatic execution feature of NNMS. Specifically, the commenters maintained that the 9,900-share order

entry size was arbitrary,[97] that it would reduce small investors' access to executions,[98] and that it would prevent small investors from competing with market makers, a purpose inconsistent with the original purpose for establishing SOES.[99] In addition, some commenters believed that NNMS would be available for the proprietary trading of market makers, but not for order entry firms.[100]

In response to the concern about the availability of NNMS, Nasdaq clarified that NNMS will be available to all NASD member firms, including order entry firms.[101] In addition, in response to the concerns regarding the 9,900-share maximum order size entry in NNMS, Nasdaq stated that the 9,900-share maximum is a technological system constraint of the NNMS automatic execution platform.[102] Nasdaq also maintained that because the current average size of a SelectNet execution is 800 shares, the 9,900-share maximum NNMS order size should be sufficient to handle the majority of SelectNet orders that will migrate to NNMS.[103] Nasdaq noted that orders of over 10,000 shares would be processed through a combination of NNMS, SelectNet, and other means.[104]

The Commission believes that the proposed automatic execution feature of NNMS is consistent with Section 15A(b)(6) of the Act because it is designed to protect investors and the public interest. In addition, the Commission believes that the proposed automatic execution feature of NNMS is consistent with Congress's finding in Section 11A(a)(1)(C)(i) of the Act that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure the economically efficient execution of securities transactions. In this regard, the Commission believes that the immediacy and certainty of order execution for NNM orders of up to 9,900 shares should strengthen the Nasdaq market and benefit market participants by permitting the prompt, efficient execution of orders of up to 9,900 shares at the best available price. Because NNMS will provide automatic executions against displayed quotations and against reserve size, NNMS's

automatic execution feature will provide prompt access to all of the available liquidity in a security at the current inside market.

In addition, the Commission notes that the proposal will extend the benefits associated with automatic executions to order entry firms and to the proprietary orders of market makers. The Commission agrees with the NASD that allowing automatic executions for broker-dealers' proprietary trades potentially may encourage broker-dealers to commit capital to the market, thereby adding to the depth and liquidity of the market for NNM securities.

Further, the Commission believes that the 9,900-share maximum order size is reasonable in light of the system constraint of the NNMS automatic execution platform. According to the NASD, the 9,900-share maximum order size should accommodate the size of the orders that are likely to be processed through NNMS.

With regard to small investors' access to executions, the Commission notes that NNMS's automatic execution feature will be available equally for the orders of market makers, order entry firms, and public customers. Accordingly, the Commission believes that the automatic execution feature of NNMS is reasonably designed to provide market makers, order entry firms, and public customers with equal access to the current inside market in NNM securities.

B. Reserve Size Feature of NNMS

The reserve size feature of NNMS will allow an NNMS market maker or its customer to display publicly part of the full size of its order or interest with the remainder held in reserve on an undisplayed basis to be displayed in whole or in part as the displayed part is executed. To use the reserve size feature, a market maker's quotation, including its agency quotation, if the Commission approves the display of separate agency quotes, initially must display a minimum of 1,000 shares, and the quotation must be refreshed to 1,000 shares to continue using the reserve size feature.

Several commenters expressed concerns with the reserve size feature. In particular, some commenters questioned Nasdaq's ability to monitor and ensure the proper use of the reserve size feature.[105] One commenter contended that reserve size is inconsistent with market transparency and that reserve size would hide the

---

[96] In approving the proposal, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[97] *See* ACIM Letter, Appendix A. *See also* Archipelago Letter, Appendix A.

[98] *See* O'Leary Letter, Appendix A.

[99] *See* Galchen Letter, Appendix A.

[100] *See, e.g.*, Miller Letter, Whitcomb Letter, ETA Letter, Sierra Nevada Letter, Mount Pleasant Letter, and Sudit Letter, Appendix A.

[101] *See* Amendment No. 1, *supra* note 5.

[102] *See* Amendment No. 2, *supra* note 5.

[103] *See* Amendment No. 2, *supra* note 5.

[104] *See* Amendment No. 2, *supra* note 5.

[105] *See, e.g.,* King Letter, Snell Letter, and Wolverton Letter, Appendix A.

depth of trading interest and act as a disincentive to display liquidity.[106] One market maker maintained that reserve size would hinder proprietary trading by market makers and, accordingly, would diminish liquidity on Nasdaq.[107]

In response to the commenters, Nasdaq asserted that reserve size would be likely to increase the amount of shares market participants commit to the market because the non-display of the reserve shares would lessen the potential negative price impacts associated with the display of larger trading interest.[108] In addition, Nasdaq maintained that the requirement that a market participant seeking to use reserve size in NNMS display a minimum of 1,000 shares also would serve to increase liquidity by providing an incentive to display a larger quotation size.[109]

The Commission believes that the reserve size feature will encourage participation in NNMS by providing market makers and their customers with greater flexibility in the handling of large orders. Increased participation in NNMS should, in turn, enhance the depth and the liquidity of the market for NNM securities, to the benefit of all market participants. The requirement that a market participant display a minimum of 1,000 shares to use the reserve size feature should encourage market participants to display orders of at least 1,000 shares, which may reduce volatility and enhance market depth at a given price. In addition, because all displayed quotations in NNMS at the same price level will have priority over reserve size quotations at that price level, NNMS will provide an incentive for market participants to display their orders.

The Commission also believes that reserve size could prove useful to institutions wishing to minimize the market impact of their orders. In addition, the reserve size feature of NNMS will allow market makers quoting in Nasdaq to compete more effectively with alternative trading systems that provide a reserve size feature. The Commission expects NASD Regulation to monitor trading to ensure the proper use of the reserve size feature (particularly priority rules) and compliance with the requirements applicable to the use of reserve size.

