purposes of the Exchange Act. Section 15A(b)(11) requires the NASD to, among other things, formulate rules designed to produce fair and informative quotations.

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

The NASD believes that the proposed rule change will not result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

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

Comments were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the NASD 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 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 such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by May 12, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[33]

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 97–10221 Filed 4–18–97; 8:45 am]

BILLING CODE 8010–01–M

[33] 17 CFR 200.30–3(a)(12) (1989).

---

## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–38512; File No. SR–NASD–97–25]**

## Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to an Extension of the Pilot for the NASD's Rule Permitting Market Makers To Display Their Actual Quotation Size

April 15, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act''), 15 U.S.C. 78s(b)(1), notice is hereby given that on April 11, 1997, the National Association of Securities Dealers, Inc. (''NASD'' or ''Association'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the extension.

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

The NASD proposes to extend the effectiveness of NASD Rule 4613(a)(1)(C) until July 18, 1997.[1] NASD Rule 4613(a)(1)(C) provides that market makers in the first fifty Nasdaq securities subject to the Commission's Limit Order Display Rule are allowed to quote their actual quote size (''Actual Size Rule''). The text of the proposed rule change is as follows. (Additions are italicized; deletions are bracketed.)

* * * * *

NASD Rule 4613 Character of Quotations

(a) Two-Sided Quotations

(1) No change.

(A)–(B) No change.

(C) As part of a pilot program implemented by The Nasdaq Stock Market, during the period January 20, 1997 through at least [April] *July* 18, 1997, a registered market maker in a security listed on The Nasdaq Stock Market that became subject to mandatory compliance with SEC Rule 11Ac1–4 on January 20, 1997 must display a quotation size for at least one normal unit of trading (or a larger multiple thereof) when it is not displaying a limit order in compliance with SEC Rule 11Ac1–4, provided, however, that a registered market maker may augment its displayed quotation size to display limit orders priced at the market marker's quotation.

(2) *Except as provided in subparagraph (a)(1)(C) above,* [E]each member registered as a Nasdaq market maker in Nasdaq National Market equity securities shall display size in its quotations of 1,000, 500, or 200 shares and the following guidelines shall apply to determine the applicable size requirement:

(A)–(C) No change.

* * * * *

**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 III 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 and Background

On August 29, 1996, the Commission promulgated a new rule, the Limit Order Display Rule[2] and adopted amendments to the Quote Rule[3] which together are designed to enhance the quality of published quotations for securities and promote competition and pricing efficiency in U.S. securities markets (these rules are collectively referred to

[1] The NASD has concurrently requested that the pilot for the Actual Size Rule be expanded to apply to 100 additional Nasdaq securities and extended until December 19, 1997. *See* Securities Exchange Act Release No. 38513 (April 15, 1997).

[2] 17 CFR 240.11Ac1–4.

[3] 17 CFR 240.11Ac1–1.

hereinafter as the ''Order Execution Rules'').[4] With respect to securities included on Nasdaq (''Nasdaq securities''), the Order Execution Rules are being implemented according to a phased-in implementation schedule. Fifty Nasdaq securities became subject to the rules on January 20, 1997 (''first fifty''); fifty more securities became subject to the rules on February 10, 1997 (''second fifty''); and an additional fifty securities became subject to the rules on February 24, 1997. The remaining Nasdaq securities will become subject to the rules according to time tables established by the Commission.[5]

In particular, the SEC's Limit Order Display Rule requires the display of customer limit orders, that: (1) are priced better than a market maker's quote; [6] or (2) add to the size associated with a market marker's quote when the market maker is at the best price in the market.[7] By virtue of the Limit Order Display Rule, investors now have the ability to directly advertise their trading interest to the marketplace, thereby allowing them to complete with market maker quotations and affect the size of bid-ask spreads.[8] The Order Execution Rules also included amendments to the SEC's Quote Rule, the most significant of which requires market makers to display in their quote any better priced orders that the market maker places into an electronic communications network (''ECN'') such as SelectNet or Instinet (''ECN Rule''). Alternatively, instead of updating its quote to reflect better priced orders entered into an ECN, a market maker may comply with the display requirements of the ECN rule through the ECN itself, provided the ECN: (1) ensures that the best priced orders entered by market makers into the ECN are included in the public quotation; and (2) provides brokers and dealers access to orders entered by market makers into the ECN, so that brokers and dealers who do not subscribe to the ECN can trade with those orders (''ECN Display Alternative'').

