

for application of a \$.0025 per share transaction fee to all agency orders transacted by CHX floor brokers in NASDAQ/NMS Securities, up to a maximum of \$100 per side. Second, the CHX fee schedule is amended to increase the current earned credit available to floor brokers by a factor of three. Finally, the schedule is modified to provide a new credit based on Consolidated Tape Association revenue generated by each floor broker. The proposed rule change is intended to stimulate growth on the Exchange, enhance the competitive capability of floor brokers and foster cooperation on the Exchange's trading floor by making a reasonable allocation of those CHX revenues generated by its floor brokers.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)(4) ⁴ of the Act in that it provides for the equitable allocation of reasonable dues, fees and other charges among its members.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were solicited or received.

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

The proposed rule change is effective immediately upon filing pursuant to Section 19(b)(3)(A)(ii) of the Act ⁵ and subparagraph (f)(2) of Rule 19b-4 under the Act ⁶ because the proposal is establishing or changing a due, fee or other charge. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule

change is consistent with the Act.⁷ Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the CHX. All submissions should refer to File No. SR-CHX-99-15 and should be submitted by October 28, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁸

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41967; File No. SR-NASD-98-85]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 2, 3, and 5 of the Proposed Rule Change by the National Association of Securities Dealers, Inc. To Establish the Nasdaq Application of the OptiMark System

September 30, 1999.

I. Introduction

On November 13, 1998, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly-owned subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") ¹ and Rule 19b-4 thereunder,² a proposed rule change to establish rules for a new facility called the Nasdaq

Application of the OptiMark System ("Application"). The Application is an electronic trading system based on information processing technology provided by OptiMark Technologies, Inc., together with its wholly-owned subsidiary, OptiMark Services, Inc. ("OSI").³ On December 11, 1998, Nasdaq filed Amendment No. 1 to the proposed rule change. The proposed rule change, as amended, was published for comment in the **Federal Register** on January 5, 1999.⁴ The Commission received four comment letters in response to the proposal.⁵ On July 16, 1999, the NASD filed Amendment No. 2 to the proposed rule change.⁶ On September 13, 1999, the NASD filed Amendments Nos. 3 and 4 to the proposed rule change.⁷ On September

³ OptiMark Technologies, Inc. is a computer technology firm that has developed certain patented technology referred to as "OptiMark™." The Application is one of several different trading services based on this technology that may be available for other markets in the future. The Commission previously approved one such service for operation on the Pacific Exchange, Inc. See Securities Exchange Act Release No. 39086 (September 17, 1997), 62 FR 50036 (September 24, 1997). While the OptiMark technology is virtually identical to that which was approved for the PCX Application, the proposed Nasdaq Application adapts and uses the OptiMark technology within the existing Nasdaq market structure.

⁴ Securities Exchange Act Release No. 40835 (December 28, 1998), 64 FR 549 (January 5, 1999).

⁵ Letter from Jerry Putnam, President, Archipelago, L.L.C., to Jonathan G. Katz, Secretary, SEC, dated January 22, 1999 ("Archipelago Letter"); letter from Ari Burstein, Assistant Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, SEC, dated January 26, 1999 ("ICI Letter"); letter from W. Dennis Ferguson, Chairman, Clearing Firms Committee, Securities Industry Association ("SIA"), to Jonathan G. Katz, Secretary, SEC, dated July 22, 1999; letter from W. Dennis Ferguson, Chairman, Clearing Firms Committee, SIA, to Richard Strasser, Assistant Director, Division of Market Regulation ("Division"), SEC, dated August 23, 1999.

⁶ Letter from Eugene A. Lopez, Vice President, Trading and Market Services, Nasdaq, to Richard Strasser, Assistant Director, Division, SEC, dated July 16, 1999 ("Amendment No. 2"). In Amendment No. 2, the NASD amended proposed NASD Rule 4993(b) to provide that a Cycle will include Nasdaq Quote Montage Profiles reflecting all bid and offer quotes as reflected in the Nasdaq Quote Montage immediately prior to the commencement of the Cycle that could potentially be traded through by a Profile.

⁷ Letter from Eugene A. Lopez, Vice President, Trading and Market Services, Nasdaq, to Richard Strasser, Assistant Director, Division, SEC, dated September 13, 1999 ("Amendment No. 3"). In Amendment No. 3, the NASD amended proposed NASD rules 4991 and 4992 to clarify that only a Clearing Broker, as that term is defined in NASD Rule 6100(f), can establish the trading limits for users, including NASD members, that are not self-clearing. In addition, Amendment No. 3 clarifies that the terms "Designated Broker" is broader than "Clearing Broker" and includes correspondent brokers. Consequently, every user must be sponsored in the Application by a Designated Broker that is a Clearing Broker and that establishes the trading limits for its users and accepts responsibility for their trades. Some users also may

⁴ 15 U.S.C. 78f(b)(4).

⁵ 15 U.S.C. 78s(b)(3)(A).

⁶ 17 CFR 240.19b-4(f)(2).

⁷ In reviewing this proposal, the Commission has considered its potential impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

⁸ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

24, 1999, the NASD withdrew Amendment No. 4 in its entirety and filed Amendment No. 5 to the proposed rule change.⁸ In Amendment No. 5, the NASD established trading parameters for the initial operations of the Application while its risk management tools are being refined, and requested that the Commission approve the Application on a pilot basis for a six-month period. The trading parameters include (1) a limitation on trading to 250 of the most actively traded Nasdaq securities, (2) a limitation on cycle frequency to one every five minutes, (3) a suspension of trading in the Application for 15 minutes if its volume equals or exceeds 12.5% of the average Nasdaq volume in the 250 securities, and (4) a suspension of trading in the Application for the remainder of the trading day if its volume equals or exceeds 15% of the average Nasdaq volume in the 250 securities. This order approves the proposed rule change, as amended, until April 3, 2000.

II. Description of the Proposal

A. Summary of the Application and Purpose

Nasdaq proposes to establish rules for a new facility called the Nasdaq Application of the OptiMark System.⁹ The Application is a computerized, screen-based trading service intended for use by both NASD members and non-members. For securities listed on The Nasdaq Stock Market,¹⁰ the Application would enable its users anonymously to represent their trading interest across a full spectrum of prices

and sizes by entering Profiles (*i.e.*, indications of trading interest) into the OptiMark System to be compared and matched with Profiles entered by other users.¹¹ At specified times during the trading day (no more than once every five minutes during the proposed pilot period), the Application would conduct certain calculations against such expressions of interest to identify specific orders capable of execution. All such orders will be immediately executed and reported, except those that involve the matching of any Nasdaq Quote Montage Profile, as discussed further below.

