15 and should be submitted by December 29, 1995.

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

Margaret H. McFarland,

Deputy Secretary.

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Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to NAqcess System and Accompanying Rules of Fair Practice

December 1, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that on November 9, 1995, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association'') 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 the NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

Pursuant to Section 19(b)(1) of the Act, attached as Exhibit A is the full text of a series of proposed rule changes by the NASD and The Nasdaq Stock Market, Inc. (''Nasdaq'') regarding the operation of The Nasdaq Stock Market's NAqcess system, a new system that offers nationwide limit order protection and price improvement[2] over the dealer quotation of small-sized customer orders. The ''Rules of Operation and Procedures for NAqcess'' (''NAqcess Rules'') will replace in its entirety the ''Rules of Practice and Procedures for the Small Order Execution System'' (''SOES Rules''), which the NASD proposes to withdraw simultaneously with the new system becoming operational. The NAqcess system rules package attached in Exhibit A is new and accordingly has not been italicized. The NASD is also proposing several new Interpretations and a new Rule in its Rules of Fair Practice to afford individual investors the opportunity to determine whether their orders are to be handled in NAqcess and to provide customer limit orders held in NAqcess or elsewhere with enhanced price protection (Exhibit B). The NASD is also proposing conforming modifications to the NASD Manual, including the Rules of Practice and Procedure for the Automated Confirmation Transaction Service (''ACT Rules'') and Schedule D to the NASD By-Laws (and all other places in the Manual that refer to SOES) to delete references to SOES and/or the SOES Rules and to replace those references with NAqcess and/or the NAqcess Rules, as appropriate. These references may be found in the ACT Rules, Section (c)(2); in Schedule D, Part V, Section (1)(f), Section (7)(a), Section (8)(c), and Section (9); and Schedule D, Part XI, Section (2)(e)(1).

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

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

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

1. Introduction

The NASD and The Nasdaq Stock Market, Inc. are proposing rules of operation and procedure and companion rules for a new service that provides investors market-wide price protection of their limit orders, the opportunity to obtain price improvement over the dealer quotation in buying and selling Nasdaq stocks, and increased access to the Nasdaq market. The new facility, to be named NAqcess and operated by The Nasdaq Stock Market, will permit significant opportunity for investors in Nasdaq securities to enter limit orders inside the Nasdaq dealer quotation and enhance the opportunity for such investors to receive executions between the best dealer bid and offer without such orders interacting with market makers. The limit orders at the top of the NAqcess limit order file that are the same as or better than the best dealer quotations will be included in the inside market for The Nasdaq Stock Market, thereby providing new levels of transparency, increased price efficiency, and greater investor protection. Further, the companion rule and Interpretations accompanying the new system will provide retail customers with enhanced price protection of their limit orders, a significant expansion over current limit order protection afforded to customers in the Nasdaq market. Finally, NAqcess will provide customers that choose to enter market orders into the system with the opportunity to obtain price improvement over the dealer quotation through interaction with customer limit orders in the NAqcess file and will provide a prompt, cost-effective execution at the best price available in the market at any particular point in time.

NAqcess and the accompanying new Rules of Fair Practice provide multiple benefits to retail investors that were heretofore unavailable to such investors. A key feature of NAqcess that is a significant enhancement over current practices in Nasdaq is the ability of investors to have limit orders placed in a central file where they can interact directly with other customer limit orders and market orders entered into the system. Under a proposed new Interpretation to Article III, Section 1 of the Rules of Fair Practice, a customer may instruct its broker-dealer to enter the customer's limit order or market order into NAqcess. Moreover, NAqcess will provide increased transparency of the best priced limit orders in NAqcess because Nasdaq will incorporate into the Nasdaq inside market limit orders that are priced the same as or better than the best dealer bid and offer displayed in Nasdaq, and their aggregate sizes in a particular security. This increased transparency will enhance the Nasdaq price discovery process. NAqcess will match incoming limit and market orders against limit orders resident in the

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[7] 17 CFR 200.30–3(a)(12) (1994).

[1] 15 U.S.C. 78s(b)(1) (1988).

[2] Commission Note: The NASD's use of the term ''price improvement'' in this proposal differs from the use of the term in recent Commission releases. Specifically, the Commission has used the term when referring to the opportunity to receive a price that is superior to best bid or offer. See, e.g., 17 CFR 11Ac1–3(a)(2); Securities Exchange Act Release No. 34902 (Oct. 27, 1994), 59 FR 55006 (Nov. 2, 1994) at text accompanying n. 32. The NASD's use of the term in this proposal, on the other hand, refers to the opportunity to receive a price that is better than the best market maker quotation, which may not be the best bid or offer to the extent NAqcess limit orders are included. In its recent rule proposal concerning the obligations of market makers executing customer orders, the Commission asked for comment on whether automated systems that include the possibility of the interaction of market orders with limit orders should be deemed to satisfy the proposal's requirement that market orders be provided with an opportunity for price improvement. Securities Exchange Act Release No. 36310 (Sept. 29, 1995), 60 FR 52792 (Oct. 10, 1995).

NAqcess file so as to permit customer orders to interact directly with each other without the participation of a market maker. The interaction of customer orders offers such orders an opportunity for price improvement over the dealer quotation and increases the likelihood that public limit orders will be executed on a more timely basis.

The companion rules and Interpretations regarding price protection in Nasdaq will also significantly enhance the protection of customer limit orders whether they are held in NAqcess or stored in a member firm's limit order file. Under a newly proposed rule, NASD member firms, whether acting as principal or agent, will not be permitted to execute an order at a price inferior to any limit order(s) in the NAqcess limit order file that the member firm is able to view, without satisfying the viewable limit order(s). An ''inferior price'' means an execution price that is lower than a buy limit order or higher than a sell limit order. In addition, if a member firm holds a customer limit order outside of NAqcess, a new Interpretation to Article III, Section 1 of the Rules of Fair Practice would require the member firm that holds the limit order to provide the customer with price protection that is equivalent to that which the limit order would have received if it had been entered into the NAqcess file. The concept of equivalent price protection is further explained below.

Aside from these major regulatory enhancements that provide for major changes in order handling and protection in The Nasdaq Stock Market, the NAqcess system itself represents a significant improvement over the current methodology for the handling of small investor orders. NAqcess, as noted, will permit interaction of small customer limit and market orders within the dealer spread and thus permit such orders to obtain significant opportunities for price improvement over the dealer quotation.

This new order delivery and execution system will replace SOES, the NASD's current system for the handling of small customer orders. Because SOES is an automated, quote-based execution system, it does not offer the opportunity for price improvement over the dealer quotation of small customer orders. Moreover, the proposed NAqcess system addresses the queuing concerns that were raised in connection with the previously proposed N—Prove system. NAqcess will distribute non-directed market orders that can not be immediately matched against NAqcess limit orders to available market makers at the inside market as the orders are presented. A market maker will provide such order an automated execution at the inside if the market maker presented with the order does not manually decline the order within a 20-second period because the market maker (consistent with SEC Rule 11Ac1–1)[3] has already effected, or is in the process of effecting an execution in the security and is in the process of updating its quotation. This approach eliminates the single-threaded distribution mechanism proposed in Notice To Members 95–20 and permits rapid distribution of orders to market makers as the orders are received.[4]

NAqcess and its companion rules represent a significant enhancement to the treatment of investor orders in The Nasdaq Stock Market. The entire proposal, when taken together with other recent enhancements to the Nasdaq trading environment, such as the Limit Order Protection Interpretation[5] and the Short Sale Rule,[6] demonstrates the significant strides that the NASD and The Nasdaq Stock Market have taken to provide increased protection of investors while continuing to preserve the benefits that its competitive dealer market structure currently provides. Individual investors seeking price improvement over the dealer quotation will be afforded a transparent mechanism to obtain greater opportunities for price improvement over the dealer quotation without market maker interaction. Moreover, through the accompanying rules, NAqcess will provide such limit orders with increased market-wide price protection. Individual investors seeking rapid execution of small market orders at the best available price will continue to be able to obtain executions promptly, while Nasdaq market makers will be permitted the opportunity to interact with such orders in a manner consistent with SEC rules and in a manner similar to market order handling in exchange markets. By permitting market makers to continue the operation of their own internal execution systems, the NASD will maintain the ability of dealers to provide liquidity and competitive mechanisms to handle customer orders.

2. NAqcess Operations

The proposed NAqcess system will provide the following:

A. *Scope of System.* NAqcess will be available for all Nasdaq issues. It will completely replace SOES which will operate until the effective date for operation of NAqcess and will be discontinued as of that date. NAqcess participation will be mandatory for market makers in all National Market securities. NAqcess participation for SmallCap market makers will be voluntary, as is SOES participation today for such market makers.

B. *Order Entry Requirements.* Agency orders may be entered into NAqcess only by member firms on behalf of customers. ''Customers'' are defined to

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[3] 17 CFR 240.11Ac1–1 (1995).

[4] The NASD believes that significant queues in excess of those currently experienced under SOES today will not occur under the new proposal. First, if the limit order file for a security has depth, market orders will immediately execute against limit orders without any delay. Because each order when received is immediately distributed to the next available market maker, the large majority of orders will be executed within 20 seconds of distribution. Even if an order is declined by a market maker at one price level, an event that the NASD believes will not be frequent, the declined order will be automatically executed without the possibility of rejection immediately upon presentation at the next price level. All of these techniques mean that it will be rare for an order not to be executed within a 20 to 40-second period after processing.

For example, assume that five market orders are entered into NAqcess at one second apart from each other and there are five market makers in the stock at the inside. Each order when received will be immediately distributed to the next market maker. Thus, order one at second one is distributed immediately to market maker one, while order two at second two is sent to market maker two immediately, and so on through order five. In most circumstances, each market maker will not decline the order within 20 seconds, and thus, each order would be executed within 20 seconds of processing. If any one of these orders were declined, the order would wait for the next available market maker for re-presentation. If that market maker remained at the same price level as that when the order was originally presented, the order would be subject to a further 20-second reaction period. In the unlikely event it was declined again, the order would be presented again for execution. If that presentation occurred at a new price level, it would be immediately executed at the new price level.

If order entry firms enter more orders than there are market makers at the inside, the queue for such orders would be the same as today in SOES when orders must be queued while waiting for a market maker to update its quotation after a SOES execution. Consequently, the NASD believes that queuing under this proposal does not represent a significant threat to prompt market order execution much different from current queuing. It should be noted as well, that market orders of eligible size entered into NAqcess are guaranteed an execution. Such execution may be effected against a customer order or a dealer's quote. Thus, in response to concerns raised in some comment letters the NASD received in response to Notice to Members 95–20 and 95–60, NAqcess will provide guaranteed executions to investors entering eligible market orders. Accordingly, the NASD believes that those comment letters from individual investors that allege that NAqcess will deprive them of an automatic execution are mistaken. Of course, it should be noted that not even in SOES is a market order guaranteed an execution at the price observed at the time the order was entered. Similarly, under NAqcess no such guarantee is extended to an investor.