In order to facilitate implementation of the SEC's Order Execution Rules and reflect the order-driven nature of the Nasdaq market that was to be brought about by the implementation of these rules, the Commission approved, on January 10, 1997, a variety of amendments to NASD Rules pertaining to Nasdaq's Small Order Execution System (''SOES'') and the SelectNet Service (''SelectNet'').[9] In particular, one of the NASD Rule changes approved by the Commission provides on a temporary basis that Nasdaq market makers in the first fifty securities subject to the Commission's Limit Order Display rule are required to display a minimum quotation size of one normal unit of trading when quoting solely for their own proprietary account (*i.e.*, the Actual Size Rule).[10] For Nasdaq securities outside of the first fifty, the minimum quotation size requirements remained the same.[11]

The NASD submitted the proposal for the Actual Size Rule because it believed, and continues to believe, that the new order-driven nature of Nasdaq brought about by the Limit Order Display Rule obviates the regulatory justification for minimum quote size requirements because investors now have the capability to display their own orders on Nasdaq. The NASD originally imposed the Mandatory Quote Size Requirements to ensure an acceptable level of market liquidity and depth in an environmental where Nasdaq market makers were the only market participants who could impact quotation prices. Now that the Limit Order Display Rule permits investors to directly impact quoted prices, however, the NASD believes it is appropriate to treat Nasdaq market makers in a manner equivalent to exchange specialists and not subject them to minimum quote size requirements when they are not representing customer orders. In sum, with the successful implementation of the SEC's Order Executive Rules, the NASD believes that Mandatory Quote Size Requirements impose unnecessary regulatory burdens on market makers.

At the same time, the NASD does not believe that implementation of the Actual Size Rule in an environment where limit orders are displayed has or will compromise the quality of the Nasdaq market. First, the display of customer limit orders enhances the depth, liquidity, and stability of the market and contributes to narrower quoted spreads, thereby mitigating the effects of the loss of displayed trading interest, if any, by market makers, Second, removing artificial quote size requirements may lead to narrower market maker spreads, thereby reducing investors' transaction costs. Third, permitting market makers to quote in size commensurate with their own freely-determined trading interest will enhance the pricing efficiency of the Nasdaq market and the independence and competitiveness of dealers quotations. Fourth, removing quotation size requirements will facilitate greater quote size changes, thereby increasing the information content of market maker quotes by facilitating different quote sizes from dealers who have a substantial interest in the stock at a particular time and those who do not.

Indeed, in its order approving the Actual Size Rule, the Commission noted that it ''preliminarily believes that the proposal will not adversely affect market quality and liquidity'' [12] and that it ''believes there are substantial reasons * * * to expect that reducing market makers' proprietary quotation size requirements in light of the shift to a more order-driven market would be beneficial to investors.'' [13] In addition, the Commission stated that, ''based on its experience with the markets and discussions with market participants, [it] believes that decreasing the required quote size will not result in a reduction in liquidity that will hurt investors.'' [14]

Nevertheless, in light of concerns raised by commentators opposed to the Actual Size Rule regarding the potential adverse impacts of the rule on market

[4] *See* Securities Exchange Act Release No. 37619A (September 56, 1997), 61 FR 48290 (September 12, 1996) (''Order Execution Rules Adopting Release'')

[5] *See, e.g.,* Securities Exchange Act Release No. 38490 (April 9, 1997).

