

approved, Nasdaq would continue during the pilot period to require NASD members seeking to effect "legal" short sales when the current best (inside) bid displayed by Nasdaq is lower than the previous bid, to execute those short sales at a price that is at least \$0.01 above the current inside bid in that security. Nasdaq believes that continuation of this pilot standard appropriately takes into account the important investor protections provided by the short sale rule and the ongoing relationship of the valid short sale price amount to the minimum quotation increment of the Nasdaq market (currently also \$0.01).

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Act⁸ in that it is designed to: (1) Promote just and equitable principles of trade; (2) foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities; (3) perfect the mechanism of a free and open market and a national market system; and (4) protect investors and the public interest.

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

Nasdaq does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

Written comments were neither solicited nor received.

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

Because the foregoing proposed rule change does not:

- (i) Significantly affect the protection of investors or the public interest;
- (ii) Impose any significant burden on competition; and
- (iii) Become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, it has become effective pursuant to section 19(b)(3)(A) of the Act⁹ and Rule 19b-4(f)(6) thereunder.¹⁰

filed to extend the short sale pilot until April 15, 2002.

⁸ 15 U.S.C. 78o-3(b)(6).

⁹ 15 U.S.C. 78s(b)(3)(A).

¹⁰ 17 CFR 240.19b-4(f)(6).

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

Nasdaq has requested the Commission waive both the 5-day notice and 30-day pre-operative requirements contained in Rule 19b-4(f)(6)¹¹ and has requested that the Commission accelerate the operative date. The Commission finds good cause to waive both the 5-day notice and 30-day pre-operative requirements because the extension of the pilot is consistent with the protection of investors and the public interest. Acceleration of the operative date will allow the pilot to continue uninterrupted through April 15, 2002, the deadline for which self-regulatory organizations must file proposed rule changes to set the minimum price variation for quoting in a decimals environment. For these reasons, the Commission finds good cause to waive both the 5-day notice and 30-day pre-operative requirements.¹²

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of Nasdaq. All submissions should refer to file number SR-NASD-2002-30 and should be submitted by April 1, 2002.

¹¹ *Id.*

¹² For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Jill M. Peterson,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45506; File No. SR-NASD-2002-18]

Self Regulatory Organizations; Notice of Filing of a Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to Member Transaction Fees

March 5, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b4 thereunder,² notice is hereby given that on February 5, 2002, the National Association of Securities Dealers, Inc. ("NASD") through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq") 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 Nasdaq. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

In order to encourage NASD members to report their trades through Nasdaq, Nasdaq is proposing to charge lower transaction fees to market participants that use Nasdaq as their market of choice for trade reporting, while charging higher fees to market participants that avail themselves of Nasdaq's quotation montage or make limited use of its transaction execution systems but elect to report trades through other facilities.³ Nasdaq

¹³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b4.

³ Nasdaq believes that this proposed rule change establishes or changes a due, fee, or other charge imposed by a self-regulatory organization and conceivably could be designated as immediately effective under Section 19(b)(3)(A) of the Act, 15 U.S.C. 78s(b)(3)(A). After discussions with Commission staff, Nasdaq determined that the proposed rule change should be filed under Section 19(b)(2), 15 U.S.C. 78s(b)(2), to provide an opportunity for a more extensive comment process. If the Commission approves this filing, however, Nasdaq reserves the right to file future modifications to the pricing structure proposed

requests that the Commission approve the proposal as an amendment to certain provisions of Nasdaq's pricing structure that are currently in effect on a pilot basis until October 31, 2002, with the proposal taking effect on the first day of the month immediately following approval by the Commission.⁴ The text of the proposed rule change is set forth below. Proposed new language is in italics; proposed deletions are in brackets.

* * * * *

7010. System Services

(a)(1) No change.

(2) Market Data Revenue Sharing

(A) For a pilot period lasting until October 31, 2002, [NASD members] *Full Contribution Members* (as defined in Rule 7010(i)(2)) shall receive a market data revenue sharing credit. The total credit shall be calculated in accordance with the following formula:

$$\text{Credit} = (0.80) \times (\text{Eligible Revenue}) \times (\text{Member's Volume Percentage})$$

(B) Definitions. The following definitions shall apply to this Rule:

(i) "Eligible Revenue" shall mean:

a. The portion of the net distributable revenues that Nasdaq, through the NASD, is eligible to receive under the Nasdaq UTP Plan, that is attributed to the Nasdaq Level 1 Service for Eligible Securities, minus

b. The portion of the fee charged to Nasdaq by NASD Regulation, Inc. for regulatory services allocated to the Nasdaq Level 1 Service for Eligible Securities.