[5] Securities Exchange Act Release Nos. 35751 (May 22, 1995), 60 FR 27997 (May 26, 1995) and 34279 (June 29, 1994), 59 FR 34883 (July 7, 1994).

[6] Securities Exchange Act Release No. 34277 (June 29, 1994), 59 FR 34885 (July 7, 1994).

exclude any broker, dealer, person associated with a member, or a member of the immediate family of a person associated with a member. Because the purpose of the system is to provide small retail customers with access to The Nasdaq Stock Market, member firms, with one limited exception,[7] are not permitted to enter proprietary orders.[8] As explained in more detail elow, customers may request that appropriately sized limit and market orders be entered into NAqcess, and if so requested, member firms must honor the customer's request.[9]

Customers may request the entry of limit orders up to 1,000 shares in National Market and SmallCap issues, except for the Nasdaq 100 issues, in which case limit orders up to 3,000 shares may be entered. This represents a difference from the original proposal [10] of 3,000 shares for all National Market issues.[11] The issue of size eligibility for limit orders generated significant comment in response to the two Notices.[12] Many commenters believed that because NAqcess is intended to provide small retail customers with limit order protection, the initial approach should reflect more closely that the average retail order size is well under 1,000 shares. For example, the Security Traders Association (''STA'') noted that the experience of STA members was that the typical retail customer order size averaged well-less than 1,000.[13] It was also noted by commenters that it could reduce the potential for investor confusion if NAqcess established a standard for limit orders that was consistent with market order size, 1,000 shares. Commenters also noted that NAqcess could potentially significantly impact market maker participation, particularly in less active securities. As a result, they suggested that the NAqcess order size should be set at lower levels at least until the NASD had thoroughly evaluated the impact of the system on market liquidity.

While the NASD believes that NAqcess will have overall a positive effect on market quality, we believe that it is prudent in this start-up period to commence NAqcess limit order size eligibility at 1,000 shares for most securities. However, limit orders up to 3,000 shares would be eligible for NAqcess for those securities that comprise the Nasdaq 100 Index. The NASD believes that this higher eligibility level is appropriate because the securities comprising the Nasdaq 100 have high levels of volume, greater market maker participation and significant market liquidity and therefore are less likely to be adversely impacted by the proposal. Because of the significant changes that NAqcess may bring to The Nasdaq Stock Market, the NASD believes that it is appropriate to commence the operation of the system with a smaller limit order size than originally proposed to permit market makers and investors to adjust to the new trading environment. The NASD proposes to monitor the limit order size requirement carefully in the initial eighteen months of NAqcess operation and may choose to expand the eligible size of limit orders, if experience demonstrates such expansion to have merit.

Market orders in National Market issues may be 1,000, 500 or 200 shares depending upon tier size determination to be made in the same manner as done in SOES today.[14] Similarly, market orders in SmallCap issues will be tiered at 500 shares or less as done in SOES today.[15]

Customers may choose to enter ''marketable limit orders.'' A marketable limit order is a limit order that is priced at the time of entry at the current inside market or better on the opposite side of the market, i.e., a marketable limit order to buy is equal to or higher than the current inside offer, while a marketable limit order to sell is equal to or lower than the inside bid. For example, if the current inside market is 20 bid and 20¼ asked, the entry of limit orders to sell priced at 20 or 19⅞ would be considered marketable limit orders. Marketable limit orders will be treated as market orders. Thus, if a firm enters a customer limit order to sell at 20 at the time the inside bid is 20, the limit order will be passed over the limit order file and if no match occurs, it will be treated as a market order and executed as discussed above in the market order handling section. If such marketable limit order, however, is greater than 1,000 shares in a Nasdaq 100 security, the marketable limit order will be returned to the order entry firm for handling outside of NAqcess, without matching against the inside market whether the inside consists of a dealer quote, limit order(s), or an aggregation thereof.

Neither a limit order nor a market order may be split up to meet the size parameters of NAqcess. The NASD will examine order handling practices of

[7] The only exception to the proprietary order prohibition is an order designated by a market maker as a ''marker order.'' A marker order is a principal order entered by a market maker in a transaction that is functionally the equivalent of a riskless principal transaction. The firm may place a principal account limit order in the NAqcess file, and if an execution is obtained, immediately pass along the benefit of such execution to a retail customer order it holds in its own file. Because the order is part of a principal transaction for the benefit of the retail customer, the NASD believes that it is appropriate to permit this limited exception to the prohibition of proprietary orders in NAqcess. The NASD will require member firms entering such orders to mark their order tickets accordingly, and will examine a firm's trading activities carefully to determine that such proprietary orders are being effected for the purposes of engaging in a riskless principal-like transaction. Marker orders, however, may not be placed with respect to customer limit orders held by the firm that exceed the permitted maximum limit order size.

[8] Member firms will be permitted, however, to enter so-called ''takeout'' orders for their own account or on behalf of a customer. A takeout order is an order that results in an immediate automatic execution of a limit order or orders in the NAqcess limit order file at the limit order price(s). There is no size limitation on the takeout order. Thus, if the NAqcess file displays limit orders at a price with an aggregate size of 15,000 shares, a single takeout order of 15,000 shares may be entered and executed. Similarly, a firm may enter a takeout order to immediately execute multiple limit orders at multiple prices in the NAqcess file. When there are multiple limit orders being taken out, each limit order will execute at each limit order's price.

[9] *See infra* Section II(A)3.A of this proposal.

[10] NASD Special Notice to Members 95–20 (Mar. 21, 1995).

[11] All SmallCap issues have a limit order size of 1,000 shares.

[12] NASD Special Notice to Members 95–20 (Mar. 21, 1995) and 95–60 (July 27, 1995).

[13] *See* letter from John Giesea, Chairman, and John Watson, President, STA (Apr. 28, 1995).

[14] Under SOES Rules, the tier sizes of 1,000, 500 and 200 shares were determined by reference to the average daily non-block volume of a security, among other things. Thus, for example, if an issue had an average daily non-block volume of 3,000 or more shares, it could qualify for a tier size of 1,000 shares.

The same concept will apply with respect to NAqcess maximum market order sizes, except that the NASD has determined to use a slightly higher average daily non-block volume of 6,000 shares. The NASD has chosen this higher level because it better reflects trading patterns consistent with the increased overall volume in Nasdaq securities.

[15] The NASD will permit market makers to establish minimum exposure limits that are equal to the maximum market order size. In addition, NAqcess will contain an automated update feature that will automatically change the market maker's quotation by a minimum increment set by the market maker after the market maker has executed a trade at a price level and has exhausted its minimum exposure limit through system executions. The NASD believes that these aspects of NAqcess are critical to an effective operation that permits a market maker to manage its risk capital, and is consistent with the SEC firm quote rule as applied to all other registered markets. The minimum exposure limit is set at the same size as the minimum quote size in Nasdaq. Under the SEC Firm Quote Rule (Rule 11Ac1–1(c)), a broker-dealer is entitled to change its quotation within a reasonable period of time after it has completed a trade at its published price. Accordingly, the NASD believes that these aspects of NAqcess are consistent with SEC and NASD rules and provide retail investors with the same access to dealer quotations as are available in any other registered marketplace.

order entry firms to determine compliance with this requirement.[16]

C. *Display of Limit Orders.* To enhance the transparency of The Nasdaq Stock Market and to assist in the price discovery process, the NASD will provide for the display of limit orders entered into NAqcess. There will be two separate approaches to the display: a consolidated inside market display and the Full File Display.

1. *Inside Market Display.* In a significant revision to Nasdaq's methodology for calculating the inside market for Nasdaq securities, The Nasdaq Stock Market will include in the Nasdaq inside market NAqcess limit orders, and their aggregate sizes, that are priced the same as or better than the best dealer bid and offer.[17] Thus, in Nasdaq the inside market will consist of a single display of the best priced quotes or limit orders, as the case may be. The inside market will be calculated in the following manner. If the best limit order(s) to buy (sell) in NAqcess is (are) better than the best Nasdaq market maker bid (offer) displayed in Nasdaq and such limit order(s) is (are) 100 shares or more, it (they) will be included in the Nasdaq inside market and disseminated as the inside bid (offer), together with the aggregate size of such order(s) and a unique indicator to denote that the inside market is represented by a NAqcess limit order or orders, rather than a quotation of a Nasdaq market maker or UTP exchange quotation. If there are multiple limit orders at the best price, aggregate size will be displayed and execution of such orders will occur on a time priority basis as explained below.

If the best-priced NAqcess limit order(s) is (are) equal to the inside dealer quotation, the limit order size will be reflected in the aggregate size of the quotation. That is, if there is a limit order to buy 500 shares at the same price as a 1,000 share dealer bid quotation, and both are the best bids reflected in Nasdaq, the aggregated size displayed as the best Nasdaq bid will reflect a size of 1,500 shares with a special indicator to denote that such size is an aggregation of a dealer quote and any limit order(s) at that price. Priority for execution will depend upon the general limit order priority rules, *i.e.,* if the limit order is received prior to the market maker quotation, it will be entitled to priority for execution purposes.[18]

The inclusion of NAqcess limit orders in the Nasdaq inside market represents a significant enhancement to The Nasdaq Stock Market. Consolidation of NAqcess orders into the Nasdaq inside quotation is the best means to communicate clearly to all investors in Nasdaq the true market for such securities at any particular point in time. The consolidation of best-priced limit orders with the best dealer bid and offer in Nasdaq provides the best level of transparency and aids in the price discovery process.

Although this represents a change from the original NAqcess proposal,[19] the NASD believes that the display of this consolidated information maintains the advantages of a competing dealer market while permitting an expansion in information available to investors.[20] The new inside quotation display will clearly identify when aggregated customer limit orders are represented in the inside market display. Accordingly, market participants will be able to ascertain when the inside quotation represents a customer limit order and when it represents a market maker whose quotation may signify that it is available to effect a significantly larger sized transaction. In this way, the NASD believes that transparency of customer orders may be enhanced while the integrity of the dealer quotation is preserved.

2. *Full File Display.* The full file display for a particular security will be made available on a query basis over Nasdaq Workstations only to Nasdaq market makers in that security. The NASD believes that, as with other U.S. market centers, display of the entire limit order file should be reserved to market makers in a particular security to assist in price discovery and to provide the market maker with an incentive to provide liquidity by risking its capital. In fact, no U.S. exchange registered with the SEC publicly disseminates any display (full or partial) of a limit order book maintained by an exchange specialist. Because of the accompanying rules described below that the NASD has proposed, customer limit orders in the file will be protected to a large extent, from inferior executions.