[6] For example, if a market maker's quote in stock ABCD is 10–10¼ (1000 × 1000) and the market maker receives a customer limit order to buy 200 shares at 10⅛, the market maker must update its quote to 10⅛–10¼ (200 × 1000).

[7] For example, if a market maker receives a customer limit order to buy 200 shares of ABCD at 10 when its quote in ABCD is 10–10¼ (1000 × 1000) and the NBBO for ABCD is 10–10⅛, the market maker must update is quote to 10–10¼ (1200 × 1000).

[8] There are eight exceptions to the immediate display requirement of the Limit Order Display Rule: (1) customer limit orders executed upon receipt; (2) limit orders placed by customers who request that they not be displayed; (3) limit orders for odd-lots; (4) limit orders of block size (10,000 shares or $200,000); (5) limit orders routed to a Nasdaq or exchange system for display; (6) limit orders routed to a qualified electronic communications network for display; (7) limit orders routed to another member for display; and (8) limit orders that are all-or-none orders. *See* Rule 11Ac1–4(c).

[9] *See* Securities Exchange Act Release No. 38156 (January 10, 1997), 62 FR 2415 (January 16, 1997) ( order partially approving SR–NASD–96–43 and approving the Actual Size Rule on a pilot basis) (''Actual Size Rule Approval Order'').

[10] Thus, the Actual Size Rule does not effect a market maker's obligation to display the full size of a customer limit order. If a market maker is required to display a customer limit order for 200 or more shares, it must display a quote size of at least 200 shares absent an exception from the Limit Order Display Rule.

[11] In particular, NASD Rule 4613(3)(2) requires each market maker in a Nasdaq issue other than those in the first fifty to enter and maintain two-sided quotations with a minimum size equal or greater than the applicable SOES tier size for the security (e.g., 1000, 500 or 200 shares for Nasdaq National Market issues and 500 or 100 shares for Nasdaq SmallCap Market issues) (''Mandatory Quote Size Requirement'').

[12] *See* Actual Size Approval Order, supra note 8, 62 FR at 2425.

[13] *Id.* 62 FR at 243.

[14] *Id.* 62 FR at 2424.

liquidity and volatility, the Commission originally determined to approve the rule on a three-month pilot basis to afford the Commission and the NASD an opportunity to gain practical experience with the rule and evaluate its effects. The factors identified by the Commission to be considered in this evaluation include, among others, the impact of reduced quotation sizes on liquity, volatility and question spreads.[15]

As detailed below, the NASD has concluded that implementation of the SEC's Order Execution Rules has significantly improved the quality of the Nasdaq market by creating a market structure where customer limit provide liquidity and effectively compete with market maker quotations. In this type of environment, the NASD believes the regulatory necessity for the Mandatory Quote Size Requirements no longer exists. Accordingly, the NASD is proposing to extend the pilot of the Actual Size Rule until July 18, 1997.

2. Economic Analysis of the Actual Size Rule[16]

Research conducted by the NASD's Economic Research Department indicates three general findings concerning implementation of the SEC's Order Execution Rules and the Actual Size Rule: (1) The SEC's Order Execution Rules have dramatically improved the quality of the Nasdaq market, particularly with respect to the size of quoted spreads; (2) among those securities subject to the SEC's Order Execution Rules, there is no appreciable difference in market quality between those securities subject to the Actual Size Rule and those securities subject to Mandatory Quote Size Requirements;[17] and (3) implementation of the Actual Size Rule has not resulted in any significant diminution of the ability of investors to receive automated executions through SOES, SelectNet, or proprietary systems operated by broker-dealers. Accordingly, as the case with 100-share minimum quotation size requirements applicable to exchange specialists in order-driven markets, the NASD believes the Actual Size Rule has not harmed investors or the quality of the Nasdaq market.