C. Reduction of the 17-Second Delay Between Executions Against a Market Maker

Nasdaq proposes to reduce the current 17-second delay between executions against the same market maker to five seconds. As noted above, one commenter believed that the proposed five-second delay between executions against a market maker would provide market makers with insufficient time to react to executions against their quotations and would create significant difficulty for market makers in maintaining control over their positions and effectuating a coherent market making strategy.[110] In addition, several commenters expressed concerns regarding the ability of Nasdaq's systems to promptly notify market participants of executions against their quotations.[111]

In response, Nasdaq maintained that a five-second interval delay (with an additional two-second internal Nasdaq system processing time) is an appropriate compromise between the need for fast executions and the need to provide market makers with adequate time to manage their capital risk through monitoring and updating their quotes in response to rapidly changing market conditions.[112] Nasdaq stated that it would monitor market performance in NNMS as it related to the five-second interval delay and would consider modifying that time period, in consultation with Commission staff.[113] As discussed more fully in Section IV.I, *infra,* Nasdaq stated that proposed enhancements to its systems, including a new central message switch that will provide faster delivery of automatic execution confirmation messages, will help to ensure that Nasdaq has the technological capability to promptly deliver notices of automatic executions.[114]

The Commission believes that the proposal to reduce the delay between executions against the same market maker from 17 seconds to five seconds will help to ensure that a market maker has no more time than is necessary after an execution before it must update its quotes. This requirement will help to ensure that a market maker cannot attempt to avoid its market making obligations by delaying after an NNMS execution before entering an updated

quote.[115] As a result, the reduced time delay between executions against a market maker's quote should increase a market maker's compliance with its obligation to make continuous, two-sided markets and promote quote competition among market makers. Such competition among market makers should, in turn, enhance the integrity of the Nasdaq market by helping to ensure the best execution of customer orders and improving the price discovery process for NNM securities.

As discussed more fully in Section IV.I, *infra,* the Commission believes, based on Nasdaq's representations, that planned enhancements to Nasdaq's systems, including the planned implementation of a new central message switch in January 2000, should enable Nasdaq to promptly deliver execution messages to market participants.[116] Accordingly, based on Nasdaq's representations, the Commission believes that Nasdaq will have the technological capability to implement the proposed five-second delay between executions against a market maker's quotation.

D. Elimination of the No Dec Feature for NNM Securities

Nasdaq proposes to eliminate the No Dec feature for NNM securities. The No Dec feature allows continuous executions against a market maker's quotation at the same price without decrementing the quoted size. Nasdaq believes that the No Dec feature has become less important because market makers are able to manage their quotations by displaying their actual size. In addition, Nasdaq believes that the No Dec feature will become less important in a market where market makers will have the ability to refresh their quotations at a size they determine.

Several commenters questioned the elimination of the No Dec feature. One commenter maintained that Nasdaq should retain the No Dec feature because it reduces quote update traffic, thereby mitigating the capacity strain on Nasdaq's network.[117] Other commenters maintained that the No Dec feature serves as a useful quote maintenance tool and that the elimination of the No Dec feature would make it more difficult

[106] *See* Morgan Stanley Letter, Appendix A.
[107] *See* Sievers Letter, Appendix A.
[108] *See* Amendment No. 2, *supra* note 5.
[109] *See* Amendment No. 2, *supra* note 5.

[110] *See* Morgan Stanley Letter, Appendix A.
[111] *See* STA Letter, Morgan Stanley Letter, ASC Letter, and BRUT Letter, Appendix A.
[112] *See* Amendment No. 2, *supra* note 5.
[113] *See* Amendment No. 2, *supra* note 5.
[114] *See* Amendment No. 2, *supra* note 5.

[115] A market maker that can avoid updating its quote for a period of time can take advantage of its temporary ability to avoid NNMS executions and wait to see how other market makers update their quotes. This delay could serve to lessen competition among market makers. *See* Securities Exchange Act Release No. 39490 (December 24, 1997), 63 FR 897 (January 7, 1998) (order approving File No. SR–NASD–97–50).
[116] *See* Amendment No. 2, *supra* note 5.
[117] *See* Archipelago Letter, Appendix A.

for market makers to provide orderly markets.[118]

In response, Nasdaq asserted that the elimination of the No Dec feature will allow market participants to more easily execute multiple customer orders at the inside and move the market to new quote levels, thereby aiding the price discovery process.[119] In addition, Nasdaq maintained that the No Dec feature is incompatible with the NNMS processing functions that immediately access displayed and reserve size and move through different price levels. Nasdaq noted that in NNMS the full size of reserve share amounts will be immediately and automatically accessible (after executions against displayed quotations), while the No Dec feature makes additional shares available on a piecemeal basis each time a quote is accessed and only after an interval delay between executions. Thus, Nasdaq concluded that NNMS's reserve size feature would speed executions, while the No Dec feature would result in slower executions.[120]

The Commission believes that it is reasonable for Nasdaq to eliminate the No Dec feature for NNM securities. Specifically, the Commission believes that the elimination of the No Dec feature should result in quicker executions and prompt access to the available liquidity at the current inside market. The Commission also believes that the elimination of the No Dec feature may allow the market to adjust more quickly to information, thereby facilitating price discovery and improving the efficiency of the Nasdaq market.

The Commission notes that market makers now have the ability to quote in actual size, and therefore have an enhanced ability to manage their quotations. In addition, NNMS's reserve size refresh and autoquote refresh features should help market makers that elect to use reserve size to manage their quotations.[121] Because the reserve size refresh function and the autoquote refresh function, as well as the ability to

quote actual size, will assist market makers, the Commission believes that market makers will be able to manage their quotations after Nasdaq eliminates the No Dec feature.

With regard to the commenter's concern that the elimination of the No Dec feature might strain the capacity of Nasdaq's network, the Commission does not believe, based on Nasdaq's representations regarding planned enhancements to its systems [122] (as discussed more fully in Section IV.I, *infra*), that the elimination of the No Dec feature will result in a capacity strain on Nasdaq's network.

E. Elimination of SOES Preferencing for NNMS Securities

Nasdaq proposes to eliminate the SOES preferencing feature for NNM securities because it is inconsistent with the processing of orders in time priority and because the preferencing feature might place the agency quotations of public customers, if the Commission approves the display of separate agency quotes, at a disadvantage. In addition, Nasdaq believes that preferencing in an automatic execution system reduces incentives for market makers to compete aggressively for orders by showing the full size and true price of their trading interest.