D. *Order Processing.* The NAqcess system will provide significant improvements over the current SOES system in the way that customer limit orders and market orders will be handled. NAqcess will attempt to match all incoming orders, limit or market, directed or non-directed, against limit orders already resident in NAqcess on a price and time priority basis.[21] If a match is found, the orders will be automatically executed against each other without the participation of a market maker. For example, assume the current inside market for a security is 20–20½ and customers enter into NAqcess a 1,000 share limit order to buy at 20⅛ and a 1,000 share limit order to sell at 20⅜. The new inside market will become 20⅛–20⅜. If a customer thereafter enters a 1,000 share limit order to sell at 20⅛, the incoming limit order to sell will match against the 1,000 share limit order to buy on the NAqcess file at 20⅛ and will be executed against that order. If a

[16] In this regard, the NASD notes that order entry firms may enter agency orders only. The rules continue in effect the definition of agency orders as found in the current SOES Rules and the new rules carry forward the existing principles regarding the aggregation of orders based on a single investment decision entered by an order entry firm. Orders entered by an order entry firm within any five minute period in accounts controlled by associated person or public customers, acting alone or in concert with other associated persons or public customers are presumed to be based on a single investment decision. In connection with this rule, the NASD notes that it will examine carefully the entry of computer-generated orders to determine whether such orders are based upon a single investment decision.

[17] This is a change from the approach originally proposed in Special Notice To Members 95–20 and 95–60. In the original NAqcess approach to the display of NAqcess limit orders, the NASD proposed to provide two separate displays of prices: the inside dealer quotation (*i.e.,* the best-priced bids and offers of Nasdaq market makers and UTP exchanges displayed in the Nasdaq market) and the top of the NAqcess limit order file (*i.e.,* the best-priced limit orders to buy and sell and their aggregate sizes). Such displays would have been separate and side-by-side. Under this new proposal, the NASD will maintain a Top of the File display on its Nasdaq Workstations, as well as include the best priced limit orders to buy and sell in the Nasdaq inside market display.

[18] Rules regarding calculation of the excess spread will not include NAqcess limit orders for purposes of determining compliance with those Rules. *See NASD Manual,* Schedules to the By-Laws, Schedule D, Part V, Sec. 2(d), CCH ¶ 1819.

[19] NASD Special Notice to Members 95–60 (July 27, 1995).

[20] One commenter specifically noted that a consolidated display of the best priced limit orders in the Nasdaq inside market was a better approach than maintaining separate displays, especially since member best execution obligations would be determined by reference to the best prices displayed by Nasdaq, whether such prices were dealer quotes or limit orders in NAqcess. *See* Lehman Bros. (Sept. 12, 1995). In addition, several vendors expressed technological concerns regarding separate displays. *See* letters from ADP (Aug. 16, 1995) and Telekurs (Aug. 14, 1995).

[21] NAqcess will match only round lots and round lot portions of mixed lot orders. Odd lot limit orders will not be matched. Odd lots are orders less than 100 shares. Odd lot limit orders will not be displayed in the inside quotation; however, odd lot limit orders will be displayed in the full file display. If an odd-lot order is executable *i.e.,* if it is a market order or an executable limit order, it will be automatically executed at the applicable inside dealer quotation. If it is a directed order, it is executed against the directed market maker. If it is a non-directed order, it will be executed automatically without any decline capability against the next available market maker at the inside dealer quotation. If the odd-lot order is a limit order that is not executable at time of entry, it will remain in the file until the inside dealer quotation moves to match the odd-lot price.

customer next sends in a market order to buy in NAqcess, the market order will match against the limit order to sell at 20⅜, rather than the dealer offer of 20½, and thus, the market order will be automatically executed immediately at 20⅜. In both cases, the orders received price improvement over the dealer quotation and immediate execution without the participation of a market maker.

If, in the scenario set forth above, the second limit order to sell is priced at 20 instead of 20⅛, the execution price would be 20⅛, the price of the limit order to buy because such order was entered into the system earlier than the second limit order to sell.

The system will only execute such matches when the execution prices would be equal to or better than the inside market. Nevertheless, limit orders priced away from the inside market, *i.e.*, limit orders to sell priced higher than the inside offer and limit orders to buy priced lower than the inside bid, will be stored in the NAqcess file. When the inside market moves to a price so that the limit order is equal to or better than the inside dealer quotation, such limit orders will be consolidated into the Nasdaq inside market and the limit order will become eligible for matching as described in this section.

When a limit order in the NAqcess file is priced the same as the inside market, the time priority of the limit order compared with the best dealer quotation will govern which price interacts first with incoming orders in NAqcess. The NASD believes that this approach is a well-understood and reasonable means for determining the interaction of such orders and provides a further incentive to market makers to provide liquidity and narrow spreads.

If no limit orders reside in the NAqcess file, market orders will be immediately assigned and distributed to market makers at the inside market. This rapid distribution should minimize the potential for queues that the original proposal found in Notice To Members 95–20 could have caused. After an order is distributed to a market maker, the market maker will be permitted a 20-second period within which it may decline a non-directed order if such action is consistent with the exceptions to the SEC's firm quote rule, Rule 11Ac1–1.[22] In other words, the market maker is permitted to decline the NAqcess order if the market maker, immediately before the presentation of the NAqcess order: (a) effected or was in the process of effecting a trade, and (b) was in the process of updating its quotation to reflect that previous transaction. When a NAqcess order is declined by a market maker, the declined order is presented to the next available market maker. If that market maker is at the same price as the market maker that originally declined the order, the second market maker also has a 20-second period to react to the order. If the second time the order would be presented, the inside market has moved to a different price level, it is automatically executed without any decline capability. For example, four market makers are at the inside bid of 20. Three market orders to sell are entered into NAqcess when there are no limit orders to buy at 20 or better. Each market order is immediately distributed to one of the three market makers. Because the first market maker had completed a trade by telephone and was about to change its quotation, the first market order is declined by the first market maker. That order is redistributed to the fourth market maker still quoting a price of 20. The fourth market maker has 20 seconds to interact with the order. If, however, there were only three market makers at 20, and all market makers had updated their quotations to reflect a price of 19⅞, the declined order would be immediately executed at 19⅞ against the first available market maker without any decline capability.

The NASD is developing an automated surveillance capability to monitor on a real-time basis whether an order was properly declined. The NASD believes that this capability is crucial to engendering investor confidence in the firmness of Nasdaq market maker quotations and should alleviate any concerns regarding "backing away" questions. The NASD notes that the 15-second decline feature was criticized in the context of the N•Prove proposal.[23] The NASD believes that this proposal to develop a real-time automated surveillance capability should alleviate any concerns about the "decline" capability. The NASD will undertake strong disciplinary measures against any firm that displays a pattern and practice of improper order declines.

Order entry firms have two alternatives in entering NAqcess orders—they may direct the order to a particular market maker with whom they have established a direct order arrangement, or they may enter a non-directed order. In either circumstance, market orders and marketable limit orders will first pass over the limit order file to obtain a match before execution against a market maker. If an order is directed pursuant to a valid agreement between the order entry firm and the market maker, the market maker may not decline the order.

E. *Opening Procedures.* NAqcess will have special opening procedures that are consistent with the opportunities for order matching and price improvement over the dealer quotation provided intra-day by NAqcess.

NAqcess's operating hours are from 9:30 a.m. to 4:00 p.m. (EST). However, limit orders may be entered and stored in NAqcess from 4:00 p.m. to 6:00 p.m. and limit and market orders may be entered from 8:30 a.m. to 9:28 a.m. At 9:28 a.m., no further orders for opening purposes will be accepted.[24] At 9:30 a.m., Nasdaq will rank all limit orders stored as of 9:28 a.m. according to price and time of entry. To the extent orders are available, the system will then match the best-priced sell limit orders against the best-priced buy limit orders in the file that are within the best dealer bid and offer as determined at 9:30 a.m. When all available limit order matches are effected, any remaining limit orders within the inside dealer quote at 9:30 a.m. will be matched against market orders stored as of 9:28 a.m. and will be executed at such limit order prices. Any remaining orders will be subject to the normal intra-day, order distribution and execution procedures. It should be noted that this opening procedure will not create a single, unitary price for all orders in NAqcess. The individual

[22] While the total time period between order entry and Nasdaq receipt of the decline is 20 seconds, the system has been designed to provide market makers with a full 15-second period in which to react to an order. The rule itself references a 15-second period in which the market maker must react. Five seconds of the 20-second period is designed to accommodate communications between Nasdaq systems and the market maker. Thus, the NASD has purposefully designed a 5-second period to accommodate the transmission of messages between the NASD host computer and member firm presentation devices. This five-second period addresses the potential delays of 3.75 seconds that may occur in broadcasting a message from the host to a workstation, and the .775 seconds that could occur in transmitting a decline message from the presentation device to the host. (It should be noted that such time periods arise in the context of the current configuration of the proposed system. Development of alternative methods of processing could increase the total time delays.) In examining the potential length of time that a message could consume in transmission from the host to the presentation device and back again, the NASD determined that market makers would be at a significant time disadvantage in that a market maker could lose up to 33% of its already limited reaction period. In this context, then, the NASD believes that it is appropriate to recognize the inherent delays of computer-to-computer data exchange, and provide additional time to account for such delays.

[23] *See* Securities Exchange Act Release No. 35275 (Jan. 25, 1995), 60 FR 6327 (Feb. 1, 1995).

[24] Orders entered from 9:28 a.m. to 9:30 a.m. will be stored and handled after the opening in line with ordinary matching and handling procedures described above.

prices of each match will be reported. Thus, assuming the dealer quotation is 20–20½, if the file contains two limit orders to buy at 20⅛, each for 1,000 shares, and there are also three 1,000 share limit orders to sell at 20⅛, two 1,000 share limit orders to sell at 20¼, and 4,000 shares to buy at the market, the system will execute as follows: the first two in time priority of the three 1,000 shares sell limit orders at 20⅛ will be matched against the two 20⅛ 1,000 share buy limit orders. The first 3,000 shares to buy at the market will be matched against the remaining limit orders to sell, with the first market order in time receiving an execution of 20⅛ and two 1,000 share market orders next in time receiving executions of 20¼. The remaining 1,000 share market order will be executed against the dealer quote according to the normal post-opening execution algorithm.

3. Rules of Fair Practice

The NASD is also proposing in conjunction with NAqcess three major changes to the Rules of Fair Practice. Under the proposed new rule and Interpretations, the treatment of limit orders will be significantly changed to promote price protection of such orders throughout The Nasdaq Stock Market. These proposed rule changes provide greatly enhanced limit order treatment over current practices. Together with existing limit order protections already in place (*i.e.*, the so-called ''Manning'' rule), the new proposals provide investors placing limit orders with significantly enhanced protections against limit order trade-throughs throughout The Nasdaq Stock Market.

A. *Customer Order Handling.* The NASD is proposing a new Interpretation under Article III, Section 1 of the Rules of Fair Practice. Under the proposal, if a customer requests that his or her order be entered into NAqcess, the member firm must do so. While the Interpretation permits a firm to charge for such services and to recommend the use of its own execution system, the member is not permitted to discriminate against customers that choose NAqcess over an internal system by imposing unfair commissions or charges. The proposed Interpretation covers both market and limit orders.

