

MEMO# 11073

June 24, 1999

NASD FILES PROPOSED RULE CHANGE RELATING TO LOCKED AND CROSSED MARKETS

1 Securities Exchange Act Release No. 41473 (June 2, 1999), 64 FR 31335 (June 10, 1999). Comments on this proposal are due to the SEC no later than July 1, 1999. 2 All times referred to in this memo are Eastern Time. 1 [11073] June 24, 1999 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 23-99 RE: NASD FILES PROPOSED RULE CHANGE RELATING TO LOCKED AND CROSSED MARKETS

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 alter the obligations regarding locked and crossed markets that occur prior to the market's open.¹ Currently, NASD rules provide that if a market participant enters a quote at or after 9:25 a.m.² that would lock/cross the market on the open, the locking/crossing market participant must take action when the market opens, but in no case later than 9:30:30 a.m., to unlock/uncross the market. The proposed rule change states that, under the current rule, however, locks/crosses still occur at the open because the passively locked/crossed market participant may not respond immediately to the action taken by the locking/crossing market participant. To address these and other concerns with locked and crossed markets, Nasdaq is proposing several amendments to its rules. In general, the proposed amendments provide that if a market participant is a party to a locked/crossed market prior to the open, beginning at 9:20 a.m., the market participant has the right to send the other parties to the lock/cross a SelectNet message ("Trade-or-Move Message"), to which the receiving market participant(s) must respond within 30 seconds by either: (1) trading with the message for the full size of the message; or (2) moving its quotation to a price level that unlocks or uncrosses the market. Locks/Crosses Occurring At or After 9:20 a.m. and Before 9:30 a.m. If a market participant locks/crosses the market between 9:20 a.m. and 9:29:59 a.m., the market participant would be required to send, prior to or immediately after entering a locking/crossing quotation, a Trade-or-Move Message(s) that was for at least an aggregate size of 5,000 shares to the party or parties that the market participant is locking/crossing. The receiving market participant will then be required to trade in full with the incoming message within 30 seconds or move its quote out of the way within 30 seconds. ³ The proposed rule change states that Nasdaq believes that the 9:20 a.m. benchmark establishes a reasonable point in time for when market participants should be actively monitoring their quotes, responding to incoming Trade-or-Move Messages, and monitoring prospectively for whether they are the actively locking/crossing market participants in the market and therefore required to send out a Trade-or-Move Message for

at least an aggregate of 5,000 shares. 2 If the receiving market participant trades in full with the message, the market participant may maintain its locked/crossed quotes and not move if it wishes to trade more shares. Thereafter, any party to the lock/cross would have the right, but not the obligation, to send a Trade-or-Move Message to any other party to the lock/cross, and any party to the lock/cross that receives a Trade-or-Move Message would then have the obligation to trade or move within 30 seconds. Locks/Crosses Prior to 9:20 a.m. For locks/crosses that occur prior to 9:20 a.m., any party to a lock/cross would have the right, but not the obligation, beginning at 9:20 a.m., to send a Trade-or-Move Message of any size to any party to the lock/cross. Any party to the lock/cross that receives a Trade-or-Move Message would have the obligation, beginning at 9:20 a.m., to trade or move within 30 seconds. Unlike locks/crosses that occur at or after 9:20 a.m., however, there is no requirement that the locking/crossing market participant send a specific number of shares to the parties to the lock/cross. According to the proposed rule change, the rationale for this distinction is that it is often difficult to determine which party actively locked/crossed the market in the period prior to 9:20 a.m. because market participants often do not actively monitor their quotes prior to that time. The proposed rule change also states that this is the reason why, under the proposed rule, the obligations and rights of the parties to the lock/cross do not start until 9:20 a.m.³ Ari Burstein Assistant Counsel
Attachment