(ii) "Eligible Securities" shall mean all Nasdaq National Market securities and any other security that meets the definition of "Eligible Security" in the Nasdaq UTP Plan.

(iii) "Member's Volume Percentage" shall mean the average of:

a. The percentage derived from dividing the total number of trades in Eligible Securities that the member reports in accordance with NASD trade reporting rules to the Automated Confirmation Transaction Service ("ACT") by the total number of trades in Eligible Securities reported to ACT by NASD members, and

b. The percentage derived from dividing the total number of shares

herein under Section 19(b)(3)(A). See discussion *infra* at n.8.

⁴ It should be noted that Nasdaq will file a new pricing structure for its SuperMontage system, which is expected to become operational later this year, and that the new pricing structure will replace the current pricing structure for the Nasdaq National Market Execution System (the "NNMS" or "SuperSOES") and SelectNet systems, including pricing pilots that are in effect. Certain aspects of the new pricing structure, however, may resemble the current structure.

represented by trades in Eligible Securities that the member reports in accordance with NASD trade reporting rules to ACT by the total number of shares represented by all trades in Eligible Securities reported to ACT by NASD members.

(iv) "Nasdaq UTP Plan" shall mean the Joint Self-Regulatory Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privilege Basis.

(b)-(h) No change.

(i) Transaction Execution Services

(1) No change.

(2) Nasdaq National Market Execution System (SuperSoes)⁵

(A) The following charges shall apply to the use of the Nasdaq National Market Execution System:

Order Entry Charge—\$0.10 per order entry (entering party only)

Per Share Charge—\$0.001 per share executed for all fully or partially executed orders (entering party only)

Cancellation Fee—\$0.25 per order cancelled (canceling party only)

(B)(i) For a pilot period [commencing on November 1, 2001 and] lasting until October 31, 2002, the per share charge will be [\$0.002 per share executed for all fully or partially executed orders (entering party only).] *determined as follows:*

Full Contribution Members: \$0.002 per share executed for all fully or partially executed orders (entering party only)

Partial Contribution Members: \$0.0025 per share executed for all fully or partially executed orders (entering party only)

(ii) *Definitions. The following definitions shall apply to this Rule:*

a. *"Full Contribution Member" shall mean an NASD member whose Reporting Percentage was at least 95%*

⁵ In Securities Exchange Act Release No. 44391 (Oct. 12, 2001), 66 FR 53276 (Oct. 19, 2001) (SR-NASD-2001-72), Nasdaq has proposed amending NASD Rule 7010(i)(2) to include a definition of "Participating UTP Exchange" and to set the price for trade executions through the NNMS by Participating UTP Exchanges at \$0.003 per share. Nasdaq proposed to define "Participating UTP Exchange" as any registered national securities exchange that has unlisted trading privileges (a "UTP Exchange") in Nasdaq-listed securities pursuant to the Joint Self-Regulatory Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on an Unlisted Trading Privilege Basis (the "Nasdaq UTP Plan" or the "Plan") and that elects to participate in the NNMS. Nasdaq represents that depending on the order in which SR-NASD-2001-72 and this filing are approved, it will submit conforming amendments either to SR-NASD-2001-72 or to this filing to reflect the approval of the other filing.

in the preceding month. Nasdaq will request that a member submit data demonstrating that it satisfies the definition of a Full Contribution Member if Nasdaq needs such data to determine whether a member is a Full Contribution Member. Nasdaq will deem a member that fails to submit such data upon request to be a Partial Contribution Member.

b. *"Partial Contribution Member" shall mean an NASD member whose Reporting Percentage was less than 95% in the preceding calendar month.*

c. *"Reporting Percentage" shall mean the average of:*

(I) *the percentage derived from dividing the total number of trades in Eligible Securities (as defined in NASD Rule 7010(a)(2)(B)) that a member reports in accordance with NASD trade reporting rules to the Automated Confirmation Transaction Service ("ACT") by the total number of trades in Eligible Securities that such member reports to all self-regulatory organizations and securities information processors, and*

(II) *the percentage derived from dividing the total number of shares represented by trades in Eligible Securities that such member reports in accordance with NASD trade reporting rules to ACT by the total number of shares represented by all trades in Eligible Securities that such member reports to all self-regulatory organizations and securities information processors.*

If Nasdaq determines that a member is causing a significant percentage of trades to be reported through an affiliate primarily for the purpose of maintaining its Reporting Percentage above 95%, Nasdaq will consider trades reported through such affiliate to be trades reported by the member for purposes of calculating the Reporting Percentage.