While some market participants may maintain that the Actual Size Rule should be abandoned because it has not had a demonstrably positive market impact, the NASD believes that the Rule should be retained because it eliminates an unnecessary regulatory requirement and, moreover, it has not had any adverse market impacts. In particular, with respect to the first fifty securities, the NASD believes that competitive forces in the marketplace, be they the result of displaying customer limit orders or market maker competition for order flow, have driven the Nasdaq market to perform the same as of the artifical 1,000 share minimum quotation size requirement was in place.[18] As a result, given that the market performs the same with or without the Actual Size Rule, the NASD believes it is far preferable for the protection of investors and the efficiency of the capital formation process to promote a regulatory environment for Nasdaq that achieves its results through aggressive competition rather than artificial regulatory fiat. In sum. in light of the performance of the first fifty securities, the NASD believes there is no regulatory basis to justify the retention of artificial quotation size requirements for Nasdaq market makers.

a. Implementation of the SEC's Order Execution Rules Has Resulted in Significant Benefits to Investors and Enhanced the Quality of the Nasdaq Market.

The NASD's analysis of the markets for the first 150 Nasdaq securities subject to the SEC's Order Execution Rules shows that:[19]

- Quoted spreads have narrowed 32.3%;[20] effective spreads have narrowed 24.6%; and actual dollar spreads have narrowed 31.8%[21]
- Average dealer spreads have narrowed 3.8%.
- The amount of time the inside spread was equal to an ⅛ increased 104.9%, meaning that quoted spreads in these securities were equal to their narrowest quote increment 47.8% of the time. In addition, inside spreads were equal to or less than a ¼ 77.1% of the time.
- The average number of market makers per stock increased 5.6%, or 1.1 market makers per stock.
- The maximum quoted depth of any single market maker at the inside bid or offer increased 37.2%.
- There has been a noticeable increase in the number of quotation updates greater than 1,000 shares. In particular, whereas before implementation of the Actual Size Rule market makers virtually never displayed sizes greater than 1,000 shares, since the rule has been in effect, 6.3% of all market maker quote updates have been for greater than 1,000 shares.

b. The Market Behavior of the ''First Forty'' Securities is Very Similar to the Market Behavior of the ''Second Forty'' Securities.

While the data set forth above indicates that implementation of the SEC's Order Execution Rules have been associated with dramatically narrower spreads and improvements in other indicia of market quality, the NASD believes that the similar performance of the second forty securities to the first forty securities indicates that the Actual

[15] *See* 62 FR 2415 at 2425.

[16] *See* 62 FR 2415 at 2425.

[17] The first fifty securities include Nasdaq's top ten issues by dollar volume plus 40 issues chosen from Nasdaq's top 500 issues: 8 ranked between 11 and 1000; 8 ranked between 101 and 200; 8 ranked between 201 and 300; 8 ranked between 301 and 400; 8 ranked between 401 and 500. The second fifty securities include the ten Nasdaq stocks ranked between 11 and 20 by dollar volume plus 40 stocks chosen from Nasdaq's top 500 stocks in the same manner explained above. The ten largest Nasdaq stocks in the first fifty have no comparable peer group among Nasdaq stocks and the next ten largest Nasdaq stocks (i.e., Nasdaq stocks ranked 11–20 in size) included in the second fifty are also not comparable to the ''bottom 40'' within the first fifty stocks and the ''second forty'' stocks are those stocks that are the ''bottom 40'' within the second fifty stocks.

[18] Some market participants may assert that the lack of difference in performance between the first forty securities and the second forty is attributable to the operation of several features of SOES. Specifically, these market participants may claim that the SOES Auto-Refresh Feature, which refreshes a market quote to the applicable SOES tier size once its quote has been completely decremented, along with the ''No Decrementation'' and ''Supplemental Size'' feature of SOES, artificially increase the number of 1000-share quotes in the first fifty securities. The ''No Decrementation'' feature of SOES allows a market maker to provide that its quote shall not be decremented after the execution of SOES orders. To use this feature, a market maker's quote size must be equal to the applicable SOES tier size. The ''Supplemental Size'' feature of SOES allows a market maker to establish a ''supplemental size'' that is used to automatically replenish a market maker's quote once it has been completely decremented. When a market maker's quote is replenished from the supplemental size, it is replenished to 1000 shares. In order to use this feature, a market maker must initially enter a quote size equal to or greater than the applicable SOES tier size. The NASD notes that market maker use of each of these system features is completely voluntary and they are available for all Nasdaq securities. Accordingly, the NASD believes it would be inaccurate to assert that these SOES features have obfuscated the impact of the Actual Size Rule.