The Commission believes that it is reasonable for Nasdaq to eliminate the SOES preferencing feature to provide for the processing of orders in price/time priority. The processing of orders in price/time priority should help to ensure that all orders are processed in a fair, equal, and orderly manner. Accordingly, the Commission finds that the elimination of SOES preferencing is designed to protect investors and the public interest by helping Nasdaq to maintain a fair and orderly market.

F. SelectNet Liability Orders

Nasdaq proposes to revise SelectNet to require the use of "oversized" preferenced SelectNet Orders. As discussed above, the proposed oversized order provisions will allow members to direct a SelectNet preferenced order to an NNMS market maker, including the market maker's agency quote, if the Commission approves the display of separate agency quotes, only if the order is designated as AON or MAQ for a size that is at least 100 shares greater than the displayed amount of the quote to which the order is directed. The oversized order requirement is designed to reduce instances of double liability for market makers. UTP exchanges, however, will continue to send and

receive SelectNet liability orders. In addition, order entry ECNs will be able to receive SelectNet liability orders.

As discussed above, thirty-two commenters objected to the elimination of SelectNet liability orders. Among other things, the commenters argued that (1) the ability to preference outside the current inside market is crucial to investors who, in some cases, would be willing to forego the inside price to access the liquidity outside the current inside market; [123] (2) the oversized order requirement might require an investor to assume an unwanted position;[124] (3) the elimination of SelectNet liability orders might undermine the integrity of the Nasdaq market because market participants will not be required to trade at their quotations;[125] (4) the elimination of SelectNet liability orders is unnecessary because the Firm Quote Rule addresses the issue of potential double liability when a market maker is effecting an execution;[126] (5) Nasdaq should retain SelectNet liability orders for quotations outside the current inside market;[127] (6) market makers will not be obligated to respond to non-liability SelectNet orders;[128] and (7) a market maker at the inside would be able to "hold" the market by repeatedly entering 100-share quotations at five-second intervals.[129]

In response to the commenters, Nasdaq maintained that the elimination of SelectNet preferencing was essential to achieving two of the proposal's goals, the reduction of dual liability [130] and the establishment of a single order execution system.[131] Nasdaq concluded that neither the Firm Quote Rule nor the retention of SelectNet liability orders for quotations outside the inside market offered viable means for preserving SelectNet liability orders. Specifically, Nasdaq asserted that retaining SelectNet liability orders for quotations outside the current inside market would create confusion in a fast-moving market and could result in significant unanticipated dual liability for market makers during

---

[118] *See* Morgan Stanley Letter and Caris Letter, Appendix A.

[119] *See* Amendment No. 2, *supra* note 5.

[120] *See* Amendment No. 2, *supra* note 5.

[121] The reserve size refresh function will refresh a market maker's displayed proprietary or agency quote, if the Commission approves the display of separate agency quotes, from its reserve size at the automatic refresh size or at a size level designated by the market maker. The autoquote refresh function will allow a market maker whose displayed proprietary quotation and reserve size have been decremented to zero to elect to have Nasdaq refresh the market maker's quotation price by an interval designated by the market maker and to refresh the market maker's displayed size to a level designated by the market maker or to the automatic refresh size (*i.e.*, 1,000 shares).

[122] *See* Amendment No. 2, *supra* note 5.

[123] *See, e.g.*, Weintraub Letter, Swenson Letter, Haber Letter, Deeney Letter, King Letter, Nemcic Letter, Schiller Letter, Vercellone Letter, Snell Letter, and Teitelman Letter, Appendix A. *See also* Chung Letter, Deeney Letter, Erman Letter, Fennell Letter, Lin Letter, Mt. Pleasant Letter, Mack Letter, Norman Letter, O'Reilly Letter, Rudd Letter, and Zucker Letter, Appendix A.

[124] *See* Catrina Letter, Mack Letter, and Lin Letter, Appendix A.

[125] *See* Whitcomb Letter and Haber Letter, Appendix A. *See also* ETA Letter, Appendix A.

[126] *See* ETA Letter, Appendix A.

[127] *See* Norman Letter and O'Reilly Letter, Appendix A.

[128] *See* Mount Pleasant Letter, Appendix A.

[129] *See* Whitcomb Letter, Appendix A.

[130] *See* Amendment No. 1, *supra* note 5.

[131] *See* Amendment No. 2, *supra* note 5.

periods of rapid price change.[132] Nasdaq also believed that the Firm Quote Rule would not eliminate the potential for double liability because Nasdaq currently maintains two systems, SOES and SelectNet, that deliver liability orders. Thus, according to Nasdaq, a market maker who receives a SelectNet message at its price and size, followed immediately by a SOES execution against its quote, would be obligated to fill both orders.[133]

In response to the commenters' concerns regarding their ability to access quotations outside the inside market in the absence of SelectNet liability orders, Nasdaq stated that market participants may attempt to access such quotations through oversized SelectNet orders or through traditional means of communication.[134] In addition, Nasdaq noted that market participants will be able to enter limit orders in NNMS outside the current inside market that will be entitled to execution at the limit price or better if the inside market rises or falls to the price level of the limit order.[135] Nasdaq also maintained that SelectNet preferencing outside the inside market would be inconsistent with the orderly and fair processing of orders in the Nasdaq market and that, in light of NNMS' reserve size feature, efforts to access a quotation outside the current inside market without attempting to exhaust interest at the inside could be inconsistent with a broker's duty of best execution.[136] Nasdaq acknowledged that market makers will not be obligated to respond to non-liability SelectNet messages, but maintained that the implementation of a single liability/execution system is essential to reduce dual liability.[137]

In response to the commenters who raised concerns about the potential for manipulative activity in NNMS, Nasdaq asserted that NASD Regulation would closely monitor quotation and order entry activity to ensure the protection of all market participants.[138] In addition, in response to the commenter who believed a market maker would be able to "hold" the market by repeatedly renewing a 100-share quotation at five-second intervals because market participants would not be able to use SelectNet liability orders to exhaust the

market maker's quotation, Nasdaq maintained that the commenter's description of trading activity was inaccurate and provided examples supporting its position.[139]

The Commission believes that the oversized order requirement and the resulting elimination of most SelectNet liability orders is a reasonable means to address the problem of double liability.[140] As noted above, Nasdaq has stated that double liability is a "significant and ongoing problem" and that reducing double liability is one of the proposal's primary goals. The Commission believes that reducing double liability may encourage market makers to display larger sized quotations, thereby providing greater liquidity to the market for NNM securities. The reduction in double liability also may enhance market makers' ability to reflect size in their quotations based on market and business factors with less concern for the potential for double liability. In addition, by preventing market participants from preferencing a quotation outside the current inside market, the elimination of most SelectNet liability orders may facilitate the fair and orderly processing of orders in the Nasdaq market.