B. *Price Protection.* The NASD is also proposing a new rule in the Rules of Fair Practice that would prohibit a member firm, whether acting as a principal or as an agent, from executing any order at a price inferior to any limit orders that the firm is able to see in the NAqcess limit order file.[25] An inferior price means an execution price that is lower than a buy limit order or higher than a sell limit order that a member firm is able to see in the NAqcess limit order file. This prohibition means that limit orders in the NAqcess file will not be traded through elsewhere in Nasdaq in most circumstances. A member firm's activity with respect to protecting NAqcess limit orders must be consistent with its best execution obligations to its own customers. When a firm acts as principal in filling a NAqcess limit order when it is in possession of an executable customer market order on the other side of the market, it should pass on the benefit of the NAqcess trade to the customer order. If the firm in receipt of the market order is acting as agent for its own customer's order, its best execution obligation would mean that it should select the appropriate market for execution, which could be NAqcess.

The price protection obligation is related to the ability of the firm to view the orders in the limit order file. Thus, under the proposal's current configuration, limit orders at the top of the file and included in the inside market calculation must be protected by all member firms. Under NAqcess system rules, limit orders ranked below the top of the file are viewable only by market makers in the particular security. Accordingly, market makers in a particular security would be obligated to protect all limit orders in that security in the NAqcess file from inferior executions that they may engage in.[26] Thus, if a market maker in a security sought to execute a 1,000 share trade at 20, when the NAqcess file displayed limit orders to buy at 20⅛ and 20¼, the market maker would be required to either execute the limit orders first or contemporaneously, depending on the size of the limit orders in NAqcess.[27]

The NASD believes it important to explain for the purposes of the price protection rule and the Interpretation regarding equivalent price protection for limit orders held outside of NAqcess, that the protectible price that generates a firm's obligation to provide price protection is the price reported for last sale reporting purposes. Some confusion has occurred regarding limit orders trading at an ''inferior price,'' especially in the context of internal sales credits. If the execution price reported via ACT for Schedule D transaction reporting purposes includes an internal sales credit that will be provided to a sales representative at the firm, the price that triggers the member firm's obligation to protect a limit order is the reported price. The internal sales credit included in the reported price has no effect on the obligation to protect the NAqcess limit order.[28]

C. *Equivalent Price Protection.* As noted earlier, the NASD, to encourage competition and to enhance the liquidity of The Nasdaq Stock Market, has determined that market makers should continue to be permitted to operate their own internal execution systems and to handle limit orders outside of NAqcess. However, the NASD also believes it is important to provide limit orders held outside of NAqcess with price protection substantially equivalent to that which NAqcess orders would have. Accordingly, the NASD has proposed an Interpretation to Article III, Section 1 of the Rules of Fair Practice

[25] It should be noted that placement of a customer limit order in the NAqcess file does not relieve a member firm of its obligation under the Limit Order Protection Interpretation of Article III, Section 1 of the Rules of Fair Practice that prohibits a member firm from trading ahead of a customer limit order it has been entrusted with. Under the so-called ''Manning'' Interpretation, if a member firm holding a customer limit order, whether from its own customer or as a result of a member-to-member order, places that order into NAqcess, the member firm is nevertheless prohibited from trading at the same price or at an inferior price to the customer order. Thus, while the newly proposed price protection rules speak in terms of protecting NAqcess orders from inferior priced transactions, if the NAqcess order is the firm's customer's order or a member-to-member order it placed in NAqcess, the firm may not trade at the same price without protecting that order.

[26] In today's environment, market makers are involved in approximately 83% of all Nasdaq trades. Consequently, it is likely that in a large majority of trades when NAqcess is operational, a market maker will be involved, and thus, orders away from the top of the file typically will be protected as well as the top of the file.

[27] The NASD will interpret the price protection rule to not apply to member firms that operate passively-priced crossing systems, such as POSIT and Instinet's Crossing Network. Generally speaking, such systems execute prices at the dealer quotation spread midpoint and would not likely trade through a NAqcess order. Members that believe that they operate systems that could qualify for this exemption should submit a request for exemption to the NASD.

The proposed rule would apply, however, to ordinary broker-dealer trading systems such as Instinet's regular trading session. Because many such trades could occur at prices that could be inferior to limit orders in NAqcess, the NASD believes it appropriate that such NASD member firms should protect NAqcess customer limit orders as would any other registered broker-dealer member firm. Orders placed in SelectNet that trade through NAqcess are also subject to the price protection rule.

[28] See NASD Special Notices To Members 95–43 (July 27, 1995) and 95–67 (Mar. 21, 1995) for a more detailed discussion of the proper means for protecting customer limit orders when firms are dealing at net prices. The same concepts apply in the context of protecting system limit orders.

that provides substance to the term equivalent price protection.[29]

First, a member firm holding a protectible customer limit order[30] outside of NAqcess must provide such order with print protection, if any transaction at a price inferior to the customer limit order occurs.[31] Thus, any firm holding a protectible customer limit order is required to contemporaneously execute, up to the size of the reported transaction, the customer limit order at the limit order price if an inferior-priced execution is reported in that security. ''Contemporaneously'' means within approximately 60 seconds of the trade report. For example, firms A and B each hold 1,000 share customer limit orders to buy priced at 20⅛. A 1,000 share trade is reported at 20. Both firms A and B are obligated to execute their limit orders at 20⅛ within 60 seconds of the trade report. If the triggering trade report had been 500 shares at 20, each firm owed its customers executions of at least 500 shares at 20⅛.

Next, if the firm holds a protectible customer limit order at a price that would match a limit order in the NAqcess file, the firm must either execute its limit order or send its limit order to NAqcess for matching. ''Matching'' means that the NAqcess limit order is the same price or lower than the firm's customer's limit order to buy or higher than the limit order to sell.

The same matching would be required if the firm holds offsetting limit orders within its own file. If the firm holds a limit order to sell at 20¼ and accepts a limit order to buy at 20¼ or higher, the firm must execute the two orders against each other. Finally, if the firm holds a limit order that is priced equal to or better than the inside market in Nasdaq, and if the firm accepts a customer market order for automated execution at the inside market, the firm must first match the market order against the limit order before it can execute the market order for its own account.

4. NAqcess Proposal—Consistent With Securities Exchange Act

The proposed NAqcess system and the accompanying proposed rule changes in the Rules of Fair Practice propose significant structural changes in The Nasdaq Stock Market that greatly benefit investors in their handling of limit orders, price improvement over the dealer quotation, and rapid execution of orders. It is important to note that no previous proposal for a Nasdaq order handling and execution system has been so interrelated with such significant changes to rules that provide price protection across the Nasdaq market. The two developments—a new system with advanced order matching features and greater transparency along with the dramatic changes to price protection of orders in and outside the system—must be considered as a part of a fully integrated approach to the handling of retail customer orders. Together, they permit retail investors greater opportunity to participate directly in the market through the use of limit orders and substantially increase their ability to receive executions between the best dealer bid and offer. Further, the NASD believes that the approach to changes in The Nasdaq Stock Market proposed in this rule filing helps to guarantee investor protection and fairness to all market participants, while still allowing the market makers to operate in a competitive dealer market. The enhanced price discovery features, the transparency of limit orders, and the interaction of limit orders and market orders should add to the liquidity, efficiency and immediacy of Nasdaq's competing dealer market structure.

Accordingly, the NASD believes that the proposed rule change is consistent with Sections 15A(b)(6), 15A(b)(9), 15A(b)(11) and 11A(a)(1)(C) of the Act. Section 15A(b)(6) requires that the rules of a 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. Section 15A(b)(9) requires that rules of an Association not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Section 15A(b)(11) requires the NASD to formulate rules governing the quality of fair and informative quotations. Section 11A(a)(1)(C) finds that it is in the public interest to, among other things, assure economically efficient execution of securities transactions. The fundamental purpose of NAqcess is to assist investors in achieving prompt, efficient executions of their small orders and to provide an opportunity for price improvement over the dealer quotation within an automated execution environment. The integrity and efficiency of Nasdaq for public investors and market-making participants is critical and the NASD believes that NAqcess will provide benefits to both constituencies. The design of NAqcess is not anti-competitive as it treats all non-directed orders uniformly; to the extent that directed orders are distinguished, by entering into such arrangements with known customers, market makers effectively waive the protections offered by the system.

The new proposals are also fully consistent with the significant national market system objectives contained in Section 11A of the Act. The NAqcess national limit order facility would advance these objectives by offering efficient execution of investors' small orders, by maintaining market maker participation through the automated delivery of orders with the ability to reject those orders if trades have already occurred, and by offering the opportunity for price improvement over the dealer quotation to orders both inside and outside of the NAqcess system. The system's functionality will more accurately reflect market makers' affirmative obligations to provide liquidity to the market, without depriving market makers of legitimate exceptions from the firmness requirements contained in Rule 11Ac1–1. In sum, the NASD believes that the entire proposal set forth herein significantly advances the goals of investor protection and greater access to The Nasdaq Stock Market.

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

The NASD does not believe that the proposed rule change will result in any

[29] The equivalent price protection Interpretation would not apply to continuous trading systems, such as that operated by Instinet, because such customers are generally sophisticated and have deliberately opted to trade in an alternative trading system. Such customers are institutions and broker-dealers that seek other advantages in trading in these alternative systems. Because of their sophistication, these customers believe they do not need the broker-dealer operating the system to provide equivalent price protection. Accordingly, the NASD will provide an exemption from the Interpretation to brokers operating such systems if they seek an exemption.

[30] A ''protectible'' order is a customer order of a size that would be eligible for entry into NAqcess. Accordingly, the Interpretation requirements do not extend to customer limit orders that are larger than 1,000 shares (or larger than 3,000 shares for Nasdaq 100 securities).