Nasdaq represents that integrating OptiMark's technology into Nasdaq will continue Nasdaq's effort to improve opportunities for investors to receive the best available prices in the marketplace and reduce trading costs. It states that the proposed Application would (1) match all trading interest on a level playing field, (2) provide an alternative method for institutional investors to transact with minimal market impact and to obtain price improvement, (3) benefit market makers by providing an additional option to manage inventory risk through fast and efficient executions, and (4) benefit issuers through enhanced liquidity and flexibility for their shareholders.

B. Description of the Operation of the Application

The NASD is establishing the Application as a facility of Nasdaq, and the NASD accordingly has represented that it will control the operation of, and be fully responsible for, the Application, including its regulation and oversight.¹² NASD members and their customers will trade on the Application in the manner described below.

Access to the Application

The Application is available to any NASD member that is a Clearing Broker, as that term is defined in NASD Rule 6100(f), that chooses to become a user and complies with all applicable rules. A user is a subscriber who has entered into an agreement with OSI to access the Application. In addition, both NASD members that are not Clearing Brokers and non-members may become users, provided they are authorized in advance by one or more Designated Brokers that are Clearing Brokers ("Designated

Broker/Clearing Brokers").¹³ These non-self-clearing users can be authorized by one or more Designated Brokers in accordance with a Designated Broker Consent Agreement. The Designated Broker Consent Agreement, between the Designated Broker and OSI or OptiMark OTC Services, Inc., provides the Designated Broker's authorization for Profiles of a user to be routed, executed, and reported in the Designated Broker's name. These agreements include any applicable credit limits imposed by the Designated Broker/Clearing Broker. A user's credit limits, as they may be established from time to time by a Designated Broker/Clearing Broker, will be programmed into the OptiMark System.¹⁴ The Designated Broker will be alerted as its potential exposure to the users it authorizes to participate in the Application, individually or in the aggregate, approaches the established credit limits ("Alarm Threshold") or reaches the limit at which the Designated Broker will no longer permit a customer to submit Profiles ("Trading Limit"). A Designated Broker is responsible for all of its users' orders and resulting transactions.

The Application would allow NASD members to access the new trading facility through the Nasdaq Workstation and the Nasdaq network that connects those Workstations. Nasdaq will provide a user interface that permits NASD members that are subscribers to the Nasdaq Workstation Service and have signed appropriate User Agreements to transmit Profiles from their Workstations to the OptiMark Matching

be sponsored by an additional Designated Broker that is a correspondence broker. As noted in the text, Amendment No. 4 was withdrawn entirely by Amendment No. 5.

⁸ Letter from Eugene A. Lopez, Vice President, Trading and Market Services, Nasdaq, to Richard Strasser, Assistant Director, Division of SEC, dated September 24, 1999 ("Amendment No. 5"). In addition to withdrawing Amendment No. 4 in its entirety, Amendment No. 5 adds a new paragraph (e) to Rule 4991 to define the term "Electronic Data Interchange" ("EDI") as a screen-based electronic communications facility that enables Designated Brokers to establish or modify trading or alert limits. Amendment No. 5 also adds a new Rule 4999 that establishes trading parameters for the initial operations of the Application. The parameters are described more fully in Section II.B *Trading Parameters for Initial Operations* below. Finally, as noted in the text, Amendment No. 5 requests that the Commission approve the Application on a pilot basis for a six-month period.

⁹ See Proposed NASD Rule 4991(a).

¹⁰ Although during the pilot period the Application would be limited to 250 of the most actively traded Nasdaq securities, Nasdaq anticipates that ultimately the Application would be available for all securities listed on Nasdaq, including securities listed on the Nasdaq SmallCap market. The Application would not be available for securities not listed on Nasdaq, such as those that may be quoted in the OTC Bulletin Board.

¹¹ For a description of a Profile, see Section II.B below.

¹² Letter from Eugene A. Lopez, Vice President, Trading and Market Services, Nasdaq, to Richard Strasser, Assistant Director, Division, SEC, dated June 3, 1999 ("June 3 Letter").

¹³ The term "Designated Broker" is defined in proposed NASD Rule 4991(c) as "an NASD member who has been designated by a User to execute, clear, and settle transactions resulting from the Application." Proposed Rule 4991(c) further provides that "[p]articipation as a Designated Broker shall be conditioned upon the Designated Broker's membership in, or maintenance of an effective clearing arrangement with a member of, a clearing agency registered pursuant to the Act," and that "[o]nly Designated Brokers that are members of a registered clearing agency ('Designated Broker/Clearing Broker') are permitted to establish trading limits for Users."

¹⁴ In Amendment No. 5, the NASD added paragraph (e) to proposed rule 4991 to provide for an "Electronic Data Interchange" ("EDI"), which is defined as "a screen-based electronic communications facility with an appropriate audit trail that enables Designated Brokers to establish or modify trading or alert limits for the purposes of Profile validation by (1) submitting such trading instructions on-line and (2) receiving notifications on-line when their instructions have been received and when they have been implemented." No more than 10 Eligible Securities can be traded in the Application until the EDI is implemented.

Module,¹⁵ which will conduct Cycles¹⁶ on a periodic basis.¹⁷

The Application also would allow access through other networks and access devices, as long as such access is properly authorized. Non-member users sponsored by NASD members (subject to the applicable agreements referenced above), as well as any NASD member, could access the Application through OptiMark-provided network(s), which may provide access through third parties.

Entry of Profiles and Incorporation of the Nasdaq Quote Montage

Users would access the Application by submitting customized expressions of trading interest called Profiles. Profiles reflect an investor's willingness to trade at a variety of prices and sizes, including the level of satisfaction, on a sliding scale, of trading at a given price and size. For example, an investor may be 100% satisfied to buy 100,000 shares of XYZ Company at a price up to \$1.00 above the current market price, but only 50% satisfied to buy that number of shares at a price \$1.50 above it, and not satisfied at all to pay more than \$2.00 above it. The satisfaction levels are expressed as a number between zero and one for each coordinate on a price/size grid.

These user-defined Profiles, which are represented by graphical user interface software, are not disclosed to other users or market participants, including any Designated Broker through whom a user is authorized to submit Profiles and obtain executions. The Profiles are received and logged in by the OptiMark Matching Module. The Application is programmed to obtain the optimal outcome of matching buyers and sellers at the best prices possible.