With regard to obtaining access to liquidity outside the current inside market, the Commission notes that market participants may attempt to access quotations outside the current inside market through the use of oversized SelectNet orders or through traditional means of communication (*e.g.*, telephone orders). Accordingly, the Commission believes that the availability of oversized SelectNet

---

[139] Specifically, Nasdaq provided scenarios indicating that a market maker could not "hold" the market at a price level. In Nasdaq's first scenario, NNMS receives a market order to sell 1,200 shares. Market maker A ("MMA") is alone at the inside bid of $20 for 100 shares, with 1,100 shares in reserve (the example assumes a previous partial execution against MMA's non-updated quote because reserve size would not be available unless MMA initially displayed a minimum of 1,000 shares). In this case, the order would execute automatically in full at $20 against displayed and reserve size and MMA's quote would be decremented to zero and refreshed or placed in a closed quote status. In the second scenario, NNMS receives a market order to sell 1,200 shares and MMA is alone at the inside bid of $20 for 100 shares, with no shares in reserve. In this case, NNMS would execute against MMA's quote and then move immediately to execute against the quotes at the next lower price level. Thus, the market would not be held at $20. If the inside offer moved to $20, MMA would violate NASD Rule 4613(e) (regarding locked and crossed markets) if MMA entered a locking bid of $20. *See* Amendment No. 2, *supra* note 5.

[140] As discussed above, UTP exchanges will continue to send and receive SelectNet liability orders. In addition, market participants will access order entry ECNs through SelectNet liability orders.

orders, as well as traditional means of communication, should provide market participants with adequate means to access quotations outside the current inside market.

As discussed above, several commenters believed that the proposed reduction in SelectNet liability orders would result in misleading or inaccurate quotations because market makers would not be required to trade at their quotations.[141] In response, Nasdaq stated that NASD Regulation would closely monitor quotation and order entry activity to ensure the protection of all market participants.[142] The Commission expects NASD Regulation to carefully monitor the conduct of market participants and to bring appropriate disciplinary action against any market participant who enters false or misleading quotations in NNMS or engages in other conduct that is inconsistent with just and equitable principles of trade.

G. ECN Participation in NNMS

Under the proposal, an ECN may participate in NNMS as either an order entry ECN or as a full participant ECN. Market participants will access an order entry ECN through SelectNet liability orders, and an order entry ECN will not provide automatic executions for orders received from those participants. An order entry ECN may request order entry capability in NNMS, which will allow it to obtain automatic executions against the quotations of NNMS market makers, including agency quotes, if the Commission approves the separate display of agency quotes.

A full participant ECN will provide automatic executions for orders the ECN receives through NNMS. Like an order entry ECN, a full participant ECN may request order entry capability in NNMS to obtain automatic executions for orders it sends through NNMS.

As discussed more fully above, ECNs and other market participants criticized the provisions of the proposal relating to ECN participation in NNMS. Two ECNs asserted that order entry participation would marginalize an ECN and was not a viable means for participating in NNMS.[143] One ECN maintained that full participation would disadvantage an ECN because (1) the ECN's reserve quotations would not participate in the NNMS sweep of the ECN's top-of-the-file orders; (2) the ECN would be subject to potential double executions; and (3)

---

[132] *See* Amendment No. 1, *supra* note 5.

[133] *See* Amendment No. 2, *supra* note 5.

[134] *See* Amendment No. 1, *supra* note 5.

[135] *See* Amendment No. 2, *supra* note 5.

[136] *See* Amendment No. 2, *supra* note 5.

[137] *See* Amendment No. 2, *supra* note 5. Nasdaq also noted that the elimination of SelectNet liability orders would apply equally to all market participants. *Id.*

[138] *See* Amendment No. 2, *supra* note 5.

[141] *See* Whitcomb Letter, ETA Letter, and Haber Letter, Appendix A.

[142] *See* Amendment No. 2, *supra* note 5.

[143] *See* Bloomberg Letter and BRUT Letter, Appendix A.

the ECN would be required to provide access through NNMS to brokers that pay no ECN fees.[144]

One market maker criticized the proposal for providing two levels of participation for ECNs but not for other market participants.[145] Several commenters believed that Nasdaq should require ECNs to be full participants in NNMS and, accordingly, subject to automatic executions.[146] In addition, one commenter expressed concern that lack of uniform access to ECN quotes would provide opportunities for manipulative and fraudulent quotation and order entry strategies.[147] Another commenter asserted that a market maker might post its quotes in an order entry ECN to avoid automatic executions.[148]

In response to the concerns regarding ECN participation, Nasdaq stated that it proposed two levels of ECN participation after some ECNs indicated that their systems were not capable of supporting a full automatic execution interface with Nasdaq at this time.[149] In addition, Nasdaq indicated that it would monitor ECN activity in NNMS with a view towards fully integrating all ECNs in the future through enhanced automation.[150] Nasdaq maintained that the proposal balances the benefits of ECN participation in NNMS with current technological constraints and provides maximum flexibility for ECNs while reducing market makers' dual liability concerns.[151]

With regard to the interaction of an ECN's reserve size with NNMS, Nasdaq stated that ECNs currently do not allow Nasdaq access to the reserve size share amounts residing in their systems.[152] Nasdaq indicated that to the extent that an ECN agrees to share its reserve size information with Nasdaq and subject the reserved shares to the automatic execution parameters outlined in the proposal, Nasdaq would be willing to program NNMS to interact with the ECN's reserve size.[153]

In response to concerns that NNMS will provide an opportunity for manipulative and fraudulent quotation and order entry activity, Nasdaq stated, as noted above, that NASD Regulation would closely monitor quotation and

order entry activity to ensure the protection of all market participants.[154]

The Commission finds that Nasdaq's proposal for ECN participation in NNMS provides an effective means for integrating ECNs into NNMS. By allowing an ECN to participate in NNMS either as a full participant ECN or as an order entry ECN, the proposal provides ECNs with the flexibility to determine the method of participation in NNMS that is most appropriate for the ECN at this time. The Commission also believes that providing two options for ECN participation in NNMS is reasonable and necessary because, according to Nasdaq, some ECNs currently are not capable of supporting a full automatic execution interface with Nasdaq. Moreover, it is not likely that ECNs that choose order entry participation will be marginalized because ECNs are frequently at the best quote in the market. Further, these ECNs have the ability to obtain automatic executions against the quotes of NNMS market makers if they so choose.

