

The Commission believes, as do two commenters, that continued locking and crossing of the market can negatively impact market quality.²⁴ As the Commission has previously stated, market makers and ECNs are required to use reasonable means to avoid locking and crossing the market.²⁵ Consequently, Nasdaq market makers and ECNs must use "reasonable means" to take out the quote that their quote, if immediately posted, would lock or cross. NASD has interpreted "reasonable means" to include referencing a SelectNet order to the firms at the bid or offer.²⁶ Experience has shown, however, that ECNs increasingly are remaining at the inside quote after executing an incoming order at the displayed size even when the incoming order exceeds the displayed ECN order size. As a result, the incidence of locked and crossed markets has increased.

The Commission believes that the proposal to require ECN orders having reserve size to interact with incoming orders from SelectNet will help reduce the frequency of locked and crossed markets on Nasdaq and, as a result, improve market quality. Moreover, the Commission believes that requiring an ECN to accept a SelectNet order for larger than the ECN's displayed size balances the interest to reduce the frequency of locked and crossed markets with market participants' desire to display only portion of a large order.

One commenter expressed concern that the proposal increases an ECN's counterparty risk by allowing non-participant broker-dealers (with whom the ECN has no contractual relationship) to access the ECN's reserve size.²⁷ The Commission notes, however, that the risk is no greater than that involved in any other broker-to-broker transaction. Moreover, the SEC's broker-dealer capital requirements as well as NSCC's novation of executed trades should greatly reduce the risk of non-performance that ECNs may face. Moreover, since the SEC implemented its Order Handling Rules, non-subscriber broker-dealer non-performance resulting from permitting

non-subscriber access in those instances.

The Commission believes that the proposed provision applying the restrictions against locking or crossing the market at the opening should help to clarify NASD members' responsibilities, including setting a deadline for required action. As a result, the proposed provision should promote a more orderly opening in Nasdaq securities.

The Commission believes that the proposal to adopt NASD Rule 4625, regarding a member's obligation to supply Nasdaq MarketWatch and Market Operations staff with certain information upon request, is consistent with the NASD's regulatory responsibilities under section 15A of the Act. The Commission believes that to properly fulfill its obligation to administer NASD and SEC rules, as well as other applicable requirements, Nasdaq staff must be able to obtain information regarding matters such as locked and crossed markets, trade reports, trading activity, and erroneous transactions on a timely basis from market participants.

In response to two commenters who were concerned with the proposal requiring ECNs to register independently for each security, Nasdaq filed Amendment No. 4 to the proposal.²⁸ This amendment clarifies that ECNs are required to register with Nasdaq Market Operations prior to being included in Nasdaq as an ECN but are not required to register manually in each security. According to the NASD, in practice, once an ECN registers with Nasdaq Market Operations, Nasdaq systems allow the ECN to enter quotations in all Nasdaq securities. The Commission believes that this amendment addresses the commenters' concerns that the rule change, as originally proposed, would unnecessarily burden ECNs by requiring them to register on a per-security basis.

The Commission believes that Amendment No. 4 should be approved on an accelerated basis because it does not impose any requirements in

addition to those originally proposed and published for comment. In fact, Amendment No. 4 revised the NASD's proposal so that the ECN registration requirement is consistent with the current practice that once an ECN registers with Nasdaq Market Operations Nasdaq systems allow the ECN to enter quotations in all Nasdaq securities.

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to the NASD,²⁹ and, in particular, with sections 15A(b)(6), 15A(b)(11), and 11A(a)(1)(C) of the Act. In addition, the Commission finds good cause for approving Amendment No. 4 to the proposal prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**.

VI. Conclusion

It is therefore ordered, pursuant to section 19(b)(2),³⁰ that the proposed rule change (SR-NASD-98-01) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³¹

Jonathan G. Katz,
Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40454; File No. SR-NASD-98-25]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Fees for Nasdaq Market Distributors or Vendors

September 22, 1998.

I. Introduction

On May 14, 1998,¹ the Nasdaq Stock Market, Inc. ("Nasdaq") filed with the

²⁹ In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

³⁰ 15 U.S.C. 78s(b)(2).