In addition to Profiles submitted directly by Users, the Nasdaq Application will include certain system-generated Profiles known as the "Nasdaq Quote Montage Profiles," which reflect the bid and offer quotes from Nasdaq Market Makers, electronic communications networks ("ECNs"), and UTP Exchange Plan Specialists as displayed in the Nasdaq Quote Montage at the time a matching Cycle begins.

Immediately prior to commencement of a Cycle, the system will view the Nasdaq Quote Montage and create Nasdaq Quote Montage Profiles for each quote that could potentially be traded through by a Profile.¹⁸ In this way, the expressions of interests of all users, as well as publicly displayed quotes that potentially could be matched with such expressions of interest, would be reflected in the Application.

When a user enters a Profile into the Application, either through the Nasdaq network or another network capable of sending Profiles to the Application, the user can choose to restrict the ability of that Profile to match with a Nasdaq Quote Montage Profile. If the user chooses to limit the ability of its Profile to match with a Nasdaq Quote Montage Profile, the user's Profile will contain an added condition that is expected to limit the user's chances of finding matches from the contra side of the market. As discussed below, the system's matching algorithm will not allow any matches at a price inferior to that of another coordinate with Standing. The NASD represents that because each coordinate from a Nasdaq Quote Montage Profile has Standing, it is afforded full price protection.¹⁹

Central Processing Cycles—OptiMark's Matching Algorithm

At one or more times throughout the trading day, all Profiles (including the Nasdaq Quote Montage Profiles) will be centrally processed by the OptiMark Matching Module operated by OSI to obtain the optimal matches among users. The maximum frequency with which these "Cycles" may take place will be every five minutes,²⁰ with no Cycle taking place prior to 9:45 a.m. EST or after 3:45 p.m. EST. The exact frequency of Cycles for any given Nasdaq security will be determined by Nasdaq, in consultation with OptiMark, based on the general characteristics of the security, the robustness of the associated Profile flow over a period, and the current level of interest expressed by users.

The OptiMark Matching Module employs a sophisticated computer algorithm that measures and ranks all relevant mutual satisfaction outcomes by matching individual coordinates from intersecting buy Profiles with

those of sell Profiles for a particular stock. These intersecting Profiles are matched in accordance with the following eligibility restrictions and priority principles.

1. Eligibility Restrictions—At commencement of a Cycle, each individual coordinate with a non-zero satisfaction value from all buy and sell Profiles received by the OptiMark Matching Module in a given eligible security would be grouped into the Buy Profile Data Base or the Sell Profile Data Base, respectively. Each individual coordinate, no matter how small or large,²¹ from either Profile Data Base would be eligible to be matched with one or more coordinates from the other Profile Data Base and would result in one or more orders,²² provided that neither of two parameters are violated.

Under the first parameter, no buy and sell coordinates could be matched in violation of any applicable user instructions for the respective Profiles, including: (a) The maximum quantity associated with the Profile; or (b) any boundary conditions restricting the aggregate number of shares that may be bought or sold at a particular price or size range.

Under the second parameter, no buy and sell coordinates could be matched at a price inferior to that of another coordinate with Standing that is eligible for matching.²³

2. Priority Principles—The methods for considering potential matches between buy and sell coordinates in the Profile Data Bases would vary, depending on whether both coordinates

²¹ The minimum trading increment would be 100 shares.

²² The proposal defines the term "Order[s]" to mean one or more order[s] generated from a Cycle at specific prices and sizes at which immediate execution may occur. To be capable of execution, orders in eligible securities must be in round lots equal to or greater than 1,000 shares, except for Orders resulting from processing the Nasdaq Quote Montage Profiles, which may be in any round lot size. Orders must be in price increments conforming to the requirements of Nasdaq trading system rules and system requirements applicable to all orders executed in Nasdaq. Such Orders shall include the following information: (1) The stock ticker symbol; (2) a designation as "buy," "sell long," "sell short," or "sell short exempt"; and (3) such other information as may be required by Nasdaq. See proposed NASD Rule 4991(h).

²³ A coordinate has Standing if: (a) It has a satisfaction value of 1, and (b) all coordinates having the same price and a smaller size, down to and including the minimum trading increment (100 shares), are included in the associated Profile at a satisfaction value of 1. Also, each coordinate from a Nasdaq Quote Montage Profile would have Standing. Conversely, no coordinate from a Profile containing any boundary conditions restricting the aggregate number of shares that may be bought or sold at a particular size range shall have Standing. For example, no coordinate from a Profile submitted by a User on an "all-or-none" basis would have Standing.

¹⁵ See proposed NASD Rule 4991(g).

¹⁶ For a description of a Cycle, see Section II.B below.

¹⁷ The primary site of the Application, which will house the computer software and hardware complex that conducts the central processing of Profiles, is located in the Nasdaq data center in Trumbull, Connecticut. Nasdaq will be the facilities manager for the OptiMark System with respect to the Nasdaq Application. Letter from Eugene A. Lopez, Vice President, Trading and Market Services, Nasdaq, to Richard Strasser, Assistant Director, Division, SEC, dated April 28, 1999.

¹⁸ See Amendment No. 2, note 6 above.

¹⁹ Letter from Eugene A. Lopez, Vice President, Trading and Market Services, Nasdaq, to Richard Strasser, Assistant Director, Division, SEC, dated March 19, 1999 ("March 19 Letter").

²⁰ The five-minute Cycle frequency is applicable for the six-month period of initial operations for which the Commission is approving the proposed rule change. Proposed Rule 4999(b).

represent satisfaction values of 1 or less than 1. As a result, there are two separate stages of a Cycle, the Aggregation Stage and the Accumulation Stage, which are discussed below.

Aggregation Stage. The OptiMark Matching Module initially would process eligible buy and sell coordinates in the Profile Data Bases, each with the full satisfaction value of 1 only. At this stage of calculation ("Aggregation Stage"), smaller-sized coordinates may be aggregated to build sufficient size to be matched with larger-sized coordinates to generate Orders in accordance with the following rules of priority, subject to the applicable eligibility restrictions:

(A) *Price aggressiveness.* A coordinate with a more aggressive price (*i.e.*, a higher price for a buy coordinate and a lower price for a sell coordinate) would have priority over coordinates with less aggressive prices.

(B) *Standing.* Among the coordinates with the same price, a coordinate with Standing would have priority over all other coordinates without Standing.