With regard to the concern that the lack of uniform access to ECN quotes will provide opportunities for manipulative and fraudulent quotation and order entry strategies in NNMS, the Commission expects NASD Regulation to carefully monitor trading in NNMS to detect manipulative quotation or order entry strategies and to bring appropriate disciplinary action against a market participant who engages in such strategies or other conduct that is inconsistent with just and equitable principles of trade.

H. UTP Exchange Participation in NNMS

Under the proposal, SelectNet will continue to serve as the primary linkage between UTP exchanges and Nasdaq. UTP exchanges will receive and be obligated to execute preferred SelectNet liability orders and they will retain their ability to send SelectNet preferenced liability orders to Nasdaq market makers.

The CHX asserted that the proposal improperly excludes the UTP exchanges, including the CHX, from full participation in NNMS.[155] The CHX noted that the proposal would allow UTP specialists to send preferenced orders through SelectNet but will not permit them to use NNMS, which, unlike SelectNet, provides for automatic executions.

In response, Nasdaq noted that Nasdaq market makers currently are not able to obtain automatic executions

against exchange specialists.[156] Nasdaq asserted that it would be inappropriate and inconsistent with the fair competition mandate of the Act for Nasdaq to provide CHX specialists with the ability to obtain automatic executions against Nasdaq members while the CHX and the other exchanges decline to provide Nasdaq members with automatic execution access to the quotes of exchange specialists through the Intermarket Trading System.[157]

The Commission believes that it is reasonable for Nasdaq to continue to use SelectNet as the primary linkage between Nasdaq and the UTP exchanges, allowing UTP exchange specialists to access the Nasdaq market through SelectNet liability orders. The Commission believes that the use of SelectNet linkage will provide UTP exchange specialists with adequate access to the Nasdaq market.

I. Technology Concerns

Several commenters expressed concerns regarding Nasdaq's technological capability to implement the proposed changes. In particular, one commenter noted that Nasdaq's systems must be able to promptly deliver critical message traffic, including messages relating to executions, size decrements, and quote updates.[158] The commenters argued that prompt message delivery is critical in light of the proposed reduction in time delays between executions against a market maker from 17 seconds to five seconds,[159] and they noted that a delay in providing notice of an execution increases the potential for double liability.[160] One commenter feared that the impact of existing problems associated with SOES technology will be exacerbated by the increased use of SOES under the proposal.[161] In addition, several commenters noted that firms must have sufficient time to modify their computer systems to implement the proposed changes.[162]

In response, Nasdaq indicated that it has and will continue to take all appropriate steps to assure the adequacy and sufficiency of the proposed systems changes.[163] Specifically, Nasdaq represented that its current automatic execution platform can be expanded

---

[144] *See* Bloomberg Letter, Appendix A.

[145] *See* Knight Letter II, Appendix A.

[146] *See* Knight Letter II, ACIM Letter, King Letter, Mack Letter, and Vercellone Letter, Appendix A.

[147] *See* Knight II, Appendix A. *See also* Mack Letter, Appendix A.

[148] *See* King Letter, Appendix A.

[149] *See* Amendment No. 1, *supra* note 5.

[150] *See* Amendment No. 1, *supra* note 5.

[151] *See* Amendment No. 1, *supra* note 5.

[152] *See* Amendment No. 1, *supra* note 5.

[153] *See* Amendment No. 1, *supra* note 5.

[154] *See* Amendment No. 2, *supra* note 5.

[155] *See* CHX Letter, Appendix A.

[156] *See* Amendment No. 1, *supra* note 5.

[157] *See* Amendment No. 1, *supra* note 5.

[158] *See* STA Letter, Appendix A.

[159] *See* STA Letter, Appendix A.

[160] *See* ASC Letter, Appendix A. *See also* BRUT Letter, Appendix A.

[161] *See* ASC Letter, Appendix A. *See also* BRUT Letter, Appendix A.

[162] *See* DLJ Letter, Appendix A. *See also* STA Letter and BancBoston Letter, Appendix A.

[163] *See* Amendment No. 1, *supra* note 5.

rapidly to add sufficient capacity to handle the increased volume of message traffic moving into automatic execution under NNMS.[164] In this regard, Nasdaq noted that it plans to replace its current Tandem K-Series host processors with new Tandem S-Series models, resulting in an approximate 25% increase in system capacity and processing speed.[165] Nasdaq stated that this increase would be augmented further by software application tuning (*e.g.*, the addition of more parallel processes to handle order flow) that will expand capacity well beyond the needs of NNMS.[166] In addition, because SelectNet uses more message capacity than SOES due to SelectNet's broadcast, negotiation, and response capabilities, Nasdaq believes that the movement of order traffic to the SOES-based automatic execution platform will reduce overall network traffic levels, thereby increasing the speed and reliability of the entire Nasdaq market.[167]

In response to the commenters' concerns regarding Nasdaq's ability to provide prompt notice of an execution, Nasdaq asserted that the delays in execution report delivery result from competition for system resources in the Nasdaq central message switch.[168] Nasdaq maintained that the migration of message traffic from SelectNet to NNMS would significantly reduce the message traffic causing these delays.[169] In addition, Nasdaq indicated that it expects to roll out an improved central message switch in January 2000, which should dramatically increase the speed of automatic execution confirmation messages and more closely synchronize automatic execution transactions with execution updates to market makers and ECNs.[170]