[31] A member's obligation to provide print protection will not be triggered by a trade report that has a special modifier, such as .SLD or otherwise, appended to it. Because such modifiers indicate the trade being reported is out of sequence or was executed under special conditions, such trade reports should not require an execution of a limit order. The NASD will closely monitor member's usage of special trade reporting modifiers to ensure that firms to not use such modifiers as a vehicle to avoid print protection obligations under the new rule.

burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

Written comments are discussed above.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. By order approve such proposed rule change, or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. In particular, the Commission requests general comments concerning the NASD's proposal and whether it is consistent with the Act. In addition, the Commission invites interested persons to address the following specific issues:

(1) The Commission recently proposed rules concerning order execution obligations.[32] Among other things, the Commission's proposal generally would: (a) require Nasdaq market makers to display in their quotations (1) customer limit orders priced better than the market maker's current quotation, or (2) the size of a customer limit order that equals the current inside bid or offer; and (b) require that market makers offer market orders for certain securities an opportunity for price improvement over the current national best bid or offer. The Commission seeks comment on whether the NASD's proposal is consistent with the Commission's proposal and with the goals set forth in the Commission's release;

(2) The NASD's proposal would eliminate SOES and does not include the immediate automatic execution feature for market orders currently available in SOES. In light of historical concern about the accessibility of market maker quotations,[33] the Commission seeks comment on the possible effects this change could have on the Nasdaq market and retail investors;

(3) The SOES Rules provide a market maker a five-minute period within which to update its quotation or reestablish its exposure limit after its exposure limit has been exhausted. Further, the current operation of SOES allows for a market maker to elect to use an automated quotation update feature which, generally, changes, by a prespecified increment, the market maker's quotation after its SOES exposure limit is exhausted. The NASD's NAqcess proposal would continue both of these features. In light of the automated quotation update feature and the lack of immediate automatic execution that would occur under NAqcess, the Commission seeks comment on whether there is a continuing need for the five-minute grace period;

(4) The NASD proposes to modify the methodology for calculating the inside Nasdaq market to include both dealer quotations and NAqcess limit orders. If a NAqcess limit order equals or improves the best market maker quotation, it will be included in the Nasdaq inside market and disseminated as the inside quotation, including the aggregate size of all orders at that price. Further, the NASD proposes to use a unique indicator to denote when the inside market is represented by a NAqcess limit order, rather than a dealer or UTP exchange quotation. The Commission requests comment on whether using an indicator for a NAqcess limit order is appropriate;

(5) As discussed above in the NASD's proposal, priority of NAqcess executions when the best bid or offer consists of both a market maker quotation and a NAqcess limit order would be based on time priority. For example, if the inside bid consists of two market makers' bids and a NAqcess limit order, and the market makers' bids were received before the NAqcess limit order, the first two incoming market orders would be delivered to the market makers and subject to potential rejection within 20 seconds, rather than delivered to the limit order for immediate automatic execution. The Commission seeks comment on whether limit orders priced equal to the inside dealer quote should be given priority over market maker quotations, the implications of such a rule, and the relative costs and benefits of such a rule, particularly given that orders against market makers are delayed for 20 seconds but are executed immediately if matched with NAqcess limit orders;

(6) The proposal would limit the maximum order size for market orders to 1,000 shares (depending on certain trading characteristics of the security). For limit orders, the maximum order size would be 1,000 shares for all securities, except for limit orders in Nasdaq 100 securities for which the maximum limit order size would be 3,000 shares. The Commission seeks comment on the appropriate maximum order size for NAqcess limit orders, and whether different thresholds should be established for different Nasdaq securities. Further, the Commission notes that the Commission's recent proposal concerning order execution obligations generally would require display of limit orders of 10,000 shares or less; the Commission requests comment on the interaction between this aspect of the Commission's proposal and the NASD's proposal;

(7) The proposed NAqcess rules would limit access to the system to agency orders entered by member firms on behalf of public customers. Generally, the proposal would exclude: (a) accounts of persons associated with any member firm, and (b) the immediate family of any person associated with a member. The Commission is interested in commenters' views on the appropriateness of these exclusions. Specifically, the Commission requests comment on: (a) whether proprietary market and limit orders should be allowed or, alternatively, whether only proprietary limit orders should be allowed; (b) whether orders from the immediate family of members should be permitted; and (c) whether orders from non-member broker-dealers (*e.g.*, options market makers and UTP specialists) to member broker-dealers should be permitted;

(8) Under the proposal, any firm holding a protectible customer limit order would be required to execute contemporaneously (*i.e.*, within 60 seconds of the trade report), up to the size of the reported transaction, the customer limit order at the limit order price if an inferior-priced execution is reported in that security. The Commission requests comment on the appropriateness of this time period;

(9) The NASD's proposal includes Rules of Fair Practice that generally would prohibit a member from trading at a price inferior to a viewable NAqcess limit order and require that orders held outside of NAqcess be provided price protection substantially equivalent to that which NAqcess orders would have.

[32] Securities Exchange Act Release No. 36310 (Sept. 29, 1995), 60 FR 52791 (Oct. 10, 1995).

[33] Division of Market Regulation, SEC, The October 1987 Market Break 9–19 (1988).

Under the proposal, for each security, only market makers in that security will be able to see the full limit order file; all other members are limited to viewing the top of the file. The Commission requests comment on whether there should be an exception to the NASD's price protection rule for block trades. In addition, the Commission requests comment on whether full file display of the NAqcess limit order file should be broadened and, if so, to what extent; and

(10) The Commission requests comment on whether the NASD's proposal, and in particular the amendments to the Rules of Fair Practice, would result in any burdens on competition, and if so, the extent of such burdens and whether they are necessary and appropriate in furtherance of 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. 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 the filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number SR-NASD–95–42 and should be submitted by January 16, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[34]

Margaret H. McFarland,

Secretary.

Exhibit A—Rules of Operation and Procedures for the NAqcess System

I. Definitions

The terms used in this Section shall have the same meaning as those defined in the Association's By-Laws and Rules of Fair Practice, unless otherwise specified.

A. The term ''NAqcess'' shall mean the limit order and market order delivery and execution system owned and operated by The Nasdaq Stock Market, Inc. (a wholly owned subsidiary of the National Association of Securities Dealers, Inc.).

B. The term ''NAqcess participant'' shall mean either a market maker or order entry firm registered for participation in NAqcess.

C. The term ''NAqcess eligible security'' shall mean any Nasdaq National Market or Nasdaq SmallCap equity security.

D. The term ''open quote'' shall mean a market maker's quotation price and size (up to its designated exposure limit) in an eligible security against which orders may be executed through the NAqcess system during normal market hours, as specified by the NASD. For the purposes of these Rules, a market maker has a ''closed quote'' when its exposure limit in NAqcess has been exhausted or it has been deemed ''closed'' pursuant to Section IV. A. 9 below.

E. The term ''NAqcess market maker'' shall mean a member of the Association that is registered as a Nasdaq market maker pursuant to the requirements of Schedule D to the NASD By-Laws and as a market maker in one or more NAqcess eligible securities.

F. The term ''NAqcess order entry firm'' shall mean a member of the Association that is registered as an order entry firm for participating in NAqcess which permits the firm to enter agency orders of limited size for delivery to and execution against NAqcess market makers and customer limit orders in NAqcess that are included in the inside market.

G. The term ''agency order'' shall mean an order from a public customer that is entered by the NAqcess order entry firm or NAqcess market maker on an agency basis.

An order will not be considered an agency order if it is for any account of a person associated with any member firm or any account controlled by such an associated person. An order will not be considered an agency order if it is for any account of a member of the ''immediate family'' (as that term is defined in the NASD Free-Riding and Withholding Interpretation, Article III, Section 1 of the Rules of Fair Practice) of an associated person who has physical access to a terminal capable of entering orders into NAqcess.

H. The term ''directed order'' shall mean an order entered into NAqcess and directed to a particular NAqcess market maker or an order entered by a NAqcess market maker that is self-directed. Each market maker has the ability to select order entry firms from which it will accept directed orders.

I. The term ''non-directed order'' shall mean an order entered into NAqcess and not directed to any particular market maker, or a directed order that has been directed to a market maker that has not identified the order entry firm as one from which it will accept directed orders, or a directed order sent to a firm that is not registered as a market maker in that security.

J. The term ''limit order'' shall mean an order entered into NAqcess that is a priced order.

K. The term ''marketable limit order'' shall mean a limit order that, at the time it is entered into NAqcess, if it is a limit order to buy, is priced at the current inside offer or higher, or if it is a limit order to sell, is priced at the inside bid or lower.

L. The term ''executable limit order'' shall mean a limit order that, at the time a limit order, market order, or marketable limit order on the opposite side of the market is entered, is either included in the inside market or is equal in price to the inside market and has time priority over other limit orders or dealer quotations included in the inside market.

M. The term ''marker order'' shall mean a limit order for a market maker's principal account that is a part of a contemporaneously executed transaction that the firm is engaged in for the benefit of one or more customers.

N. The term ''takeout order'' shall mean an order entered by an NASD member firm, acting as principal or as agent, that executes against NAqcess limit orders viewable by that firm.

O. The term ''inside market'' shall mean the best dealer bid, UTP exchange bid, or NAqcess limit order(s) to buy and the best dealer offer, UTP exchange offer or NAqcess limit order(s) to sell, as the case may be, displayed by Nasdaq.

P. The term ''UTP exchange'' shall mean any registered national securities exchange that has unlisted trading privileges in Nasdaq securities.

Q. The term ''matched or crossed file'' shall mean the entry of: (1) a bid quotation by a market maker equal to or greater than a limit order to sell resident in the NAqcess file in the same security; or (2) an offer quotation by a market maker equal to or less than a limit order to buy resident in the NAqcess file in the same security.

R. The term ''maximum market order size'' shall mean the maximum size of individual market orders for a NAqcess eligible security that may be entered into or executed through NAqcess. The maximum market order size for each security shall be advertised in the system and published from time to time by the Association. In establishing the maximum market order size for each Nasdaq National Market security, the Association generally will give

[34] 17 CFR 200.30–3(a)(12).

consideration to the average daily non-block volume, bid price, and number of market makers for each security. Maximum market order size for Nasdaq National Market securities shall be 200, 500 or 1,000 shares, depending upon the trading characteristics of the securities.[1] These sizes may be adjusted on an issue by issue basis, depending upon trading characteristics of the issue and other relevant factors as determined by the Association. Maximum market order size for Nasdaq SmallCap securities shall be 500 shares.

S. The term ''maximum limit order size'' shall mean the maximum size of a limit order for a security that may be entered into or matched through NAqcess. The maximum limit order size for Nasdaq National Market securities shall be 1,000 shares for each tier of Nasdaq National Market securities, except for the securities that comprise the Nasdaq 100 Index,[2] which shall have a maximum limit order size of 3,000 shares. Maximum limit order size for Nasdaq SmallCap securities shall be 1,000 shares.

T. The term ''exposure limit'' shall mean the number of shares of a NAqcess eligible security specified by a NAqcess market maker that it is willing to have executed for its account by orders entered into NAqcess on either side of the market.

U. The term ''minimum exposure limit'' for a security shall mean an exposure limit equal to the maximum market order size for that security.

V. The term ''automated quotation update facility'' shall mean the facility in the NAqcess system that allows the system to automatically refresh a market maker's quotation in any security that the market maker designates when the market maker's exposure limit has been exhausted. The facility will update: (1) either the bid or the offer side of the quote using a quotation interval designated by the market maker, depending upon the side of the market on which the execution has occurred and refresh the market maker's exposure limit; or (2) close the market maker's quote for five minutes, within which time the market maker shall update its quote or be placed in a suspended state for 20 days.

W. The term ''Automated Confirmation Transaction service'' (''ACT''), for purposes of the NAqcess rules, shall mean the automated system owned and operated by The Nasdaq Stock Market, Inc. which accommodates trade reporting of transactions executed through NAqcess and submits locked-in trades to clearing.