(C) *Time of entry.* Among the coordinates with the same price and Standing, the time of the entry of the associated Profile would determine relative priority, with earlier submissions having priority. All Profiles submitted by users would be appropriately time-stamped with a unique serial number when received by the OptiMark Matching Module. Because each Nasdaq Quote Montage Profile would be generated from the most current quotation prevailing at the time of commencement of a Cycle, the effective time of entry of a Nasdaq Quote Montage Profile would be later than that of any other Profile submitted by a user.

(D) *Size.* Among the coordinates with the same price, Standing and time of entry, priority would be determined by size, with larger sizes having higher priority.

Such sorting enables the system to construct a single buy coordinate list and a single sell coordinate list, where the top coordinate on each list has priority over the rest. Once the priority buy and sell coordinates are established, the system will select the coordinate with the earlier time of entry at the top of either list as the "aggregation attractor" and then will seek to aggregate one or more coordinates from the contra list (in strict order or priority on that list) against the aggregation attractor to match its size and price. The matches against the aggregation attractor must comply with all applicable eligibility restrictions. If the matches

against the aggregation attractor are successful (*i.e.*, matches consistent with eligibility restrictions), the Cycle will result in the generation of Orders. The system will then go on to select the next aggregation attractor, and the process will continue. If the matches against the aggregation attractor are unsuccessful, the next aggregation attractor will be selected (skipping over the failed one), and the process will continue as before. The Aggregation Stage will terminate when no further aggregation are possible.²⁴

Accumulation Stage. Upon completion of the Aggregation Stage, the OptiMark Matching Module would consider potential matches between eligible buy coordinates and sell coordinates in the Profile Data Bases where one or both parties have a satisfaction value of less than 1 but greater than 0. At this stage of calculation ("Accumulation Stage"), only those buy and sell coordinates with the same associated price and size would be matched to generate Orders in accordance with the following rules of priority, subject to the applicable eligibility restrictions:

(A) *Mutual satisfaction.* A potential match with a higher mutual satisfaction value (the product of the two satisfaction values) would take precedence over other potential matches with lower mutual satisfaction values.

(B) *Time of entry (based on the earlier Profile).* Among the potential matches with the same mutual satisfaction, the match with the earlier time of entry, as determined initially by the effective time of entry assigned to the earlier of the buy and sell Profiles involved (the "earlier Profile"), would have priority over other potential matches.

(C) *Size.* Among the potential matches with the same mutual satisfaction and time of entry for the earlier Profile, priority would be given to the one with a larger size.

(D) *Time of entry (based on the later Profile).* Among the potential matches with the same mutual satisfaction, time of entry (for the earlier Profile), and size, the match with the earlier time of entry, as determined this time by the effective time of entry assigned to the later of the buy and sell Profiles involved (the "later Profile"), would have priority over other potential matches.

(E) *Price assignment.* In regard to all remaining ties between potential matches, which would consist solely of the coordinates for a single pair of buy and sell Profiles from two users that may be matched with the same mutual satisfaction, time of entry and size, but

at different prices, priority would be given to the match at a price more favorable to the use whose Profile has the earlier time of entry. For example, among the last potential matches remaining at the price of 10 and at 10¹/₈, if the sell Profile is the earlier Profile, then the match would take place at the price of 10¹/₈. Two or more Profiles that are entered into the system representing the same number of shares may result in executions at differing prices depending on the other information and conditions entered into the system.

Generation of Orders Resulting From OptiMark Cycles

Any Orders generated from a Cycle at specific prices and sizes that involve the matching of any two user-submitted Profiles, in whole or in part, will be immediately executed. The trade between the matched users will be transmitted automatically through Nasdaq's Automated Confirmation Transaction Service ("ACT") for trade reporting and clearing purposes (discussed more fully below).

Orders generated from a Cycle at specific prices and sizes that involve the matching of any Nasdaq Quote Montage Profile, in whole or in part, will be immediately delivered to the relevant participant through Nasdaq's existing delivery and execution systems, which will be adapted for this purpose. Currently, this means Nasdaq's Small Order Execution System ("SOES") and its SelectNet Service. To facilitate the delivery and execution of any Orders resulting from the Nasdaq Quote Montage Profiles, Nasdaq intends to employ these evolving trading systems in the form that they exist at the time the Application begins operations. Any Order transmitted through these means to the participant's quote will be executed, unless the quote has been executed or canceled, in whole or in part, prior to delivery from the Application. If the quotation against which the contra Profile was matched has been executed or canceled, in whole or in part, prior to delivery from the Application, the Orders generated by the Application that correspond to the executed or canceled quotation shall be canceled without imposing any liability against the displayed quotation. In the case of any Orders delivered from the Application to any UTP Plan Exchange Specialist, those executed by the Exchange shall be considered executed and reported on such Exchange.²⁵

²⁴ March 19 Letter, note 19 above.

²⁵ See proposed NASD Rule 4994(a), *Order Execution, Reporting, and Clearing*.

Clearance and Settlement

As indicated above, transactions that result from matches through the Application will be cleared using Nasdaq's post-execution service, ACT. Accordingly, final locked-in trades will be forwarded to the National Securities Clearing Corporation ("NSCC") in the ordinary course, and will clear and settle regular way through NSCC as would any other Nasdaq transaction. All users will receive a report of any execution resulting from processing the Profiles submitted by them (including any execution resulting against a displayed quotation) as soon as possible after the execution takes place. Users that are not self-clearing will have the option of re-allocating for clearing purposes all or a portion of any execution to another broker by the end of the trading day. A Designated Broker generally will be notified promptly after the close of the trading day to the extent it has been allocated for clearing purposes any transaction resulting from a Profile submitted by a user sponsored by that Designated Broker.²⁶

The Designated Broker that agreed to sponsor a user in the Application is fully responsible for the clearance and settlement of that user's trades. Nasdaq and the operator of the OptiMark Matching Module are not responsible for either the user or another Designated Broker failing to pay for or to deliver the securities traded through this facility. Further, the NASD, Nasdaq and any other subsidiary or affiliate, and the operator of the OptiMark Matching Module are not deemed parties to or participants in, as principal or as agent, any trade that may occur through the Application. In proposed NASD Rule 4998(a), the Association states that neither Nasdaq, the NASD, nor any affiliate, operator, licensor, or administrator of the OptiMark Matching Module may be held responsible for any damages arising from the use of the Application. In addition, proposed NASD Rule 4998(b) states that neither Nasdaq, the NASD, nor any affiliate, operator, licensor, or administrator of the Application makes any express or implied warranties with respect to any results that a user or Designated Broker using the Application may expect. Paragraph (b) of the proposed NASD Rule 4994 states that responsibility for clearance and settlement remains with the Designated Broker. The User Agreements that each party must sign prior to entering a Profile into the

Application likewise make clear that the responsibility for clearance and settlement lies with the Designated Broker, and that the Designated Broker must evaluate the ability of users to settle trades when it authorizes a user to submit Profiles under its sponsorship.