Nasdaq also noted that it is in the process of testing a Transmission Control Protocol/Internet Protocol ("TCP/IP")-based, API communications protocol for NNMS, which Nasdaq expects to implement by the end of February 2000.[171] Nasdaq stated that the API would allow NNMS participants to more seamlessly link their internal systems with NNMS for trading, risk management, and regulatory compliance purposes.[172] Nasdaq asserted that the TCP/IP protocol should increase the speed and reliability of NNMS and

remove most, if not all, of the technological objections to NNMS.[173]

The Commission believes that the proposed enhancements to Nasdaq's systems, including the new Tandem S-Series host processors and software modifications, the improved central message switch, and the TCP/IP-based, API communications protocol for NNMS, will help to ensure that Nasdaq has the technological capability to implement the proposed changes. The Commission expects that Nasdaq will implement these changes before it moves to the new NNMS trading platform. The Commission also expects Nasdaq to provide sufficient lead time for market participants before implementing NNMS, and to closely monitor operation of NNMS and to implement additional technological changes as necessary.

J. NNMS Fees

One commenter expressed concern that the fee system for NNMS may operate in a discriminatory and anticompetitive manner.[174]

In response, Nasdaq noted that the fees to be assessed under NNMS mirror the current fees for Nasdaq's automatic execution facilities (*i.e.*, $0.50 per side) and SelectNet ($1.00 per execution, order entry side only).[175] Nasdaq will treat a simultaneous execution against an NNMS participant's displayed and reserve sizes as a single execution. For example, a 5,000-share NNMS automatic execution order that interacts with the quotes of three market participants will result in a $0.50 fee for the order entry firm and a $0.50 fee for each of the three market participants whose quotes were accessed, regardless of whether the order also interacted with any of the market participants' reserve sizes.[176] Nasdaq indicated that it is reviewing modifications that may reduce NNMS fees in the future.[177]

The Commission believes that the proposed NNMS fees provide for the equitable allocation of reasonable dues, fees, and other changes, consistent with Section 15A(b)(5) of the Act.

K. Executions Against SOES Market Makers During Locked and Crossed Markets

The Commission believes that it is reasonable for Nasdaq to retain the current five-second delay between SOES executions against the quotation of market maker in SmallCap securities

during locked and crossed markets.[178] The Commission believes that retaining the five-second delay between SOES executions during locked and crossed markets will help to ensure that locked or crossed markets are resolved promptly, thereby improving market quality, providing more informative quotation information, and contributing to the maintenance of a fair and orderly market. In addition, the Commission believes, as it has concluded previously, that the five-second delay between SOES executions during locked and crossed markets provides market makers with a brief period to update their quotations while encouraging market makers to quickly remedy a locked or crossed market.[179] Accordingly, the Commission believes that the proposal to retain the five-second delay between SOES executions during locked and crossed markets is reasonably designed to protect investors and the public interest and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

L. Technical Amendments

The Commission believes that the proposed technical, non-substantive amendments to the NASD Manual will clarify the NASD's rules to reflect the proposed changes. Because these changes will reduce confusion and help to ensure compliance with the NASD's rules, the Commission finds that the changes are designed to protect investors and the public interest.

The Commission finds good cause for approving Amendment Nos. 1, 2, and 3 to the proposal prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment Nos. 1 and 2 respond to the concerns raised by the commenters, provide additional representations concerning the operation of the proposal, and clarify the proposed changes. Among other things, Amendment No. 1 makes clear that order entry firms will be able to participate in NNMS and that Nasdaq would be willing to program NNMS to interact with an ECN's reserve size to the extent that the ECN agrees to share its reserve size information with Nasdaq and subject the reserved shares to the automatic execution parameters outlined in the proposal. Amendment No. 2 describes Nasdaq's technological capability to implement the proposed changes and provides additional

---

[164] *See* Amendment No. 2, *supra* note 5.
[165] *See* Amendment No. 2, *supra* note 5.
[166] *See* Amendment No. 2, *supra* note 5.
[167] *See* Amendment No. 2, *supra* note 5.
[168] *See* Amendment No. 2, *supra* note 5.
[169] *See* Amendment No. 2, *supra* note 5.
[170] *See* Amendment No. 2, *supra* note 5.
[171] *See* Amendment No. 2, *supra* note 5.
[172] *See* Amendment No. 2, *supra* note 5.

[173] *See* Amendment No. 2, *supra* note 5.
[174] *See* ETA Letter, Appendix A.
[175] *See* Amendment No. 1, *supra* note 5.
[176] *See* Amendment No. 1, *supra* note 5.
[177] *See* Amendment No. 1, *supra* note 5.

[178] *See* Amendment No. 3, *supra* note 5.
[179] *See* Securities Exchange Act Release No. 38115 (January 3, 1997), 62 FR 1351 (January 9, 1997) (order approving File No. SR–NASD–95–54).

explanations concerning the rationale for the proposed changes. Amendment No. 3 strengthens the proposal by retaining the current five-second delay between SOES executions during locked and crossed markets, thereby encouraging market makers to quickly correct locked or crossed quotations. Accordingly, the Commission believes that granting accelerated approval of Amendment Nos. 1, 2, and 3 is appropriate and consistent with Sections 15A(b)(6) and 19(b)(2) of the Act.[180]

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 1, 2, and 3, including whether Amendment Nos. 1, 2, and 3 are 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–99–11 and should be submitted by February 15, 2000.

VI. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act (specifically, Sections 11A and 15A of the Act) and the rules and regulations thereunder applicable to a national securities association.

It Is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,[181] that the proposed rule change (SR–NASD–99–11), as amended, be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[182]

Margaret H. McFarland,

Deputy Secretary.

Appendix A—Comment Letters Regarding SR–NASD–99–11

1. Letter from John M. Schaible, President, NexTrade, to Jonathan G. Katz, Secretary, SEC, dated May 3, 1999.

2. Letter from Steven Weil to SEC, dated May 8, 1999 (''Weil Letter I'').

3. Letter from Steven Weil to Jonathan G. Katz, Secretary, SEC, dated May 7, 1999. (''Weil Letter II'').

4. Letter from Kenneth D. Pasternak, President, and Walter F. Raquet, Chief Operating Officer, Knight Securities, Inc., to Jonathan G. Katz, Secretary, SEC, dated May 21, 1999 (''Knight Letter I'').

