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NASD FILES PROPOSED RULE CHANGE TO MODIFY SOES AND SELECTNET AND REOPENS COMMENT PERIOD ON LIMIT ORDER BOOK PROPOSAL

[10941] April 29, 1999 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 12-99 RE: NASD FILES PROPOSED RULE CHANGE TO MODIFY SOES AND SELECTNET AND REOPENS COMMENT PERIOD ON LIMIT ORDER BOOK PROPOSAL

____ The National Association of Securities Dealers, Inc. ("NASD"), through its wholly-owned subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), has filed with the Securities and Exchange Commission ("SEC") a proposed rule change (attached) to modify its Small Order Execution System ("SOES") and SelectNet service. The resulting new system will be referred to as the Nasdaq National Market Execution System ("NNMS"). In addition, the SEC has reopened the comment period for Nasdaq's limit order book proposal and is requesting additional comments on the proposal. The more significant aspects of the proposals are discussed below. Modifications to SOES/SelectNet The proposed rule change is intended to address the problem of potential "dual liability" for a market maker's displayed quote. According to Nasdaq, multiple access points to a market maker's quote, through a combination of SOES and SelectNet, as well as through a firm's internal order receipt/execution and telephone access facilities, can subject market makers to dual liability for orders that reach their quote at or near the same time through different systems. To address this, Nasdaq is proposing several modifications to its negotiation and automatic execution systems. Under the proposals, SelectNet would be re-established as a non-liability, order delivery and negotiation system for Nasdaq National Market ("NNM") securities. In particular, the use of SelectNet for the entry of any preferenced orders directed to market makers in NNM securities would be prohibited unless these orders are at least one normal unit of trading (i.e., 100 shares) in excess of the displayed amount of the NNMS market maker's quote to which they are directed ("over-sized order requirement"). In addition, these orders must also be designated as either "All-or-None" of a size that is at least 100 shares greater than the displayed amount of the NNMS market maker's quote to which the order is directed, or as a "Minimum Acceptable Quantity" order with a value of at least 100 shares greater than the displayed amount of the NNMS market maker's quote to which the order is directed. SelectNet will be programmed to reject preferenced messages violating this requirement. In addition, SOES would be modified for the trading of NNM securities through several changes. First, the maximum order size for NNM securities entered into NNMS will be increased to 9,900 shares from current order size maximums. Second, market makers will be allowed to use NNMS on a proprietary basis, including being able to obtain automatic execution for orders sent to other NNMS participants, when trading NNM securities. Third, the current 17-second interval delay between automatic executions against the same market maker will be reduced to 5 seconds in NNMS. Fourth, Nasdaq will design NNMS to permit interaction of orders against a market maker's "reserve size" 1Nasdaq recently filed a proposal with the SEC that would permit the separate display of customer orders by market makers in Nasdaq through a market maker agency identification symbol ("Agency Quote"). The SEC has extended the comment period for that proposal until June 1, 1999. A copy of the proposal will be sent to the Equity Markets Advisory Committee under separate cover. (including a market maker's posted agency quote) after yielding priority to displayed quotes at the same price. According to Nasdaq, these changes will ensure that market makers are not subject to potential dual liability as the result of the duplicative receipt of liability orders through separate systems. The proposals also would implement several other changes, including additional requirements for the use of NNMS’s reserve size functionality and the elimination of the No Decrementation (“NO DEC”) feature and the existing SOES preferencing feature for NNM securities. Solicitation of Comments Nasdaq views the proposed modifications to SOES and SelectNet, as well as its proposal for the separate display of agency quotes,1 as interim measures pending SEC action on its limit order book proposal. In the release proposing the SOES/SelectNet rule changes, the SEC acknowledges that both the SOES/SelectNet modifications and the agency quote proposal could modify the Nasdaq market in ways that some may consider less desirable than the results of a proposed limit order book. The SEC states, however, that because these proposals are largely alternatives to each other, market participants should have the chance to formally comment on the limit order book proposal in light of the SOES/SelectNet and agency quote proposals. The SEC therefore is formally reopening the comment period on the limit order book proposal. In particular, the SEC requests comment on whether the limit order book proposal should be approved on a pilot basis and if so, how a pilot program should be structured. In addition, the SEC requests comment on whether the pilot program should include a limited number of securities across a range of the NNM market or securities representing a substantial portion of the trading market. For example, should the pilot include 250 securities, of which 20 were from the Nasdaq top 100 securities and the rest chosen from different quintiles of NNM securities? Or, should the pilot comprise 1000 securities including the Nasdaq top 100 securities, with the remainder chosen from quintiles of NNM securities? Finally, the SEC requests comment on how long a pilot program should last, i.e., would six months, or one year, provide sufficient information to evaluate a pilot program and would a pilot program of this length and breadth potentially harm the Nasdaq market on a lasting basis? Comments on this proposal are due to the SEC no later than June 1, 1999. If you have any comments you would like the Institute to consider including in a comment letter, please provide them to Ari Burstein by phone at (202) 371-5408, by fax at (202) 326-5841, or by e-mail at aburstein@ici.org no later than May 14. Ari Burstein Assistant Counsel Attachment

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