Finally, trades executed through the Application will not be subject to NASD Rule 11890, regarding clearly erroneous trades. The Application will require parties entering Profiles to agree that, once matched, their Profiles cannot be deemed to be erroneously entered. Consequently, Nasdaq is amending Rule 11890 to make clear that the Rule cannot be used by any Application user as a means to break a trade resulting from an OptiMark match.

Trade Reporting, Short Sales, and Halts

As with other execution services provided by Nasdaq, a public trade report will be immediately disseminated by Nasdaq for any executions resulting from the Application. These trade reports will be reported on behalf of the sell side party to the trade. The report for any resulting transaction will not be distinguished on the public tape from any other trade reported through Nasdaq. SEC Transaction Fees (Section 31 Fees)²⁷ apply and will be charged against the seller(s).

With respect to the Nasdaq's short sale rule, Rule 3350, which applies to Nasdaq National Market securities, the OptiMark Matching Module will be programmed to capture the bid price direction at the commencement of every Cycle, as well as the short sale status of every Profile entered (*i.e.*, whether it is marked short, and whether or not it is exempt). It will exclude any Profile that could result in a match and execution of any transaction in a Nasdaq National Market security that would be prohibited by the short sale rule.

Nasdaq will suspend within the Application any activity in any security that is subject to a trading halt or suspension pursuant to Commission or rules, Nasdaq Market Emergency Rules, or if deemed necessary for the protection of investors or to preserve system capacity and integrity.

Recordkeeping, Surveillance, and Inspection

The NASD will maintain, or cause to be maintained, all of the records relating to the Application that are maintained for other facilities of Nasdaq, including a detailed audit trail of each transaction resulting from the Application.²⁸

OptiMark will maintain all records that are required by the Nasdaq to fulfill its regulatory responsibilities and will provide such records upon request to the Nasdaq or the Commission.²⁹ Information regarding all profiles submitted to the Application, whether executed or not, is subject to review by the Commission and NASD Regulation, and may be used for the purpose of ensuring that any activity conducted through the Application is consistent with the federal securities laws and NASD rules. Thus, although the Profiles entered into the facility may be anonymous with respect to other users and the operators of the system itself, regulatory authorities would have full access to all information entered.

NASD Regulation, Inc. ("NASDR") has determined that a Profile should be considered an order with respect to the NASD's Order Audit Trail System, NASD Rules 6950-6957 ("OATS").³⁰ When a customer or another member firm gives an order to a member firm that, in turn, is entered into the Application as a Profile, the member firm must comply with the requirements of OATS. A member firm would be required to record and report the receipt of the order, along with any subsequent routing, cancellation, and modification of the order. In addition, when the order is routed to the Application, the route would be required to be reported to OATS in the same manner as orders routed to any other Nasdaq execution facility.³¹

The operations of all components of the Application will be monitored on an ongoing basis under Nasdaq's inspection, surveillance, and compliance programs. All information regarding activity in the Application will be maintained and provided to the NASD on a regular and continuous basis for normal surveillance purposes. In addition, the NASD will monitor OptiMark personnel who perform services for the Application to make sure that their activity is consistent with the NASD's responsibilities as a self-regulatory organization.

inspection like any of Nasdaq's other trading services, such as SelectNet or SOES.

²⁹ Letter from Eugene A. Lopez, Vice President, Trading and Market Services, Nasdaq, to Robert L.D. Colby, Deputy Director, Division, SEC, dated May 24, 1999; June 3 Letter, note 12 above.

³⁰ Letters from Thomas R. Gira, Vice President, Market Regulation, NASDR, to Richard C. Strasser, Assistant Director, Division, SEC, dated July 8 and July 28, 1999.

³¹ The OATS requirements also would apply when a member firm enters a proprietary non-market-making order into the Application for execution. The OATS requirements would not apply when a non-member user submits a Profile directly to the Application pursuant to a Designated Broker Consent Agreement. *Id.*

²⁶ In the comparison, clearance and settlement process, the specific identity of the counterparties to a particular trade will be temporarily masked until 4:30 p.m. of the trade day.

²⁷ 15 U.S.C. 78ee.

²⁸ As a facility of Nasdaq, the Nasdaq Application is subject to SEC review, examination and

As a party that has agreed to participate in the operation of the Application as a facility of Nasdaq, OptiMark is required to assist the NASD in any way deemed necessary by the NASD in carrying out the NASD's regulatory responsibilities with respect to the Application. OptiMark personnel will perform administrative and computer services and will not be permitted to trade through the Application. In addition, OptiMark personnel will not be permitted to advise others with respect to trading any particular security or securities, other than to carry out such functions as may be prescribed by the NASD for OptiMark personnel who are members of a Nasdaq service desk team. OptiMark will take reasonable steps to ensure that no OptiMark employee who provides services to the Application is subject to a statutory disqualification, as defined in Section 3(a)(39) of the Act.³² OptiMark also will establish adequate safeguards and procedures to facilitate the confidentiality of trading information of Application users. Finally, all of the operations of OptiMark that are related to the operation of the Application as a facility of Nasdaq, including those portions developed by OptiMark, are subject to Commission oversight, examination, and inspection.³³

System Capacity and Integrity

The Application will be operated by Nasdaq, which will adhere closely to all of the principles applied by the Commission in reviewing automation at markets operated by the self-regulatory organizations.³⁴ Nasdaq has reviewed the proposed system and believes that it will provide sufficient capacity to handle the volume of data reasonably anticipated for the Application. Further, Nasdaq has reviewed the system's security measures that will be in place and carefully considered all aspects of the system to ensure that it has been designed to prevent unauthorized access to the Application. Because the primary site of the system will be operated from Nasdaq's own data processing facility, Nasdaq believes that it will be able to maintain the security of the operations and to monitor closely and maintain the reliability of the system and its software.³⁵