II. NAqcess Participant Registration

A. All members participating in NAqcess shall register and be authorized as NAqcess market makers and/or order entry firms. Registration as a NAqcess participant shall be conditioned upon the member's initial and continuing compliance with the following requirements: (1) membership in a clearing agency registered with the Securities and Exchange Commission which maintains facilities through which NAqcess compared trades may be settled; or entry into a correspondent clearing arrangement with another member that clears trades through such clearing agency; (2) registration as a market maker (if applicable) in Nasdaq pursuant to Schedule D of the NASD By-Laws and compliance with all applicable rules and operating procedures of the Association and the Securities and Exchange Commission; (3) maintenance of the physical security of the equipment located on the premises of the member to prevent the unauthorized entry of orders or other data into NAqcess or Nasdaq; and (4) acceptance and settlement of each trade for which it is responsible that is executed through the facilities of the NAqcess service, or if settlement is to be made through another clearing member, guarantee of the acceptance and settlement of such identified NAqcess trades by the clearing member on the regularly scheduled settlement date.

B. Upon effectiveness of the member's registration to participate in NAqcess, participants may commence activity within NAqcess for entry and/or execution of orders, as applicable, and their obligations as established in this rule will commence.

C. Pursuant to Schedule D to the NASD By-Laws, participation as a NAqcess market maker is required for any Nasdaq market maker registered to make a market in a Nasdaq National Market security. A market maker in a Nasdaq SmallCap security may withdraw from and reenter NAqcess at any time, and without limitations, during the operating hours of the service.

D. Each NAqcess participant shall be under a continuing obligation to inform the Association of noncompliance with any of the registration requirements set forth above.

III. Operating Hours of NAqcess

The operating hours of NAqcess will be the normal market hours specified for The Nasdaq Stock Market.

IV. Participant Obligations in NAqcess

A. Market Makers

1. A NAqcess market maker shall commence participation in NAqcess by initially contacting the Market Operation Center to obtain authorization for market making in particular Nasdaq securities and identifying those terminals on which the NAqcess trade information is to be displayed. Thereafter, on-line registration on a security-by-security basis is permissible, consistent with the requirements of Schedule D to the NASD By-Laws.

2. Participation as a NAqcess market maker obligates the firm, upon presentation of a market order or marketable limit order through the service, to execute such order as provided in Section V. A. 5. below. NAqcess market makers are not permitted to decline orders directed to the firm pursuant to a directed order arrangement acknowledged by the market maker. The system will transmit to the market maker on the Nasdaq Workstation screen and printer, if requested, or through a computer interface, as applicable, an execution report generated following each execution.

3. For each NAqcess eligible security in which a market maker is registered, the market maker shall enter into NAqcess its exposure limit. For a Nasdaq National Market security, that limit shall be any amount equal to or larger than the minimum exposure limit for the particular security. If no exposure limit is entered for a Nasdaq National Market security, the firm's exposure limit will be either the default size selected by the particular market maker or the minimum exposure limit. ''Default size'' shall mean an exposure limit greater than the minimum exposure limit that may be selected by a market maker for individual securities or for all securities in which it makes a market.

4. A NAqcess market maker may elect to use the automated quotation update

[1] The applicable maximum market order size for each Nasdaq National Market security is determined generally by the following criteria:

(i) a 1,000 share maximum market order size shall apply to Nasdaq National Market securities with an average daily non-block volume of 6,000 shares or more a day, a bid price of less than or equal to $100, and three or more market makers;

(ii) a 500 share maximum market order size shall apply to Nasdaq National Market securities with an average daily non-block volume of 2,000 shares or more a day, a bid price of less than or equal to $150, and two or more market makers; and

(iii) a 200 share maximum market order size shall apply to Nasdaq National Market securities with an average daily non-block volume of less than 2,000 shares a day, a bid price of less than or equal to $250, and that have two or more market makers.

[2] The Nasdaq 100 Index is an index comprised of many of the largest capitalized issues quoted in the Nasdaq National Market. The securities that make up the Nasdaq 100 are changed from time to time and The Nasdaq Stock Market publishes notice of such changes as they occur.

facility in one or more securities in which it is registered. The facility will update the market maker's quotation automatically by a quotation interval designated by the market maker, once its exposure limit in the security has been exhausted. The facility will update the market maker's quotation in either the bid or the offer side of the market by the interval designated and will reestablish the market maker's displayed size and either the default size or the minimum exposure limit; or the facility will close the market maker quote for five minutes.

5. Matched or crossed file. If a market maker's quotation change matches or crosses a limit order residing in the NAqcess limit order file, the system will automatically provide a notification to the market maker that informs the market maker of its obligation to protect all limit orders residing in the NAqcess file that would be affected by the quotation change. If the market maker enters the matching or crossing quotation change after this notification, limit orders in the file for the particular security will be automatically executed against the matching or crossing market maker, provided however, that if the number of shares in the limit order file that would be matched or crossed is greater than five times the maximum market order size for that particular security, or if the quotation change matches and crosses multiple price levels, the quotation change will be rejected. To effect such quotation change, the market maker first must manually enter a takeout order for the affected orders in the file prior to re-entering its quotation update.

6. The market maker may terminate its obligation by keyboard withdrawal from NAqcess at any time. However, the market maker has the specific obligation to monitor its status in NAqcess to assure that a withdrawal has in fact occurred. Except as otherwise permitted by Section 70 of the Uniform Practice Code regarding the Association's authority to declare clearly erroneous transactions void, (''UPC Section 70''), any transaction occurring prior to the effectiveness of the withdrawal may remain the responsibility of the market maker. In the case of a Nasdaq SmallCap security, a market maker whose exposure limit is exhausted will be deemed to have withdrawn from NAqcess and may reenter at any time. In the case of a Nasdaq National Market security, a market maker whose exposure limit is exhausted will have a closed quote in Nasdaq and NAqcess and will be permitted a standard grace period of five minutes within which to take action to restore its exposure limit, if the market maker has not authorized use of the automated quotation update facility. A market maker that fails to renew its exposure limit in a Nasdaq National Market security within the allotted time will be deemed to have withdrawn as a market maker. Except as provided in subsection 7 below, a market maker that withdraws from a Nasdaq National Market security may not re-register in NAqcess as a market maker in that security for twenty (20) business days.

7. Notwithstanding the provisions of subsection 6 above, (i) a market maker that obtains an excused withdrawal pursuant to Part V of Schedule D to the NASD By-Laws prior to withdrawing from NAqcess may reenter NAqcess according to the conditions of its withdrawal; and (ii) a market maker that fails to maintain a clearing arrangement with a registered clearing agency or with a member of such an agency, and is thereby withdrawn from participation in ACT and NAqcess for Nasdaq National Market securities, may reenter NAqcess after a clearing arrangement has been reestablished and the market maker has complied with ACT participant requirements, provided however, that if the Association finds that the ACT market maker's failure to maintain a clearing arrangement is voluntary, the withdrawal of quotations will be considered voluntary and unexcused pursuant to Schedule D and these rules.

8. In the event that a malfunction in the market maker's equipment occurs rendering on-line communications with the NAqcess service inoperable, the NAqcess market maker is obligated to immediately contact the Market Operations Center by telephone to request a closed quote status from NAqcess. For Nasdaq securities, such request must be made pursuant to the requirements of Part V, Schedule D to the NASD By-Laws. If the closed quote status is granted, Market Operations personnel will enter such status notification into NAqcess from a supervisory terminal. Such manual intervention, however, will take a certain period of time for completion and, unless otherwise permitted by the Association pursuant to its authority under UPC Section 70, the NAqcess market maker may continue to be obligated for any transaction executed prior to the effectiveness of its closed quote.

B. Order Entry

1. Only market and limit agency orders may be entered in NAqcess by the NAqcess order entry firm through either its Nasdaq Workstation or computer interface. The system will transmit to the order entry firm on the Nasdaq Workstation screen and printer, if requested, or through a computer interface, as applicable, an execution report generated following each execution. NAqcess market makers may enter limit agency orders in NAqcess for any NAqcess eligible security, but may not enter agency market orders or marketable limit orders in securities in which they make markets, unless such orders are self-directed. As a limited exception to the prohibition of the entry of proprietary orders into NAqcess, NAqcess market makers may place marker orders into NAqcess. The benefit of any such marker order execution must be passed immediately to one or more customer limit orders held by the firm placing the marker order. Marker orders may not be placed with respect to customer limit orders held by the firm that exceed the maximum limit order size permitted by these rules.

2. NAqcess will accept both market and limit agency orders of appropriate size for execution. Agency orders may be directed to a specific NAqcess market maker, self-directed by the NAqcess market maker, or may be non-directed, thereby resulting in execution against the next available NAqcess market maker. If an order is directed to a market maker by an order entry firm from which it has not agreed to accept direct orders, the order will be executed on a non-directed basis.

3. Only agency orders no larger than the maximum market and limit order sizes may be entered by a NAqcess order entry firm into NAqcess for execution against an NAqcess market maker or against an executable limit order. Orders in excess of the maximum order sizes may not be divided into smaller parts for purposes of meeting the size requirements for orders entered into NAqcess. All orders based on a single investment decision that are entered by a NAqcess order entry firm for accounts under the control of associated persons or public customers, whether acting alone or in concert with other associated persons or public customers, shall be deemed to constitute a single order and shall be aggregated for determining compliance with the maximum order size limits. Orders entered by the NAqcess order entry firm within any five-minute period in accounts controlled by associated persons or public customers, acting alone or in concert with other associated persons or public customers, shall be presumed to be based on a single investment decision. An associated person or customer shall be deemed to control an account if the account is his or her personal account or an account in

which he or she has a beneficial interest; the person exercises discretion over the account; the person has been granted a power of attorney over the account; or the account is the account of an immediate family member as that term is defined in the Board of Governors Interpretation on Free-Riding and Withholding, Article III, Section 1 of the NASD Rules of Fair Practice.

4. No order will be considered an agency order from a public customer if it is for any account of a person associated with any member firm or any account controlled by such an associated person. No order will be considered an agency order from a public customer if it is for any account of a member of the ''immediate family'' (as that term is defined in the NASD Free-Riding and Withholding Interpretation, Article III, Section 1 of the Rules of Fair Practice) of an associated person who has physical access to a terminal capable of entering orders into NAqcess.

5. No member or person associated with a member shall utilize NAqcess for the execution of agency orders in a SmallCap security in which the member is a Nasdaq market maker but is not a NAqcess market maker.

6. NAqcess will accept the following types of agency orders during normal market hours: (a) day orders; (b) good-till-canceled (''GTC''); and (c) good till date (''GTD'').

V. Execution of NAqcess Orders

A. *General Execution Procedures*: Orders in Nasdaq equity securities entered into NAqcess may be directed or non-directed. Non-directed market orders and non-directed marketable limit orders will be processed according to the procedures established below. Non-directed odd-lot orders that are market orders or marketable limit orders will be automatically executed in NAqcess against the next available market maker at the inside market and execution reports will be delivered to the order entry firm and the market maker.