(3)-(4) No change.

(5) Quotation Updates

(A) Except as provided in subparagraph (B), for a pilot period [commencing on February 1, 2002 and] lasting until October 31, 2002, a fee of \$0.01 per quotation update will be charged to [NASD members] *Full Contribution Members* that post quotations in the Nasdaq quotation montage, and a fee of \$0.02 per quotation update will be charged to *Partial Contribution Members* that post quotations in the Nasdaq quotation montage. A "quotation update" includes any change to the price or size of a displayed quotation or reserve size.

(B) A quotation update fee will not be charged for a change in the displayed quotation or reserve size that is performed automatically by the Nasdaq

National Market Execution System ("NNMS") when an execution against the quotation occurs (other than a change performed by the "Autoquote Refresh" functionality of the NNMS, for which a fee will be assessed).

(j)–(p) 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, Nasdaq 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. Nasdaq 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. Purpose

On September 28, 2001, Nasdaq filed proposed rule changes to make modifications to the pricing structure for the NNMS and SelectNet service.⁶ Nasdaq designed these changes as an interim modification to begin the process of aligning the charges to market participants for using the NNMS and SelectNet more closely with the costs of providing these services and the benefits that they provide to market participants. On October 4, 2001, Nasdaq filed additional rule changes to increase the per share charge for use of the NNMS and introduce a liquidity provider rebate for NASD members.⁷

On October 9, 2001, Nasdaq filed a proposed rule change—SR–NASD–2001–71—to introduce a mechanism for sharing market data revenue with NASD members, to introduce a quotation update charge, and to modify the fees for use of the NNMS and the liquidity provider rebate in order to calibrate the level of fees and rebates to the contributions that types of members make to the support of the Nasdaq

market.⁸ On November 29, 2001, after discussions with Commission staff, Nasdaq withdrew SR–NASD–2001–71 prior to the date scheduled for its implementation, December 1, 2001, to allow Nasdaq to make adjustments to the mechanism for market data revenue sharing and the quotation update charge, and to provide interested persons with a greater opportunity to comment on aspects of the proposal concerning differentiation among members. On December 27, 2001, Nasdaq refiled a proposal to introduce a quote update fee and market data revenue sharing program.⁹

In this filing, Nasdaq is offering incentives to market participants that support Nasdaq operations through trade reporting. The proposal delineates two types of members. A "Full Contribution Member" is defined as an NASD member that reports at least 95% of the trades that it reports through the Automated Confirmation Transaction System ("ACT"), Nasdaq's trade reporting system, either directly or as a result of an execution through a Nasdaq transaction execution system. The percentage would be measured with reference to both the total number of trades and the total number of shares represented by those trades. All other NASD members will be considered "Partial Contribution Members" under the proposal.

A member's status will be evaluated on a monthly basis, with reference to trade reporting activity during the preceding month. Nasdaq will request that a member submit data demonstrating that it satisfies the definition of a Full Contribution Member if it needs such data to determine the status of a particular member, and will deem a member that fails to submit such data upon request to be a Partial Contribution Member.¹⁰ In addition, if Nasdaq determines that a member is causing a significant percentage of trades to be reported through an affiliate (i.e. a person that

controls, is controlled by, or is under common control with a member) primarily for the purpose of maintaining its Reporting Percentage above 95%, Nasdaq will consider trades reported through such affiliate to be trades reported by the member for purposes of calculating the Reporting Percentage. This flexibility in the application of the rule is necessary to ensure that a member does not evade the intent of the rule by conducting non-Nasdaq business through an affiliate while retaining its own status as a Full Contribution Member for the business that it does conduct through Nasdaq.