Fees for the Application

The NASD will submit a fee filing pursuant to Section 19(b) of the Act³⁶ to address the execution charges that will be assessed. The NASD plans to assess a fee for every execution that occurs as a result of a match; OSI will not separately assess a fee.³⁷ A market participant whose quote in Nasdaq is accessed through the Application will not pay any fee.³⁸

Trading Parameters for Initial Operations

In Amendment No. 5, the NASD added proposed NASD Rule 4999 to establish trading parameters for operation of the Application during the proposed pilot period.³⁹ Under proposed Rule 4999(a), the number of Eligible Securities is limited to a maximum of 250 issues specifically approved by Nasdaq. These securities were selected primarily on the basis of their historical volume and index trading activities and are among the top tier of Nasdaq's most actively-traded and well-capitalized issues. The proposal authorizes the NASD to amend the list of securities by filing a proposed rule change with the Commission pursuant to Section 19(b)(3)(A) of the Act. In addition, only 10 of the initial 250 Eligible Securities may be traded through the Application until an appropriate EDI facility is implemented.⁴⁰

Proposed Rule 4999(b) limits the maximum frequency of Cycles to one every five minutes, except that no Cycle may take place at any time during a trading day when Nasdaq has suspended all trading activities through the Application pursuant to proposed NASD Rule 4999(c). Under proposed NASD Rule 4999(c), all trading activities in the Application will be suspended immediately for the remainder of the trading day if the cumulative total daily volume of transactions resulting from all Cycles that are executed and reported through Nasdaq systems since the opening of regular trading hours on that day ("Application Volume") equals or exceeds 15% of the "Volume Trigger." The term "Volume Trigger" is defined in proposed NASD Rule 4999(d) as the share-volume equivalent (based on a weighted average dollar price) of the average daily aggregated dollar volume

of all transactions, including those resulting from all Cycles, that are executed and reported through Nasdaq systems in the current approved list of 250 Eligible Securities for the preceding 30 consecutive trading days. In addition, if the Application Volume equals or exceeds 12.5% of the Volume Trigger, all trading through the Application will be suspended immediately thereafter for 15 minutes. Trading will resume upon expiration of the 15-minute halt and will continue until the regularly scheduled close of the Nasdaq Application; provided, however, that trading will be shut down for the day, as described above, if Application Volume equals or exceeds 15% of the Volume Trigger.

III. Comment Summary and NASD Response

The Commission received four letters in response to its request for comments on the proposed rule change.⁴¹ The ICI Letter strongly supported approval, asserting that the Application would increase liquidity, reduce trading costs, and increase the efficiency of the Nasdaq market. The Archipelago Letter, however, expressed concern that the Application should not be approved unless it was properly integrated into the marketplace. In particular, the Archipelago Letter was concerned that (1) the proposal did not include a fee schedule, (2) the proposal did not require the Application to access customer limit orders priced below a market maker's or ECN's best quote and therefore could generate a substantial number of executions that traded through investor orders, and (3) the maximum frequency of Cycles (every 90 seconds) was too short a period given that the Application would be exempt from many requirements that govern the operation of continuous markets.

In its response to the Archipelago Letter,⁴² Nasdaq stated that its practice was not to include fee schedules in system approval filings and that it planned to make a separate fee filing at a subsequent time. With respect to the possibility that customers' orders not equal to the best quote could be traded through, Nasdaq noted that such orders would not be publicly displayed and that no inter-linked market has a requirement that precludes a trade-through in such circumstances. Finally, Nasdaq noted that, during the proposed pilot period, Cycles would be limited to no more than one every five minutes.

The Clearing Firm Committee of the SIA ("Committee") submitted two

³² 15 U.S.C. 78c(a)(39).

³³ Letter from Eugene A. Lopez, Vice President, Trading and Market Services, Nasdaq, to Richard Strasser, Assistant Director, Division, SEC, dated April 28, 1999.

³⁴ See note 50 below.

³⁵ March 19 Letter, note 19 above.

³⁶ 15 U.S.C. 78s(b).

³⁷ March 19 Letter, note 19 above.

³⁸ Amendment No. 3, note 7 above.

³⁹ As discussed further below, the NASD is proposing trading parameters in response to comments raised by the public and the SEC staff.

⁴⁰ See note 14 above for a description of the EDI facility.

⁴¹ See note 5 above.

⁴² Amendment No. 3, note 7 above.

comment letters,⁴³ each of which expressed concern that the Application presented unique risks for clearing firms who acted as Designated Brokers and introduced significant risk into the clearance and settlement system. The Committee believed that these risks should be addressed before the Commission approved the proposed rule change. Specifically, the Committee was concerned that the Application did not provide clearing brokers with a sufficient capability to monitor the intra-day positions of the users that they sponsor in the Application because their trades would not be disclosed to the clearing brokers until the end of the trading day. The Committee noted that the counterparty, concentrated positions, and liquidity of an issue all were important factors to be considered in risk management. The Committee believed that real-time monitoring of positions was not as critical in the market for exchange-listed securities because the depth and liquidity of that market would allow a Clearing Broker to trade out of a position if necessary due to the failure of a correspondent or user. It asserted that, in the over-the-counter market, many issues were thinly traded and would leave the Clearing Brokers with an unacceptable level of risk.

The Committee also was concerned about the unwieldy methods for communicating changes in Trading Limits and Alarm Thresholds to the Application. The Committee contrasted the Application with the risk management tools currently provided to Clearing Brokers in ACT, which allows them to set credit limits for their correspondents, to monitor the trading of correspondents on an intra-day basis, and to block reporting to ACT when a correspondent reaches its trading limits. The Committee believed that automated risk management tools should be a prerequisite to approval of the Application. In particular, it asserted that the Application should provide enhancements that allowed Clearing Brokers to monitor risk effectively on an intra-day basis and that placed control of credit limits with the Clearing Brokers. If such enhancements were not provided, the Committee expressed concern that responsible firms would restrict access to the Application by establishing conservative credit limits, but that other Clearing Brokers with less sophisticated risk management systems might act less responsibly. These less responsible firms might be susceptible

to failure, thereby causing a domino effect throughout the industry.⁴⁴

The NASD responded to the Clearing Committee's concerns in two letters.⁴⁵ First, it emphasized that only Designated Brokers that are Clearing Brokers will be allowed to establish Trading Limits and Alarm Thresholds for non-self-clearing users of the Application. Second, the NASD noted that both users that are not members of the NASD and NASD members that are not self-clearing must be sponsored by a Designated Broker that is a Clearing Broker before they can participate in the Application. Third, the NASD emphasized that the Trading Limits established by a Clearing Brokers establish a "hard ceiling" for user Profiles. The Application would reject any Profile that created a potential for a user's trading to exceed its Trading Limit. Finally, the NASD stated that it was committed to enhancing the Application in the future and that it had begun to examine changes to the Application that would more closely integrated ACT risk management with the Application. In the meantime, however, as discussed above, the NASD has proposed to limit the Application to 250 of the largest Nasdaq stocks, to cap the maximum daily volume that may be done through the Application, and to provide an electronic means for delivering and receiving confirmation of intra-day credit adjustments.