5. Letter from James M. Hensley, President, Sierra Nevada Securities, Inc., to Jonathan G. Katz, Secretary, SEC, dated May 24, 1999 (''Sierra Nevada Letter'').

6. Letter from Brent M. Weisenborn, Chairman, Security Investment Company of Kansas City (''KCMO''), to Jonathan G. Katz, Secretary, SEC, dated May 25, 1999 (''Weisenborn Letter'').

7. Letter from Mktmaven to SEC (sent by e-mail) dated May 24, 1999 (''Mktmaven Letter'').

8. Letter from Samuel F. Lek, Chief Executive Officer, Lek Schoenau & Company, Inc., to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Lek Letter'').

9. Letter from James F. Mytinger, Treasurer, Kansas City Securities Association, to Jonathan G. Katz, Secretary, SEC, dated May 26, 1999 (''KCSA Letter'').

10. Letter from Christopher Halford, KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Halford Letter'').

11. Letter from Stuart Cave, KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Cave Letter'').

12. Letter from Ludwell G. Gaines III, KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Gaines Letter'').

13. Letter from Steven R. Hook, KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Hook Letter'').

14. Letter from Richard Kitzmiller, KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Kitzmiller Letter'').

15. Letter from Jeffrey Frankel, KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Frankel Letter'').

16. Letter from Bruce K. Schmidt, KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Schmidt Letter'').

17. Letter from James F. Mytinger, KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Mytinger Letter'').

18. Letter from Trent McCann, KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''McCann Letter'').

19. Letter from Lance Turpin, KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Turpin Letter'').

20. Letter from Kyle Malmstrom, KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Malmstrom Letter'').

21. Letter from Ron F. Boyle III, KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Boyle Letter'').

22. Letter from Carl L. Means, Jr., KCMO, to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 (''Means Letter'').

23. Letter from Oren Galchen to Jonathan G. Katz, Secretary, SEC, dated May 22, 1999 (''Galchen Letter'').

24. Letter from Richard Y. Roberts, Thelen Reid & Priest LLP, on behalf of the Electronic Traders Association (''ETA''), to Jonathan G. Katz, Secretary, SEC, dated May 28, 1999 (''ETA Letter'').

25. Letter from Robin Roger, Principal and Counsel, Morgan Stanley Dean Witter, to Jonathan G. Katz, Secretary, SEC, dated May 28, 1999 (''Morgan Stanley Letter'').

26. Letter from Dan Liu, Executive Vice President, *et. al.*, Automated Securities Clearance Ltd., to Jonathan G. Katz, Secretary, SEC, dated May 28, 1999 (''ASC Letter'').

27. Letter from David K. Whitcomb, Professor of Finance and Economics, Rutgers University, Faculty of Management, Department of Finance and Economics, to Jonathan G. Katz, Secretary, SEC, dated June 1, 1999 (''Whitcomb Letter'').

28. Letter from Brian Hyndman, President, *et al.*, The Brass Utility, L.L.C., to Jonathan G. Katz, Secretary, SEC, dated May 28, 1999 (''BRUT Letter'').

29. Letter from Diane Murphy, Managing Director/Nasdaq Trading, BancBoston Robertson Stephens, to Jonathan G. Katz, Secretary, SEC, dated June 1, 1999 (''BancBoston Letter'').

30. Letter from Bruce Miller, Professor of Accounting, The Anderson School at UCLA, to Jonathan G. Katz, Secretary, SEC, dated May 28, 1999 (''Miller Letter'').

---

[180] 15 U.S.C. 78o–3(b)(6) and 78s(b)(2).

[181] 15 U.S.C. 78s(b)(2).

[182] 17 CFR 200.30–3(a)(12).

31. Letter from Timothy J. Wilson to Jonathan G. Katz, Secretary, SEC, dated May 23, 1999. ("Wilson Letter").

32. Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, SEC, dated June 1, 1999 ("ICI Letter").

33. Letter from Dinuka L. Samarasinghe to Jonathan G. Katz, Secretary, SEC, dated May 23, 1999 ("Samarasinghe Letter").

34. Letter from Gregg Giaquinto, In-House Counsel, Electronic Trading Group, L.L.C. ("ETG"), to Jonathan G. Katz, Secretary, SEC, dated June 1, 1999 ("ETG Letter").

35. Letter from Paul R. Rudd to Jonathan G. Katz, Secretary, SEC, dated May 23, 1999 ("Rudd Letter").

36. Letter from William B. Norman to Jonathan G. Katz, Secretary, SEC, dated May 25, 1999 ("Norman Letter").

37. Letter from Michael O'Reilly to Jonathan G. Katz, Secretary, SEC, dated May 25, 1999 ("O'Reilly Letter").

38. Letter from Gabriel Levin to Jonathan G. Katz, Secretary, SEC, dated May 21, 1999 ("Levin Letter").

39. Letter from Jeremy Zucker to Jonathan G. Katz, Secretary, SEC, dated March 29, 1999 ("Zucker Letter").

40. Letter from David O'Leary to Jonathan G. Katz, Secretary, SEC, undated, received June 3, 1999 ("O'Leary Letter").

41. Letter from Tolga Erman to Jonathan G. Katz, Secretary, SEC, dated May 25, 1999 ("Erman Letter").

42. Letter from Piers Fennell to Jonathan G. Katz, Secretary, SEC, dated May 28, 1999 ("Fennell Letter").

43. Letter from Mike Wolverton to Jonathan G. Katz, Secretary, SEC, dated May 28, 1999 ("Wolverton Letter").

44. Letter from Neal King to Jonathan G. Katz, Secretary, SEC, dated May 24, 1999 ("King Letter").

45. Letter from Nikhil Atreya to Jonathan G. Katz, Secretary, SEC, dated May 27, 1999 ("Atreya Letter").

46. Letter from Joel Haber to Jonathan G. Katz, Secretary, SEC, dated May 28, 1999 ("Haber Letter").

47. Letter from Joshua Weintraub to Jonathan G. Katz, Secretary, SEC, undated, received June 2, 1999 ("Weintraub Letter").