[19] Statistics concerning the first 150 Nasdaq securities subject to the Order Execution Rules reflect a comparison of the markets for these securities for the 20 trading days before January 20, 1997 and the 24 trading days after February 24, 1997.

[20] A *quoted spread* is the difference between the inside bid and ask. The individual dollar spreads used to calculate the average for a given stock are weighted by the amount of time each spread was in effect for the day, *i.e.*, the spread's duration.

[21] An *effective spread* is measured by taking the absolute difference between a transaction price and the bid-ask midpoint, multiplied by two. Each effective spread is weighted by the share volume of the associated transaction. An *actual spread* is measured by taking the transaction price minus the bid-ask midpoint for market maker sells, and the bid-ask midpoint minus the transaction price for market maker buys. The figure is multiplied by two to compare the quoted spread, and the average is volume-weighted.

Size Rule did not impair the markets for these securities. In particular, a comparison of the first forty securities and the second forty securities reveals that: [22]

- Dollar quoted spreads decreased 33.8% for the first forty securities and 33.7% for the second forty.
- Effective spreads decreased 26.6% for the first forty securities and 27.4% for the second forty.
- Actual dollar spreads decreased 30.5% for the first forty securities and 33% for the second forty.
- Dealer dollar spreads decreased 7.4% for the first forty securities and 4.9% for the second forty.
- The average number of market makers for the first forty securities increased 4.1% and the average for the second forty increased 2.7%.
- 10% of the quote updates by market makers in the first forty securities were for 100 shares, as compared to 5.7% for the second forty.
- 66.5% of the quote updates by market makers in the first forty securities were for 1,000 shares, as compared to 77.5% for the second forty.
- 6.0% of the quote updates by market makers in the first forty securities were for greater than 1,000 shares, as compared to 6.2% for the second forty.
- By one measure of market liquidity, the amount of transaction volume required to move the bid-ask midpoint (''BAM''),[23] liquidity for both groups of securities appears to have diminished at narrower price movements, but less so for larger price movements.[24] Specifically, the amount of stock needed to move the BAM 1⁄16 to an 1⁄8 decreased 26.5% for the first forty securities and 21.3% for the second forty. In addition, the amount of stock needed to move the BAM an 1⁄8 to a 1⁄4 decreased 11.7% for the first forty and 4.9% for the second forty. It is interesting to note, however, that the performance of the two groups begins to diverge for larger BAM movements. Specifically, the amount of stock needed to move the BAM 3⁄8 to a 1⁄2 increased .2% for the first forty, but decreased 4.5% for the second forty. Similarly, the amount of stock needed to move the BAM greater than a 1⁄2 increased 6.1% for the first forty, but decreased 1.1% for the second forty.
- By two measures, volatility in the first forty securities has declined since implementation of the Actual Size Rule. However, by two other measures volatility increased.[25] Specifically, for the first forty securities, the percentage change in the range of trade prices decreased 6.6% [26] and the percentage change in the standard deviation of trade prices declined .78%.[27] On the other hand, the percentage change in the range of the BAM increased 3.44% [28] and the percentage change in the standard deviation of the BAM increased 1.7%.[29] In comparison, for the second forty securities, the percentage change in the range of trade prices increased 8.5%; the percentage change in the standard deviation of trade prices increased 18.68%; the percentage change in the range of the BAM increased 24.52%; and the percentage change in the standard deviation of the BAM increased 25.82%. While it may appear that volatility did not increase in the first forty to the same extent that it did for the second forty, once differences in volume between the two groups are controlled or ''normalized,'' these apparent differences in volatility decline significantly.

c. Implementation of the Actual Size Rule Has Not Resulted in Any Diminution in the Ability of Investors To Receive Automated Executions Through SOES, SelectNet, or Other Proprietary Systems Operated by Broker Dealers.