IV. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association, particularly the requirements of Section 15A(b).⁴⁶ The NASD's proposal to establish rules to implement the Application is consistent with the requirements of Section 15A(b)(6) that the rules of an association be designed to remove impediments to and perfect the mechanism of a free and open market and a national market system, while protecting investors and the public interest. In addition, NASD's proposal is consistent with the

requirements of Section 15A(b)(6) that an association's rules be designed to prevent fraudulent and manipulative acts and practices, and to promote just and equitable principles of trade, and not be designed to permit unfair discrimination between customers, issuers, and broker-dealers.⁴⁷

The Commission also finds that the proposed rule change is consistent with Section 11A of the Act.⁴⁸ The Commission believes that the proposed Application would further the purposes of Section 11A and the development of a national market system by promoting economically efficient execution of securities transactions, fair competition among markets, the best execution of customer orders, and an opportunity for orders to be executed without the participation of a dealer.

The Commission previously approved a proposed rule change by the Pacific Exchange, Inc. ("PCX"), to establish the PCX Application of the OptiMark System, which permits trading through the OptiMark system of equity securities listed or traded on the PCX.⁴⁹ Approval of the Nasdaq Application of the OptiMark System will extend to investors the opportunity to take advantage of the OptiMark trading program for securities quoted on Nasdaq. The Application provides a new and potentially more efficient way to match and execute trading interest in securities. The Application could be particularly useful in meeting the demands of sophisticated portfolio managers and other market professional implementing complex trading strategies. These market participants often desire to minimize the market effect of their transactions through expression of varied trading interests on a confidential basis. The Application will give these investors a means for carrying out their investment strategies, often without the participation of a dealer. At the same time, the Application will allow retail customers, through member users, to interact with institutional trading interests. As discussed above, retail trading interest may enter the Application through a broker-dealer directly or through the Nasdaq Quote Montage Profiles.

The Commission believes that the Application, as a facility of Nasdaq, is designed to operate in a manner that is consistent with the regulatory purposes

⁴⁴ The Committee also believed that the NASD's reliance on the legal agreements required of users and Designated Brokers who participate in the Application represented an attempt to conduct improper rulemaking.

⁴⁵ Letter from Richard Ketchum, President, NASD, and Phillip J. Riese, CEO, OptiMark Technologies, Inc., to Jonathan G. Katz, Secretary, Commission, dated September 3, 1999; letter from Eugene A. Lopez, Vice President, Trading and Market Services, Nasdaq, to Richard Strasser, Assistant Director, Division, SEC, dated July 26, 1999.

⁴⁶ 15 U.S.C. 78o-3(b).

⁴⁷ In approving the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁴⁸ 15 U.S.C. 78k-1.

⁴⁹ Securities Exchange Act Release No. 39086 (September 17, 1997), 62 FR 50036 (September 24, 1997).

⁴³ See note 5 above.

of the Act. The NASD will control the operation of the Application and will be fully responsible for all activity that takes place through the Application, including its regulation and oversight. As part of its obligations under the Act and pursuant to its own rules, the NASD will conduct all necessary surveillance of the operation of and trading through the Application. The NASD also has represented that the Application will have a full audit trail capability, adequate computer capacity to handle and process user Profiles and order flow, and adequate computer security and procedures to ensure the safety and confidentiality of user transmissions.⁵⁰ Finally, OptiMark, as a party that has agreed to operate portions of a facility of a self-regulatory organization, is required to cooperate with the NASD in meeting its regulatory responsibilities and will be subject to Commission oversight and examination.

Access to OptiMark will be limited to NASD members that are Clearing Brokers, as well as non-self-clearing NASD members and non-members who will have access to the Application only through a Designated Broker/Clearing Broker.⁵¹ With respect to these users, before submitting Profiles to the Application, the Designated Broker/Clearing Broker will be required to authorize their access to the Application and accept responsibility for their transactions. The Designated Broker Agreement will impose credit limits on the user's trading through the Application, and these credit limits will be programmed into the OptiMark Matching Module. The Designated Broker will be alerted as its potential exposure to its customers, individually or in the aggregate, approaches the established credit limits. The Application will not allow any user to enter a Profile that could result in a transaction that exceeded the user's credit limit. This "hard ceiling" on a user's trading means that a Designated

Broker/Clearing Broker will always know the maximum amount of exposure that it could have in the Application.

The Application does not at this point provide a clearing broker with the opportunity to monitor its intra-day exposure to its users or permit a Clearing Broker to input its Trading Limits and Alarm Thresholds directly into the Application. The Application therefore does not provide some of the risk management tools that currently are available to Clearing Brokers through ACT for trading in Nasdaq securities. The Commission believes, however, that the Application provides reasonable risk management tools for its initial operations during the six-month pilot period. These tools include the hard ceiling on a user's trading, the addition of an EDI for communication of Trading Limits and Alarm Thresholds, and the trading parameters that will restrict the scope of the initial operations of the Application. The limitation of Eligible Securities to 250 of the most actively-traded securities on Nasdaq provides greater assurance that the depth and liquidity of the market should help to ensure that a Clearing Broker may trade out of a position quickly if necessary. The limitation on frequency of Cycles to one every five minutes will provide a Clearing Broker with a greater opportunity to modify its credit limits in response to notices that a user is approaching its credit limit. The addition of the EDI will enhance the ability of clearing brokers to modify credit limits quickly and accurately. Finally, the absolute limitation on trading volume in the Application to 15% of total Nasdaq volume in the 250 Eligible Securities helps to ensure that the Application will not become a primary facility of the Nasdaq market while the Application's risk management tools are being refined during the six-month pilot period.⁵² The NASD has agreed to work on these enhancements and to submit them to the Commission before the six-month pilot period expires.