1. *Entry of Limit Orders*: Limit orders may be entered into NAqcess by order entry firms and by market makers up to the maximum limit order size allowed for a particular security. Limit orders priced away from the Nasdaq inside bid or offer (as the case may be) as well as limit orders consolidated in the inside market will be stored in the NAqcess limit order file. Limit orders in securities priced at $10 or more shall be priced in increments of an eighth or more; limit orders in securities that are priced at under $10 may be placed in increments of a sixteenth or less depending upon the dealer quotation increments permitted.

2. *Display of NAqcess Limit Orders*: (a) Consolidated Display of Limit Orders In Inside Market: If a NAqcess limit order to buy or sell for 100 shares or more is better than the best dealer bid or offer, the limit order to buy or sell will be displayed in the Nasdaq inside market. Such display will contain the limit order price, size (which shall be aggregated if two or more limit orders are at the same best price) and an indicator to note that the inside market consists of a limit order rather than a market maker or UTP exchange quotation. If a NAqcess limit order of 100 shares or more is at the same price as the best dealer bid or offer, the size displayed in the inside market will be an aggregation of any same-priced limit orders and a single dealer quote at the best price.

(b) Full Limit Order File Display: All Nasdaq market makers in a particular security may request via Nasdaq Workstations a display of all limit orders in such security entered in the NAqcess limit order file. Such displays will be available on a query basis only to a registered market maker in a particular security.

3. *Execution of Limit Orders*: A limit order that matches or crosses a limit order on the opposite side of the market will be automatically executed against the matching or crossing order when such orders are at the inside market or better, and have priority over the dealer quotation. The priority rules for limit order interaction shall be that orders that are best in price shall be executed against each other first. If two or more orders are at the same price on the same side of the market, then the order that was received first in time shall be accorded priority over other orders at the same price. Limit orders that cross each other in price shall be executed at the price of the order that entered the file first. A limit order matches a limit order on the file when: the limit orders are consolidated in the inside market on Nasdaq; are on opposite sides of the market; and are equal in price. A limit order crosses a limit order on the file when: both limit orders are either consolidated in the inside market or better than the inside market; are on opposite sides of the market from each other; and the subsequent limit order is at a superior price to the existing limit order (i.e., the sell (buy) limit order is priced below (above) a limit order to buy (sell)). Execution of limit orders will occur up to the size of the initial limit order or the subsequent limit order, whichever is smaller, and without the participation of a market maker. The unexecuted balance of a limit order is entered into the NAqcess file for subsequent matching, unless such balance is less than 100 shares, in which case the balance is automatically executed against the next available market maker, if equal to the inside quotation. If there is a limit order at the same price as the best dealer quotation (i.e., if a limit order to buy is the same as the best dealer bid, or a limit order to sell is the same as the best dealer offer), the order or quote that has time priority shall be matched against the incoming limit order.

4. *Takeouts of Limit Orders:* Any NASD member firm, acting as principal or as agent, may enter into NAqcess an order or orders that execute(s) any limit order(s) consolidated in the inside market or otherwise displayed in the NAqcess limit order file. Such orders shall be known as ''takeout'' orders. A takeout order may be for any size up to the aggregate amount of shares displayed in the NAqcess limit order file at a particular price. Takeout orders must be executed against limit orders on the opposite side of the market in order of price and time. A firm entering a takeout order for limit orders at multiple prices may enter a single takeout order at a price either at or above or below the NAqcess limit orders, as the case may be, and each limit order will be executed at each such price. Takeout orders do not reduce a firm's exposure limit.

5. *Entry and Execution of Market Orders:* (a) Market orders up to the maximum market order size for NAqcess eligible security may be entered into NAqcess. If at the time a market order is entered into NAqcess there is a limit order on the opposite side of the market that resides in the NAqcess limit order file and is reflected in the inside market as the best bid or offer, the incoming market order will be automatically executed against the limit order at the limit order price without the participation of a market maker. If a market order is not fully executed against the limit order file, the balance of such market order will be treated as any other market order as set forth in subparagraph (b) below, provided that if the balance of the market order is odd-lot size, the balance will be automatically executed against the next available market maker at the inside quotation. If there is a limit order consolidated in the inside market at the same price as a dealer bid or offer (i.e., if a limit order to buy is the same as the best dealer bid, or a limit order to sell is the same as the best dealer offer), the order or quote that has time priority

shall be matched against the incoming market order.

(b) If there is no limit order residing in NAqcess that has been consolidated in the inside market on the opposite side of the market from the market order, each market order will be assigned to a market maker at the inside market and will be executed against the next available market maker at the current inside market after a display period of 15-seconds. The market maker to which a market order is displayed may decline the market order within the 15-second period if the market maker has contemporaneously executed another transaction and is in the process of updating its quotation pursuant to SEC Rule 11Ac1–1. If a market order or a marketable limit order is declined by a market maker, the order is returned to the system for distribution to the next available market maker. If that market maker is at the same price level as the first market maker who declined the order, the second market maker has 15 seconds to react to the order. If the originally declined order is re-presented to a market maker at a price level different from its original presentation(s), the order is automatically executed at that price level without any market maker ability to decline.

(c) If the NAqcess limit order file does not have any executable limit orders at the time a directed market order is entered, directed market orders will be automatically executed against the directed order market maker without a 15-second decline capability. Directed limit orders that are not matched by incoming limit or market orders will be automatically executed against the directed order market maker when the inside market is changed to match the directed limit order price. Directed odd-lot orders (orders of less than 100 shares) that are market orders or marketable limit orders also will be automatically executed against the directed order market maker. Non-directed odd-lot orders that are market orders or marketable limit orders will be automatically executed against the next available market maker at the current inside market. An odd-lot limit orders that is not executable at time of entry will be stored and executed against the best dealer bid or offer, as the case may be, when such quotation reaches the limit order price.

6. *Entry and Execution of A Marketable Limit Order:* Marketable limit orders that meet the maximum market order size requirements will be accepted and treated as market orders. Marketable limit orders greater than the maximum market order size will be returned to the order entry firm for handling outside of NAqcess.

7. *NAqcess Opening Procedures:* NAqcess will permit the entry of limit orders and market orders outside of normal market hours, except that market orders will not be accepted between 4:00 and 6:00 p.m. Orders entered at such times will not be executed but will be stored for matching and execution at the next market opening. NAqcess permits the entry of such orders between 4:01 p.m. to 6:00 p.m. and 8:00 a.m. to 9:28 a.m. (Orders entered from 9:28 to 9:30 will be stored and handled according to normal market procedures after the opening procedures are concluded.)

Matching and execution at the NAqcess opening will occur according to the following procedures:

At 9:28 a.m., NAqcess will stop accepting orders for execution in the NAqcess file for opening purposes. At 9:30 a.m., NAqcess will commence execution procedures for opening orders in NAqcess by first ranking and matching limit orders in NAqcess in sequence of the highest price buy order against the lowest price sell order. When all available limit orders are matched and executed, market orders on a time priority basis will be matched and executed against any remaining limit orders in the NAqcess file within the inside quotation at the limit order price(s). Any remaining market limit orders will be stored in the NAqcess file. Any remaining orders will be subject to normal order execution processes.

VI. Clearance and Settlement

All transactions executed in NAqcess shall be transmitted to the National Securities Clearing Corporation to be cleared and settled through a registered clearing agency using a continuous net settlement system.

VII. Obligation to Honor System Trades

If a trade reported by a NAqcess participant, or clearing member acting on its behalf, is reported by NAqcess to clearing at the close of any trading day, or shown by the activity reports generated by NAqcess as constituting a side of a NAqcess trade, such NAqcess participant, or clearing member acting on its behalf, shall honor such trade on the scheduled settlement date.

VIII. Compliance With Procedures and Rules

Failure of a NAqcess participant or person associated with a NAqcess participant to comply with any of the rules or requirements of NAqcess may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Article III, Section 1 of the Rules of Fair Practice. No member shall effect a NAqcess transaction for the account of a customer, or for its own account, indirectly or through the offices of a third party, for the purpose of avoiding the application of these rules. Members are precluded from doing indirectly what is directly prohibited by these rules. All entries in NAqcess shall be made in accordance with the procedures and requirements set forth in the NAqcess User Guide. Failure by a NAqcess participant to comply with any of the rules or requirements applicable to NAqcess shall subject such NAqcess participant to censure, fine, suspension or revocation of its registration as a NAqcess market maker and/or order entry firm or any other fitting penalty under the Rules of Fair Practice of the Association.

IX. Termination of NAqcess Service

The Association may, upon notice, terminate NAqcess service to a participant in the event that a participant fails to abide by any of the rules or operating procedures of the NAqcess service or the Association, or fails to pay promptly for services rendered.

Exhibit B—Interpretations Related to Member Firm Responsibilities Regarding Orders in NAqcess

In its efforts to maximize the protection of investors and to enhance the quality of the marketplace, the NASD and The Nasdaq Stock Market, Inc. have developed a nationwide limit order protection, price improvement, and market order handling facility of The Nasdaq Stock Market. This nationwide facility is herein referred to as ‘‘NAqcess’’.

The NASD Board of Governors is issuing these Interpretations to the Rules of Fair Practice to provide: (1) Customers the right to have their orders entered and protected in NAqcess; and (2) member firm provision of equivalent protection for limit orders held in a member firm’s proprietary limit order system. These Interpretations are based upon a member firm’s obligation to provide best execution to customer orders under Article III, Section 1 of the Rules of Fair Practice and a member firm’s obligations in dealing with customers as principal or agent to buy and sell at fair prices and charge reasonable commissions or service charges under Article III, Section 4 of the Rules of Fair Practice. Accordingly, it shall be deemed a violation of Article

III, Section 1 of the Rules of Fair Practice for a member or a person associated with a member to violate the following provisions:

1. Member Firm Obligation Regarding Investors' Directions on Order Handling

NAqcess will provide individual investors with significant opportunities to achieve limit order protection and price improvement. The NASD recognizes that member firms operating as market makers also operate trading systems which offer significant protection and execution opportunities for customer limit orders. Accordingly, nothing herein is intended to limit a member's ability to recommend use of its own or another member firm's proprietary system for handling limit and market orders where equivalent protection is afforded. In light of the significant benefits offered to customers by the NAqcess system, however, members must abide by the directions of its customers who request that the firm enter their orders in NAqcess.

Further, nothing in this Interpretation requires a member firm to accept any or all customer limit orders. Member firms accepting limit orders that are placed in NAqcess or otherwise may charge fair and reasonable commissions, commission equivalents, or service charges for such handling, provided that such commissions, commission equivalents, or service charges do not violate Article III, Section 4 of the Rules of Fair Practice. In no event, however, shall a member impose any fee or charge that effectively operates as a disincentive to the entry of orders in the nationwide facility and thereby interferes with the investor's ability to choose order handling alternatives.