³¹ 17 CFR 200.30-3(a)(12).

¹ The NASD initially submitted this proposal on March 16, 1998. However, a substantive amendment was requested to clarify the applicability of the proposed fee. The NASD filed Amendment No. 1 on April 28, 1998. See letter from Thomas P. Moran, Senior Attorney, Office of General Counsel, The Nasdaq Stock Market, Inc., to Mignon McLemore, Esq., Division of Market Regulation, SEC, dated April 28, 1998 ("Amendment No. 1"). On May 14, 1998, the Board

²⁴ See Instinet and Morgan Stanley Letters.

²⁵ See Letter to Joseph R. Hardiman, President, NASD, from Richard R. Lindsey, Director, Division, SEC, dated November 22, 1996 (noting that, in the OTC market, a Nasdaq market maker holding a limit order that is marketable against another market maker's or ECN's quote may send a SelectNet message to the market maker or ECN displaying the existing quote. However, after using reasonable efforts to execute against the existing quote, the market maker should display the limit order even if it locks the market).

²⁶ See NASD Notice to Members 97-49.

²⁷ See Bloomberg Letter.

²⁸ In Amendment No. 4, Nasdaq is withdrawing the previously proposed amendment to NASD Rule 4623(b)(4) and is proposing to replace it with the following (new language is italicized; deletions are bracketed):

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

Securities and Exchange Commission ("SEC" or "Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")² and Rule 19b-4 thereunder,³ a proposed rule change to amend NASD Rule 7010, on system services. The proposed rule change establishes an annual, scaled administrative fee, payable by Nasdaq market data distributors or vendors, for data usage monitoring costs and other administrative expenses incurred by Nasdaq. A notice of the proposed rule change appeared in the **Federal Register** on June 3, 1998.⁴ The Commission received no comment letters concerning the proposed rule change. The Commission is approving the proposed rule change.

Nasdaq has established an annual, scaled fee for Nasdaq real-time market data distributors or vendors to cover the expenses Nasdaq incurs to administer and monitor market data usage.

Previously, Nasdaq real-time market data distributors or vendors were required to submit annually a list, certified by a public accountant and paid for by the distributor or vendor, of all subscribers receiving real-time Nasdaq data.⁵ Alternatively, a Nasdaq real-time market data distributor or vendor could elect to pay a lower fee and have its service usage verified by an on-site review ("OSR") conducted by Nasdaq staff. The purpose of both the accountant certification and the OSR was to provide Nasdaq with independent confirmation of Nasdaq data usage. Nasdaq has eliminated the certified-list requirement and OSR alternative, and thus their attendant costs, and replaced them with the annual scaled administrative fees proposed in this filing.⁶ Nasdaq will

filed another substantive amendment modifying the proposed rule language. See letter from Thomas P. Moran, Senior Attorney, Office of General Counsel, The Nasdaq Stock Market, Inc., to Katherine A. England, Division of Market Regulation, SEC, dated May 14, 1998 ("Amendment No. 2").

² 15 U.S.C. 78s(b)(1).

³ 17 CFR 240.19b-4.

⁴ Securities Exchange Act Release No. 40035 (May 27, 1998), 63 FR 30276.

⁵ Once this administrative fee becomes effective, Nasdaq will suspend indefinitely its current contractual requirement that Nasdaq real-time data distributors or vendors provide an annual accountant-certified list of their subscribers who receive Nasdaq data.

⁶ Distributors using per-quote and usage based reporting will have their monitoring fees determined by having their monthly payment totals divided by the professional subscriber fee rate, resulting in a terminal equivalent. For example, a distributor or vendor that is being charged \$1,000 month for its per-quote usage of Nasdaq Level 1 Service will have that \$1,000 fee divided by the existing \$20 monthly Level 1 per-terminal fee which results in a terminal equivalent of 50 with an annual monitoring fee of \$500.

retain the right, however, to demand a certified usage report, paid for by the distributors or vendor, in cases involving discrepancies in distributor or vendor reporting.⁷