Although it is approving the Application for a six-month pilot period, the Commission stresses the need for Clearing Brokers to recognize the different nature of the risk management tools provided by the Application and those provided by ACT

for trading through other Nasdaq facilities. It is of paramount importance that Clearing Brokers set appropriate user credit limits *in advance* of trading through the Application. Unlike in ACT, where Clearing Brokers have an opportunity to monitor their intra-day exposure to correspondents and to refuse to accept responsibility for certain large trades after they have been executed,⁵³ in the Application, Clearing Brokers must set credit limits based on a recognition that they will not have this opportunity to decline a transaction. To help monitor the credit limits set by clearing brokers in the Application, Nasdaq will provide reports, upon request, to the Commission and NSCC showing each participating Clearing Broker's total allocated trading limits for its customer base.

The Commission believes that the NASD is adopting reasonable requirements for the clearance and settlement of transactions resulting from the Application. All such transactions will be reported through ACT, forwarded to NSCC in the ordinary course, and clear and settle regular way as would any other Nasdaq transaction. The Commission also believes that the proposal is designed in a manner that will allow the NASD to meet its obligations with respect to the recordkeeping and reporting of transactions resulting from the Application. As with other execution services provided by Nasdaq, a public trade report will be immediately disseminated by Nasdaq for any executions resulting from a Cycle in the Application. The report for such transactions will not be distinguished on the public tape from any other trade reported through Nasdaq. Although such transaction reports may occur in rapid sequence, the individual transaction reports will still be displayed in the order of execution of the transactions.

In addition, all transactions resulting from the Application will comply with the applicable SEC and NASD rules, including the NASD's short sale rule, Rule 3550.

In sum, the Commission historically has encouraged markets to integrate new data communications and trade execution mechanisms into their markets in furtherance of the development of the national market system. The Application is likely to promote competition among market centers because it has the potential to attract new market participants and to increase order flow to Nasdaq. By

⁵⁰ As with any other facility of a self-regulatory organization, the Commission expects to conduct a full EDP review of the Application and its operations. See e.g., the Commission's Automation Review Policy guidelines, Securities Exchange Act Release No. 27445 (Nov. 16, 1989), 54 FR 48703 (Nov. 24, 1989); Securities Exchange Act Release No. 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991).

⁵¹ NASD members will be required to maintain information and records concerning non-member access for which they are responsible. The NASD has represented to the Commission that it would require its members to make such non-member user information available to the NASD upon request, so that the NASD can fulfill its duties regarding surveillance. Telephone conversation between Eugene A. Lopez, Vice President, Trading and Market Services, Nasdaq, and Daniel M. Gray, Special Counsel, Division, SEC, on June 29, 1999.

⁵² The SIA Clearing Committee expressed the view that the NASD's reliance on contractual requirements included in the User and Designated Broker Agreements was not appropriate because such agreements had not been subject to public comment. The Commission disagrees and notes that the relevant provisions of these agreements were described in the notice of the proposed rule change that was published for public comment.

⁵³ The ACT risk management functions are set forth in NASD Rule 6150.

attracting order flow, the Application may provide a new and enhanced source of liquidity for investors. Finally, existing market interest on Nasdaq will be adequately integrated into the Application through the Nasdaq Quote Montage Profiles, which will create the opportunity for trading interest expressed through user Profiles to interact with publicly displayed quotes.

The Commission finds that good cause exists to approve Amendment Nos. 2, 3, and 5 to the proposed rule change prior to the 30th day after the date of publication of filing thereof in the **Federal Register**. Amendment No. 2 expands the range of publicly displayed bid and offer quotes that will be included in a Cycle as Nasdaq Quote Montage Profiles and that will thereby interact with user Profiles. As the NASD notes, this change will make the Application more consistent with the PCX Application of the OptiMark System that previously was approved by the Commission. Amendment No. 3 merely clarifies that all users must be either self-clearing or sponsored by a Designated Broker that is a Clearing Broker, and that only Designated Brokers that are Clearing Brokers can establish the trading limits for users. Finally, Amendment No. 5 provides for an EDI to enhance the ability of Designated Brokers to modify Trading Limits or Alarm Thresholds, and establishes several trading parameters for the initial operations of the Application during the six-month pilot period; these trading parameters limit the scope of the Application during the pilot. The Commission therefore finds good cause to accelerate approval of Amendment Nos. 2, 3, and 5.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 2, 3, and 5, including whether they are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the 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 also will be

available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-98-85 and should be submitted by October 28, 1999.

VI. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁵⁴ that the proposed rule change (SR-NASD-98-85) is approved on a pilot basis until April 3, 2000.⁵⁵

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵⁶

Jonathan G. Katz,

Secretary.

[FR Doc. 99-26154 Filed 10-6-99; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41946; File No. SR-NASD-99-5]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. Clarifying Web CRD Policies

September 29, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on September 24, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary NASD Regulation, Inc. ("NASD Regulation" or "NASDR"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Regulation. NASDR has designated this proposal as new constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule under Section 19(b)(3)(A)³ of the Act, which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this

⁵⁴ 15 U.S.C. 78s(b)(2).

⁵⁵ Approval of the pilot should not be interpreted as indicating that the Commission is predisposed to approving the proposal permanently.

⁵⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

notice to solicit comments on the proposed rule change from interested persons.

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

NASD Regulation proposes to clarify Forms U-4 and U-5.

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

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

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

1. Purpose

The purpose of the proposed rule change is to clarify Forms U-4 and U-5. Members file Forms U-4 and U-5 electronically pursuant to NASD Rule 1140, with one exception. New member applicants file their initial Forms BD and U-4 on paper under NASD Rule 1013. Because the majority of the filings will be done electronically, NASDR has determined that mailing address for the Central Registration Depository ("CRD") should be removed from the cover pages of Forms U-4 and U-5 to help eliminate any potential confusion among members about how to submit the Forms. NASDR has issued numerous communications to members about Web CRD and electronic filing requirements, and anticipates that members and new member applicants will comply with the rules and stated policies. NASDR will be submitting a separate rule filing further clarifying Rule 1013 and how new member applicants will be given access to Web CRD so that all amendments to their initial Forms BD and U-4 will be submitted electronically in compliance with Commission requirements.⁴

2. Statutory Basis

NASDR believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6)⁵ of the

⁴ See Securities Exchange Act Release No. 41594 (July 2, 1999), 64 FR 37586 (July 12, 1999).

⁵ 15 U.S.C. 78o-3(b)(6).