The per share charge for the execution of orders in the NNMS will remain \$0.002 per share for Full Contribution Members, while Partial Contribution Members will pay \$0.0025 per share.¹¹ Nasdaq's new quotation update fee, which went into effect on February 1, 2002, will remain \$0.01 per quotation update for Full Contribution Members but will be increased to \$0.02 per update for Partial Contribution Members.¹² Finally, Nasdaq's new market data revenue sharing program, which also went into effect on February 1, 2002, will be modified to make it available only to Full Contribution Members.

Nasdaq represents that it is proposing these changes to its pricing structure in order to meet the competitive challenges posed by UTP Exchanges. From 1986 until 1999, only the Chicago Stock Exchange, Inc. ("CHX") traded Nasdaq-listed securities pursuant to the Nasdaq UTP Plan, and only on a very limited scale. In late 1999 and early 2000, however, trading volumes in Nasdaq securities expanded dramatically. As a result, five additional exchanges—the Cincinnati Stock Exchange, Inc. ("CSE"), the Philadelphia Stock Exchange, Inc. ("Phlx"), the Pacific Exchange, Inc. ("PCX"), the American Stock Exchange LLC ("AMEX"), and the Boston Stock Exchange, Inc. ("BSE")—have commenced, or announced their intention to commence, trading of

⁶ See Securities Exchange Act Release No. 44899 (Oct. 2, 2001), 66 FR 51707 (Oct. 10, 2001) (SR–NASD–2001–63); Securities Exchange Act Release No. 44898 (Oct. 2, 2001), 66 FR 51703 (Oct. 10, 2001) (SR–NASD–2001–64).

⁷ See Securities Exchange Act Release No. 44914 (Oct. 9, 2001), 66 FR 52649 (Oct. 16, 2001) (SR–NASD–2001–68); Securities Exchange Act Release No. 44910 (Oct. 5, 2001), 66 FR 52167 (Oct. 12, 2001) (SR–NASD–2001–67).

⁸ See Securities Exchange Act Release No. 45342 (Jan. 28, 2002), 67 FR 5109 (Feb. 1, 2002) (SR–NASD–2001–96). The proposal was effective upon filing and was implemented on February 1, 2002.

⁹ To eliminate any administrative burdens associated with verification of a member's status, a member could authorize the NASD to certify its status to Nasdaq on the basis of Order Audit Trail System ("OATS") data. Nasdaq, however, would not have access to the member's OATS data.

¹¹ In SR–NASD–2001–72, Nasdaq proposed amending NASD Rule 7010(i)(2) to provide that Participating UTP Exchanges will pay \$0.003 per share for NNMS executions. Nasdaq proposed to define a "Participating UTP Exchange" as any UTP Exchange that elects to participate in the NNMS. Other UTP Exchanges access the Nasdaq market through telephone linkages and therefore are not assessed charges for the use of Nasdaq transaction execution systems. Depending on the order in which SR–NASD–2001–72 and this filing are approved, Nasdaq will submit conforming amendments either to SR–NASD–2001–72 or to this filing to reflect the approval of the other filing.

¹² However, quote updates that are performed automatically by SuperSOES as the result of trade executions would continue to be free for all members.

Nasdaq-listed securities pursuant to unlisted trading privileges. Moreover, some UTP Exchanges are aggressively pursuing the trade reporting revenue associated with internalized trades and trades conducted through the facilities of electronic communications networks. Nasdaq has every intention of being an active participant in the competition for trade execution and reporting.

Nasdaq represents that self-regulatory organization pricing structures routinely distinguish among members on the basis of level of usage of a particular system. For example, Nasdaq's current pricing for liability orders executed through its SelectNet service charges \$0.90 per order for the first 25,000 orders that a member executes during a month, but only \$0.60 for the next 25,000, and \$0.10 for the next 200,000, with all remaining orders being free. Thus, a member that conducts a great deal of business through SelectNet will pay a lower per order charge than a member that conducts relatively little business.