The NASD believes that the following statistics indicate that implementation of the Actual Size Rule has not diminished the ability of small investors to receive automated executions through SOES up to the size of their SOES orders.[30]

- For the top ten Nasdaq stocks, 99% of SOES volume and 99% of SOES trades were executed at one price. Thus, for all but 1% of SOES orders, investors received SOES executions at the price and size they desired. Similarly, for the first forty securities, 98% of SOES volume and 98% of SOES trades received an execution at one price.
- For the top ten Nasdaq stocks, the aggregate depth of all market makers at the inside was less than 1,000 shares 2.7% of the time. Similarly, for the first forty securities, the aggregate depth of all market makers at the inside was less than 1,000 shares 7.85% of the time.
- For the top ten stocks, the aggregate depth of all market makers at the inside was less than 500 shares 1.6% of the time. Similarly, for the first forty securities, the aggregate depth of all market makers at the inside was less than 500 shares 4.3% of the time.

Moreover, SOES volume and SelectNet volume in the first fifty securities indicates that the Actual Size Rule has had no impact on the ability of investors to receive executions through SOES or SelectNet. In fact, as detailed below, volume in both these systems has increased since implementation of the Actual Size Rule.[31]

- The average daily share volume through SOES increased 1.08 million shares a day, or 8.8%.
- The average daily dollar volume through SOES increased $44.53 million a day, or 4.6%.
- The average daily share volume through SelectNet increased 5.29 million shares a day, or 176.8%.

[22] The comparison of the first forty securities and the second forty securities is based on an analysis of the 31 trading days after February 10, 1997.

[23] Under this analysis, volume is summed for each day until the BAM has moved away from the starting BAM (the ''base'') by a specific amount. Once this occurs, the base BAM is reassigned and volume is summed again until the bid-ask midpoint has moved again by the specified amount. For example, consider the calculation of ''Volume Per $.125 to $.25 Movement in the BAM.'' If the bid-ask midpoint is 20 for ABCD security at the beginning of the day, the algorithm will sum volume until the bid-ask midpoint has moved to at least $20.125 but less than $20.25, or at most $19.75 but at least $19.875. If such a movement should occur, the algorithm will note the total volume and use it as one observation in final calculations. Volume is defined as net volume transacted by market makers in a principle capacity with a non-market maker or another market maker acting as agent. All transactions in which two market makers trade as agent or two non-market makers trade are excluded from the calculations. If market makers (in aggregate) are net sellers (buyers) before an increase (decrease) in the BAM, then this occurrence is included in the above analysis. If, however, market makers are net sellers (buyers) before a decrease (increase) in the BAM, then this ''counter-intuitive'' occurrence is excluded from this analysis. ''Counter-intuitive'' cases accounted for about 35% of the total events analyzed.

[24] Because customer limit orders can now affect the inside market under the Display Rule, the NASD believes it would be expected that liquidity would decrease with respect to smaller price movements.

[25] In this connection, it is also important to note that volatility for stocks included in the top 1,000 Nasdaq stocks that were not subject to the Order Handling Rules increased as well. Specifically, the standard deviation of the BAM increased 12.8% for this group of stocks.

[26] *Range of the trade price* measures the range of price movement over a day as a percentage of the day's highest price. The calculation takes the difference between the day's highest transaction price and the day's lowest transaction price, divided by the highest transaction price.

[27] *Standard deviation of price* measures the ''bounce'' in trade price over the course of a day. Technically, it is the standard deviation of the logarithm of prices observed during a given day. The use of logarithms results in a measure that represents the volatility of price relative to the level of price.