2. Equivalent Protection for Orders Held Outside of NAqcess

As a further adjunct to a member firm's best execution obligations, the NASD Board of Governors has interpreted Article III, Section 1 of the Rules of Fair Practice to require member firms that do not enter customer limit orders into NAqcess, but hold such protectible orders in their own proprietary system, to provide such orders with price protection at least equivalent in substance to that which the order would have received had the order been entered into NAqcess. For the purposes of this Interpretation, a ''protectible limit order'' shall mean a limit order that meets the maximum limit-order size criteria as set forth in the Rules of Operation and Procedure for NAqcess at Section I.S. For the purposes of this Interpretation, equivalent price protection shall mean:

A. Print Protection

If a transaction in a Nasdaq security is reported via the Automated Confirmation Transaction Service (''ACT'') at a price inferior to the price of customer limit order(s) that the firm is holding (*i.e.*, if the reported price is a price lower than a buy limit order or higher than a sell limit order being held by the firm), the firm holding the limit order(s) is required on a contemporaneous basis to execute the limit order(s) at the limit price(s) up to the size of the reported transaction.

B. Matching Limit Orders

If the firm holds a customer buy (sell) limit order in its proprietary limit order file and that limit order matches a sell (buy) limit order in NAqcess, the firm holding the limit order must either provide its customer with an immediate execution at the limit order price or must immediately direct the order to NAqcess. A limit order held by a firm would match a limit order in NAqcess when the limit order in NAqcess is at the same price or is priced lower than the firm's customer's limit order to buy or higher than the firm's customer limit order to sell (''offsetting limit orders'').

C. Matching Limit Order Interaction Within A Firm's File

If the firm holds two or more offsetting customer limit orders within its own proprietary file, the firm must execute the offsetting limit orders.

D. Interaction Between Limit and Market Orders Held Within A Firm's File

While holding a customer limit order that is priced equal to or better than the best bid or offer in the security disseminated in Nasdaq, if a firm accepts customer market orders for automated execution against the best bid or offer in the security disseminated in Nasdaq, the firm, pursuant to its obligation set forth in the Interpretation to the Rules of Fair Practice, Article III, Section 1, (the so-called ''Manning Interpretation''), must first permit the market orders to execute against any applicable limit orders it holds before the firm may execute the market orders for its own account.

E. Examples of Equivalent Protection

The NASD Board of Governors has provided the following examples to further explain a member firm's equivalent protection obligation for orders held outside of NAqcess:

Print Protection The best dealer bid and offer in Nasdaq (''the inside price'') is 20 bid–20¼ offer. Firm ABCD holds a customer limit order of 1,000 shares to buy at 20⅛ in its own proprietary file. Firm MNOP reports a transaction in the subject security via ACT, disseminating a price of 20¹⁄₁₆ for 500 shares. Contemporaneous with the dissemination of the trade report, firm ABCD is required to provide an execution of its customer limit order for at least 500 shares at 20⅛.

Matching Limit Orders The inside price is 20 bid–20¼ offer. NAqcess is displaying a 1,000 share customer limit order to buy at 20⅛ for customer X. Firm ABCD thereafter receives from customer Y a 1,000 share limit order to sell at 20⅛ that the firm ABCD retains for handling outside of NAqcess. Upon receipt of the limit order, firm ABCD must execute customer Y's limit order for 1,000 shares at 20⅛.

Matching Limit Order Interaction Within A Firm's File. The inside price is the same as above. Firm ABCD holds a customer limit order to buy 1,000 shares at 20⅛. Firm ABCD thereafter receives a customer limit order to sell 1,000 shares at 20⅛. Firm ABCD must match the orders and execute the trade.

Interaction Between Limit and Market Orders Held Within A Firm's File. The inside price is the same as above. Firm ABCD holds a customer limit order to buy 1,000 shares at 20⅛. Firm ABCD thereafter receives a customer market order to sell 1,000 shares. Firm ABCD must match the two orders and execute the trade at 20⅛. Similarly, if the limit order to buy were priced at 20, the firm would have to execute the market order against the limit order at 20.

Price Protection for NAqcess Limit Orders, Rules of Fair Practice, Article III, Section [XX]

No member firm shall execute an order as principal or as agent at a price inferior to any limit order(s) viewable in NAqcess to the member firm, provided however, that a member firm executing a transaction that is larger than the limit order(s) viewable in NAqcess at an inferior price must contemporaneously satisfy the limit order(s) viewable in NAqcess. An ''inferior price'' means an execution price that is lower than a buy limit order or higher than a sell limit order that is viewable in NAqcess. The term ''limit orders viewable in NAqcess'' shall mean those orders that the member firm is able to view either as consolidated in the Nasdaq inside market or as reflected in the Full Limit Order File Display as the firm is authorized to view under the Rules of Operation and Procedure.

[FR Doc. 95–29950 Filed 12–7–95; 8:45 am]

BILLING CODE 8010–01–P

[Rel. No. IC–21561; File No. 812–9588]

American Skandia Life Assurance Corporation, et al.

December 1, 1995.

AGENCY: U.S. Securities and Exchange Commission (''SEC'' or ''Commission'').

ACTION: Notice of Application for Exemption Under the Investment Company Act of 1940 (the ''1940 Act'').

APPLICANTS: American Skandia Life Assurance Corporation (''ASLAC''), American Skandia Life Assurance Corporation Variable Account B (Class 1) (''Account B—Class 1''), American Skandia Life Assurance Corporation Variable Account B (Class 2) (''Account B—Class 2''), and American Skandia Marketing, Inc. (''ASM'').

RELEVANT 1940 ACT SECTIONS: Sections 6(c), 17(a), 17(b), 17(d) and 26(b) of the 1940 Act and Rule 17d–1 thereunder.

SUMMARY OF APPLICATION: Applicants seek an order of approval under Section 26(b) of the 1940 Act and exemptions from Sections 6(c), 17(a), 17(b), 17(d) of the 1940 Act and Rule 17d–1 thereunder. The requested order would exempt Applicants from those Sections of the 1940 Act and the Rule set out above to the extent necessary to permit certain underlying mutual funds of the separate account to be substituted for certain other underlying mutual funds.

FILING DATE: The application was filed on May 2, 1995 and amended on November 17, 1995.

HEARING OR NOTIFICATION OF HEARING: An order granting the application will be issued unless the SEC orders a hearing. Interested persons may request a hearing by writing to the Secretary of the SEC and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the SEC by 5:30 p.m. on December 26, 1995, and should be accompanied by proof of service on Applicants in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Secretary of the SEC.

ADDRESSES: SEC, Secretary, 450 Fifth Street, NW., Washington, DC 20549. Applicants: John T. Buckley, Esq., Werner & Kennedy 1633 Broadway, New York, New York 10019 and American Skandia Life Assurance Corporation, c/o Jeffrey M. Ulness, Esq., One Corporate Drive, Shelton, CT 06484.

FOR FURTHER INFORMATION CONTACT: Edward P. Macdonald, Staff Attorney, or Brenda D. Sneed, Chief (Office of Insurance Products), Division of Investment Management, at (202) 942–0670.

SUPPLEMENTARY INFORMATION: The following is a summary of the application. The complete application may be obtained for a fee from the Public Reference Branch of the SEC.

Applicants' Representations

1. ASLAC, the depositor of both Account B—Class 1 and Account B—Class 2 (collectively, the ''Separate Account''), is a stock life insurance company organized under the laws of the State of Connecticut and wholly-owned by American Skandia Investment Holding Corporation (''ASIHC''), which is an indirect wholly-owned subsidiary of Skandia Insurance Company Ltd., a corporation organized under the laws of the Kingdom of Sweden.

2. ASM, the underwriter of variable annuity contracts issued through the Separate Account and offered by ASLAC, is registered with the SEC and is a member of the NASD. ASM is 100% owned by ASIHC.

3. The Separate Account is a separate account of ASLAC, and is registered under the 1940 Act as a unit investment trust. ASLAC established the Separate Account to the purpose of funding certain flexible purchase payment deferred variable annuity contracts (the ''Contracts''). Account B—Class 1 subaccounts each invest exclusively in one of the corresponding portfolios of six open-end management investment companies. The following five Contracts are funded, through the sub-accounts of Account B—Class 1: American Skandia Advisors Plan (''ASAP'') [32];[1] ASAP II [21];[2] the LifeVest Personal Security Annuity (''PSA'') [32]; the Alliance Capital Navigator Annuity (''Alliance Navigator'') [15]; and the StageCoach Variable Annuity (''StageCoach'') [8] (collectively, the ''Class 1 Contracts'').

Account B—Class 2 sub-accounts each invest exclusively in one of the corresponding portfolios of six open-end management investment companies. ASLAC currently offers two Contracts that invest in Account B—Class 2: the Wrap Fee Contracts (''Wrap Fee'') [42].

4. Under the Contracts affected by the proposed substitutions, six open-end management investment companies currently offer shares of several of their portfolios to the Separate Account: The Alger American Fund (''Alger Fund''); Alliance Variable Products Series Fund, Inc. (''AVP''); Neuberger & Berman Advisers Management Trust (''AMT''); American Skandia Trust (''AST''); and Scudder Variable Life Investment Fund (''Scudder''). In addition, six portfolios of the Janus Aspen Series (''Janus'') are offered to Account B—Class 2 but not Account B—Class 1. All such investment companies in which the Separate Account invest are collectively referred to as ''Underlying Funds.''

5. The proposed substitutions would result in a reduction in variable investment options and corresponding portfolios available as follows. ASAP and PSA would be reduced to 21 (a reduction of 11 each) and Wrap Fee would be reduced to 21 (a reduction of 21). Applicants state that funding such varied products through a consolidated fund structure will aid in the growth of the Underlying Funds resulting in lower operating costs through economies of scale. Applicants further state that regardless of whether one Contract achieves more popularity or appeal, or is no longer marketed by ASLAC, the interests of Contract owners will be protected by like underlying portfolios of all ASLAC nonproprietary variable annuities.

6. Of the Underlying Funds, only AST is affiliated with ASLAC or the Separate Account. None of the Underlying Funds, their investment managers, or underwriters are affiliated with ASLAC, the Separate Account or AST through any corporate ownership.

7. Applicants state that in the registration statements filed by the Separate Account, ASLAC expressly reserved the right both on its own behalf and on behalf of the Separate Account to eliminate sub-accounts, combine two or more sub-accounts, or substitute one or more Underlying Funds for others in which its sub-accounts are invested.

8. ASLAC, on its own behalf and on behalf of the Separate Account, proposes to effect the following substitutions of shares of the following portfolios (the ''Transferee Portfolios'') for shares of other portfolios (the ''Transferor Portfolios'') (collectively, the ''Substitution(s)''): (i) the AST Phoenix Balanced Asset Portfolio will be substituted for the Alger Balanced, Alliance Total Return, AMT Balanced, Scudder Balanced, and Janus Aspen

[1] The numbers in brackets denote the number of portfolios which are currently available under the Contracts.

[2] ASAP II, the Alliance Navigator and the Stagecoach Contracts will not be subject to the proposed substitutions.