II. Discussion

The Commission believes the proposed rule change is consistent with the Act and the rules and regulations thereunder.⁸ Specifically, the Commission believes that the approval of the proposed rule change is consistent with section 15A(b)(5)⁹ of the Act. Instead of requiring a public accountant's certification from its members verifying usage of Nasdaq market data, the Nasdaq will assess them an annual administrative fee which will be used to conduct Nasdaq-initiated OSRs, manage distributor applications, monitor vendor services, and perform other compliance activities. The revenue generated from this fee will benefit all Nasdaq members as it will allow Nasdaq staff to equitably and uniformly apply its expertise when conducting an OSR of any member. This fee structure should also reduce members' expenses as it is priced at levels similar to current OSR fees which, being consistently less expensive than the cost of obtaining an independent verification of data usage from a certified public accountant, are used by the majority of Nasdaq real-time market data distributors or vendors. As such, the Commission believes this administrative fee will not result in a material increase in overall monitoring fees paid by most Nasdaq data distributors or vendors.¹⁰

For 1998 billing purposes only, Nasdaq will not impose those administrative fees on any firm that incurs costs and submits a certified usage report in 1998 prior to the effective date of Nasdaq's new fee schedule. See Amendment No. 2, *supra* note 1.

⁷ Similarly, the submission of an unrequested, accountant-certified usage list will not preclude Nasdaq from conducting its own OSR nor will it exempt a distributor or vendor from payment of the administrative fee.

⁸ The Commission has considered the proposed rule's impact on efficiency, competition and capital formation. This new fee structure should allow Nasdaq staff to directly and uniformly apply its expertise in monitoring data usage. The new fee structure also establishes a more efficient means of fee collection. Moreover, this terminal-based fee, compared to that of a CPA certification, should provide vendors and distributors with a reduction in expenses. 15 U.S.C. 78c(f).

⁹ Section 15A(b)(5) requires the Commission to determine that the Association's rules are designed to provide for the equitable allocation of reasonable dues, fees, and other charges among members and issuers and other persons using any facility or system which the association operates or controls.

¹⁰ According to Nasdaq, it does not currently require delayed data distributors to meet audit requirements or pay an OSR fee. Nasdaq believes that the imposition of new minimal charges on delayed distributors is justified to compensate

III. Conclusion

For the above reasons, the Commission believes that the proposed rule change is consistent with the provisions of the Act, and in particular with section 15A(b)(5).

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹¹ that the proposed rule change (SR-NASD-98-25) be, and hereby, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Jonathan G. Katz,

Secretary.

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OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

Small Business Administration

Interim Policy Directive, Small Business Competitiveness Demonstration Program

AGENCY: Office of Federal Procurement Policy (OFPP); Small Business Administration (SBA).

ACTION: Interim policy directive with request for comments.

SUMMARY: The OFPP and SBA are revising the interim policy directive and test plan dated April 16, 1993, (which revised the final policy directive and test plan dated August 31, 1989) to implement amendments to the Small Business Competitiveness Demonstration Program made by the Small Business Reauthorization Act of 1997, Pub. L. 105-135. Section 401 of Pub. L. 105-135 extends the Program indefinitely; section 402 requires monitoring of goal attainment on an annual basis; and sections 403-405 contain other technical changes to the

Nasdaq for the resources expended in initiating, managing and monitoring vendors' accounts to ensure they are in compliance with Nasdaq requirements, particularly those designed to protect investors. See letter from Thomas P. Moran, Senior Attorney, Office of General Counsel, The Nasdaq Stock Market, Inc. to Katherine A. England, Assistant Director, Division of Market Regulation, SEC, dated September 14, 1998 (detailing the allocation of Nasdaq resources used in monitoring delayed data usage).

Nasdaq also advises that those vendors who receive both delayed and real-time data, will not be billed separately for each type of data but will only pay for the highest level of service received. This practice will continue for Nasdaq's proposed administrative fees as well. See Amendment No. 1, *supra* note 1.

¹¹ 15 U.S.C. 78s(b)(2).

¹² 17 CFR 200.30-3(a)(12).