[28] *Range of the Bid-Ask Midpoint* is calculated by taking the difference between the day's high value of the bid-ask midpoint minus the low value, divided by the high value.

[29] *Standard deviation of the Bid-Ask Midpoint* measures the ''bounce'' in the bid-ask midpoint over the course of a day. It uses the same calculation as the standard deviation of price, substituting the bid-ask midpoint for trade price.

[30] The statistics concerning SOES accessibility are based on the 20 trading days following February 10, 1997.

[31] The statistics concerning SOES volume and SelectNet volume are based on the 31 trading days following February 10, 1997.

• The average daily dollar volume through SelectNet increased $303.18 million a day, or 140.3%.

Finally, the NASD notes that several NASD members operate their own automated trading systems that guarantee execution of customer orders up to the applicable SOES tier size or greater. The NASD estimates that these systems accommodate a significantly large number of the customer accounts participating in the Nasdaq market. Based on an informal survey of several of these firms, the NASD is aware of no instances where a firm has significantly changed the execution guarantees provided through its automated execution system.

3. Statutory Basis

For the reasons noted above, the NASD believes the proposed rule change is consistent with Sections 11A(a)(1)(C), 15A(b)(6), 15A(b)(9), and 15A(b)(11) of the Exchange Act. Section 11A(a)(1)(C) provides that it is in the public interest to, among other things, assure the economically efficient execution of securities transactions and the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities. 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 Exchange Act. Section 15A(b)(11) requires the NASD to, among other things, formulate rules designed to produce fair and informative quotations.

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

The NASD believes that the proposed rule change will not result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

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

Comments were neither solicited nor received.

## III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. 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 such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by May 12, 1997.

## IV. Commission's Findings and Order Granting Accelerated Approval of the Proposed Rule Change

The Commission finds that the NASD's proposal is consistent with the Act and the rules and regulations thereunder applicable to a national securities association. Specifically, the Commission finds that the proposed rule change is consistent with Section 15A(b)(9) in that it permits Nasdaq market makers to quote in 100 share increments for an additional three months in a manner equivalent to exchange specialists. This has not resulted in significant reductions in Nasdaq market quality to date. In addition, consistent with Section 15A(b)(11), the Actual Size Rule is designed to produce accurate and informative quotations that disclose the true trading interest of the market maker.

The Commission approved the Actual Size Rule on a three-month pilot basis so that the effects of the rule could be assessed. The Commission continues to believe that a reduction in the quotation size requirement reduces the risks that market makers must take, and should encourage them to maintain competitive prices even in the changing market conditions resulting from the Order Execution Rules. Although the economic analysis from the NASD has not indicated any notable detrimental effects, the Commission believes that the proposed rule change will benefit the markets by providing more experience with the rule before a decision is made regarding permanent approval. Accordingly, the Commission believes that the pilot should be extended beyond the April 18, 1997 expiration date. The Commission, therefore, finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**.

The Commission requests that the NASD continue to evaluate the effects of the reduction in the minimum quotation size for those Nasdaq stocks included in the pilot.

Specifically, the NASD should continue its analysis of: (1) The number of market makers in each of the 50 securities, and any change in the number over time; (2) the average aggregate dealer and inside spread by stock over time; (3) the average spread for each market maker by stock; (4) the average depth by market maker (including limit orders), and any change in the depth over time; (5) the fraction of volume executed by a market maker who is at the inside quote per stock; and (6) a measure of volume required to move the price of each security one increment (to determine the overall liquidity and volatility in the market for each stock).

It is *therefore ordered*, pursuant to Section 19(b)(2) of the Exchange Act,[32] that the proposed rule change, SR–NASD–97–25, be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[33]

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 97–10222 Filed 4–18–97; 8:45 am]

**BILLING CODE 8010–01–M**

[32] 15 U.S.C. § 78s(b)(2) (1988).

[33] 17 CFR 200.30–3(a)(12) (1989).