48. Letter from Bryan D. Chung to Jonathan G. Katz, undated, received June 2, 1999 ("Chung Letter").

49. Letter from Jeffrey A. Deeney to Jonathan G. Katz, Secretary, SEC, dated May 28, 1999 ("Deeney Letter").

50. Letter from Steven Weil to Jonathan G. Katz, Secretary, SEC, dated May 28, 1999 ("Weil Letter III").

51. Letter from Bob Sievers, Access Securities, to SEC, dated June 2, 1999 ("Sievers Letter").

52. Letter from Steve Swanson, President, Mount Pleasant Brokerage Services, LP, to Jonathan G. Katz, Secretary, SEC, dated June 1, 1999 ("Mt. Pleasant Letter").

53. Letter from Arthur J. Kearney, Chairman, and Leopold Korins, President and CEO, Security Traders Association ("STA") to Jonathan G. Katz, Secretary, SEC, dated June 3, 1999 ("STA Letter").

54. Letter from Howard Teitelman to Jonathan G. Katz, Secretary, SEC, dated May 20, 1999 ("Teitelman Letter").

55. Letter from Justin Schiller to Jonathan G. Katz, Secretary, SEC, undated, received June 4, 1999 ("Schiller Letter").

56. Letter from James T. Snell, Registered Representative, Heartland Securities, to Jonathan G. Katz, Secretary, SEC, dated May 24, 1999 ("Snell Letter").

57. Letter from Matthew D. Nemcic to Jonathan G. Katz, Secretary, SEC, undated, received June 3, 1999 ("Nemcic Letter").

58. Letter from Kenneth D. Pasternak, President, and Walter F. Raquet, Chief Operating Officer, Knight Securities, Inc., to Jonathan G. Katz, Secretary, SEC, dated June 4, 1999 ("Knight Letter II").

59. Letter from Richard D. Schenkman, Executive Vice President, Instinet Corporation, to Jonathan G. Katz, Secretary, SEC, dated June 7, 1999 ("Instinet Letter").

60. Letter from Paul B. O'Kelly, Chicago Stock Exchange ("CHX"), to Jonathan G. Katz, Secretary, SEC, dated June 7, 1999 ("CHX Letter").

61. Letter from Bernard L. Madoff, Chairman, Trading Committee, Securities Industry Association ("SIA"), to Jonathan G. Katz, Secretary, SEC, dated June 2, 1999 ("SIA Letter").

62. Letter from Brian L. Mack to Jonathan G. Katz, Secretary, SEC, dated May 28, 1999 ("Mack Letter").

63. Letter from Jon Vercellone to Jonathan G. Katz, Secretary, SEC, undated, received June 4, 1999 ("Vercellone Letter").

64. Letter from Yu-Hui J. Lin to Jonathan G. Katz, Secretary, SEC, dated May 30, 1999 ("Lin Letter").

65. Letter from Cornel Catrina to Jonathan G. Katz, Secretary, SEC, dated May 29, 1999 ("Catrina Letter").

66. Letter from William H. Sulya, Senior Vice President and Director of Nasdaq/OTC Trading, A.G. Edwards & Sons, Inc. ("A.G. Edwards"), to Margaret H. McFarland, Deputy Secretary, SEC, dated June 7, 1999 ("A.G. Edwards Letter").

67. Letter from Greg Swenson to Jonathan G. Katz, Secretary, SEC, undated, received June 8, 1999 ("Swenson Letter").

68. Letter from Kevin M. Foley, Bloomberg L.P. ("Bloomberg"), to Jonathan G. Katz, Secretary, SEC, dated June 4, 1999 ("Bloomberg Letter").

69. Letter from Hill, Thompson, Magid & Co., Inc. ("Hill"), to Jonathan G. Katz, Secretary, SEC, dated June 7, 1999 ("Hill Letter").

70. Letter from Mike Cormack, Manager, Equity Trading, American Century Investment Management ("ACIM"), to Jonathan G. Katz, Secretary, SEC, dated June 3, 1999 ("ACIM Letter").

71. Letter from Ephraim F. Sudit, Ph.D., Professor of Accounting and Information Systems, Rutgers University, to Jonathan G. Katz, Secretary, SEC, dated June 1, 1999 ("Sudit Letter").

72. Letter from Matthew D. Lang, Senior Compliance Officer, USCC Trading, to Jonathan G. Katz, Secretary, SEC, dated June 8, 1999 ("USSC Trading Letter I").

73. Letter from Robert L. Padala, Managing Director, Over-the-Counter Trading, Donaldson, Lufkin & Jenrette ("DLJ"), to Jonathan G. Katz, Secretary, SEC, dated June 14, 1999 ("DLJ Letter").

74. Letter from Gerald D. Putnam, Chief Executive Officer, Archipelago, L.L.C. ("Archipelago"), to Jonathan G. Katz, Secretary, SEC, dated June 14, 1999 ("Archipelago Letter").

75. Letter from Darren Caris, Torrey Pines Securities, to Jonathan G. Katz, Secretary, SEC, dated June 16, 1999 ("Caris Letter").

76. Letter from Neil C. Feldman, President, USCC Trading, to Jonathan G. Katz, Secretary, SEC, dated June 17, 1999 ("USCC Trading Letter II").

77. Letter from Lon Gorman, Executive Vice President, Charles Schwab ("Schwab"), to Jonathan G. Katz, Secretary, SEC, dated June 16, 1999 ("Schwab Letter").

78. Letter from Michael T. Dorsey, Senior Vice President and General Counsel, Knight Securities, Inc., to Jonathan G. Katz, Secretary, SEC, dated June 23, 1999 ("Knight Letter III").

79. Letter from Maria A. Silverstein, The Security Traders Association of New York, to Jonathan G. Katz, Secretary, SEC, and Robert Colby, Deputy Director, Division of Market Regulation, SEC, dated March 22, 1999.

[FR Doc. 00–1697 Filed 1–24–00; 8:45 am]

BILLING CODE 8010–01–P