Similarly, the distinction between Full Contribution Members and Partial Contribution Members recognizes that although most members are well-integrated into Nasdaq's market structure and would therefore be considered Full Contribution Members, other members may choose not to use Nasdaq as their market of first choice for trade reporting. For example, a member may use Nasdaq's quotation montage to advertise available liquidity, but the quote may be accessed through non-Nasdaq systems and reported to a UTP Exchange. Nasdaq believes that it must ensure that the capacity of its quotation engine is adequate to support the member's quotation activity and it must finance the regulatory infrastructure that oversees the member's activities on Nasdaq and the market in general, but it would receive proportionately less revenue from the member than from a comparable member that reported trades through ACT. Accordingly, when a Partial Contribution Member chooses to use Nasdaq systems for quotation or trade execution, Nasdaq believes that it should be permitted to assess a higher charge than it does on a Full Contribution Member. The distinction between types of members is comparable to any other pricing structure that offers lower prices to regular users of a service but charges higher prices to less regular users. Unlike a system of volume-based discounts, however, the proposal would not disadvantage small firms that report most of their trades through Nasdaq but do not achieve a high volume.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the Act, including section 15A(b)(5) of the Act,¹³ which requires that the rules of the NASD provide for the equitable allocation of reasonable fees, dues, and other charges among members and issuers and other persons using any facility or system which the NASD operates or controls, and section 15A(b)(6) of the Act,¹⁴ which requires rules that are not designed to permit unfair discrimination between customers, issuers, brokers or dealers. In Nasdaq's view, these provisions require Nasdaq to establish prices that provide similar treatment to similarly situated members; they do not require Nasdaq to provide identical treatment to all market participants without regard to their level of participation in the market.

As the Commission has noted in the context of another self-regulatory organization's fees, the Act "prohibits 'unfair discrimination,' not 'discrimination' simpliciter * * *".¹⁵ Nasdaq believes that the proposed fee structure distinguishes among market participants in order to reward those who do the most to finance market innovations such as SuperSOES and who contribute the most to the liquidity and efficient operation of Nasdaq's market, while imposing higher fees on market participants that receive the benefits of posting quotations on Nasdaq systems but pay relatively little to support the operation of those systems. Thus, the economic incentives embodied by the new fee structure are designed to promote behavior that benefits both the market structure that Nasdaq offers to investors and Nasdaq as a business. As another self-regulatory organization noted when it established a credit available only to certain of its market participants, "measures * * * designed to promote and encourage certain behaviors and/or discourage others * * * [are] an appropriate, nondiscriminatory business strategy."¹⁶

Moreover, Nasdaq believes that the level of fees charged to market participants under the proposal is reasonable. By definition, a Partial Contribution Member will make less use of Nasdaq systems than a Full Contribution Member. Accordingly, assessing higher fees on the former will

not result in the member paying unreasonably high fees for the services that it does obtain from Nasdaq.

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

Nasdaq does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. Nasdaq believes that the proposal is designed as a reasonable response to the competitive challenges posed by UTP Exchanges. UTP Exchanges are actively seeking to encourage market participants to report trades in Nasdaq securities through their facilities. In order to remain competitive, Nasdaq believes that it must create incentives for market participants to report trades through Nasdaq.

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

The Commission received a number of comment letters that referenced SR-NASD-2001-71, a proposed rule change that contained a proposal similar to the proposal contained in this filing but that was withdrawn prior to its implementation. SR-NASD-2001-71 was withdrawn for the specific purpose of allowing interested persons a greater opportunity to comment on the proposal in isolation from other changes to Nasdaq's pricing structure that were filed with SR-NASD-2001-71 and in other contemporaneous filings relating to Nasdaq fees. Accordingly, Nasdaq proposes to respond to any written comments received on the proposed rule change contained herein after the proposed rule change has been published for comment and the comment period has expired. Nasdaq did not solicit or receive written comments on the proposed rule change contained herein.

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.

¹³ 15 U.S.C. 78o-3(b)(5).

¹⁴ 15 U.S.C. 78o-3(b)(6).

¹⁵ Securities Exchange Act Release No. 37250 (May 29, 1996), 61 FR 28629 (June 5, 1996) (SR-CBOE-96-23) (quoting *Timpinaro v. SEC*, 2 F.3d 453, 456 (D.C. Cir. 1993)).

¹⁶ Securities Exchange Act Release No. 44292 (May 11, 2001), 66 FR 27715 (May 18, 2001) (SR-Phlx-2001-49).

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-2002-18 and should be submitted by April 1, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Jill M. Peterson,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45499, File No. SR-NASD-98-26 Amend. No. 12]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Order Granting Accelerated Approval to Amendment No. 12 to a Proposed Rule Change Relating to an Extension of the NASD Short Sale Rule and Continued Suspension of Primary Market Maker Standards Set Forth in NASD Rule 4612

March 4, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ notice is hereby given that on February 28, 2002, the National Association of Securities Dealers, Inc., through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq") filed with the Securities and Exchange Commission ("Commission" or "SEC")

the proposed rule change as described in Items I and II below, which Items have been prepared by Nasdaq. 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

Nasdaq is proposing to extend the pilot program of the NASD short sale rule ("Rule 3350") from March 1, 2002 until December 15, 2002. Nasdaq is also seeking to continue the suspension of the effectiveness of the Primary Market Maker ("PMM") standards currently set forth in NASD Rule 4162 also from March 1, 2002 until December 15, 2002. The text of the proposed rule change is as follows. Additions are italicized; deletions are bracketed.

NASD Rule 3350

* * * * *

(l) This section shall be in effect until December 15, 2002 [March 1, 2002].

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

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

A. Background and Description of the NASD's Short Sale Rule

Section 10(a) of the Act gives the Commission plenary authority to regulate short sales of securities registered on a national securities exchange, as needed to protect investors. Although the Commission has regulated short sales since 1938, that regulation has been limited to short sales of exchange-listed securities. In 1992, Nasdaq, believing that short-sale regulation is important to the orderly operation of securities markets, proposed a short sale rule for trading of its National Market securities that incorporates the protections provided by Rule 10a-1 under the Act. On June 29, 1994, the SEC approved Rule 3350 applicable to short sales² in Nasdaq

² A short sale is a sale of a security that the seller does not own or any sale that is consummated by the delivery of a security borrowed by, or for the account of, the seller. To determine whether a sale is a short sale members must adhere to the definition of a "short sale" contained in Rule 3b-

National Market ("NNM") securities on an eighteen-month pilot basis through March 5, 1996.³ The NASD and the Commission have extended Rule 3350 numerous times, most recently, until March 1, 2002. Rule 3350 employs a "bid" test rather than a tick test because Nasdaq trades are not necessarily reported to the tape in chronological order. The Rule prohibits short sales at or below the inside bid when the current inside bid is below the previous inside bid. Nasdaq calculates the inside bid from all market makers in the security (including bids for exchanges trading Nasdaq securities on an unlisted trading privileges basis), and disseminates symbols to denote whether the current inside bid is an "up-bid" or a "down-bid." To effect a "legal" short sale on a down-bid, the short sale must be executed at a price at least \$.01 above the current inside bid. Rule 3350 is in effect from 9:30 a.m. until 4 p.m. each trading day.

To reduce the compliance burdens on its members, Rule 3350 also incorporates seven exemptions contained in Rule 10a-1 under the Act, that are relevant to trading on Nasdaq.⁴ For example, in an effort to not constrain the legitimate hedging needs of options market makers, Rule 3350 also contains a limited exception for standardized options market makers. The Rule also contains an exemption for warrant market makers similar to the one available for options market makers.

B. Background of the Primary Market Maker Standards

To ensure that market maker activities that provide liquidity and continuity to the market are not adversely constrained when the Rule is invoked, Rule 3350 provides an exemption for "qualified" Nasdaq market makers (*i.e.*, market makers that meet the PMM standards). Presently, NASD Rule 4612 provides

3 under the Act, which is incorporated into Nasdaq's short sale rule by NASD Rule 3350(k)(1).

³ See Securities Exchange Act Release No. 34277 (June 29, 1994), 59 FR 34885 (July 7, 1994) ("Short Sale Rule Approval Order").

⁴ See NASD Rule 3350(c)(2)-(8). The Rule also provides that a member not currently registered as a Nasdaq market maker in a security that has acquired the security while acting in the capacity of a block positioner shall be deemed to own such security for the purposes of the Rule notwithstanding that such member may not have a net long position in such security if and to the extent that such member's short position in such security is subject to one or more offsetting positions created in the course of bona fide arbitrage, risk arbitrage, or bona fide hedge activities. In addition, the NASD has recognized that SEC staff interpretations to Rule 10a-1 under the Act dealing with the liquidation of index arbitrage positions and an "international equalizing exemption" are equally applicable to the NASD's short sale rule.

¹⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).