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SEC APPROVES PROPOSAL TO MODIFY NASD SMALL ORDER EXECUTION SYSTEM AND SELECTNET SERVICE

1 Securities Exchange Act Release No. 42344 (January 14, 2000), 65 FR 3987 (January 25, 2000). 2 SOES currently permits the automatic execution of retail agency orders of 200, 500, or 1,000 shares at the inside market. 3 The reserve size feature of NNMS will allow an NNMS market maker or its customer to display publicly part of the full size of its order or interest with the remainder held in reserve on an undisplayed basis to be displayed in whole or in part as the displayed part is executed. To use the reserve size feature, a market maker's quotation initially must display a minimum of 1,000 shares, and the quotation must be refreshed to 1,000 shares to continue using the reserve size feature. [11607] February 4, 2000 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 5-00 SEC RULES COMMITTEE No. 16-00 RE: SEC APPROVES PROPOSAL TO MODIFY NASD SMALL ORDER EXECUTION SYSTEM AND SELECTNET SERVICE

_____ The Securities and Exchange Commission ("SEC") has approved a proposed rule change1 filed by the National Association of Securities Dealers, Inc. ("NASD"), through its wholly-owned subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq"), to modify the rules governing Nasdaq's Small Order Execution System ("SOES") and SelectNet Service ("SelectNet"). The changes to Nasdaq's trading systems are designed to address the problem of potential dual liability for Nasdaq market makers. According to Nasdaq, multiple access points to a market maker's quote, through SOES and SelectNet as well as a firm's internal order delivery and telephone facilities, can subject market makers to unintended dual liability for orders that reach a market maker's quote at or near the same time through different systems. In order to address these issues, Nasdaq is modifying SOES and SelectNet to re-establish SelectNet as a non-liability order delivery and execution system for Nasdaq National Market ("NNM") securities and to amend SOES to facilitate the automatic execution of orders. The modified SOES will be called the Nasdaq National Market Execution System ("NNMS''). In particular, NNMS will: (1) increase the maximum order size for NNM securities that are eligible for automatic execution to 9,900 shares;2 (2) allow market makers and order entry firms to enter proprietary orders into NNMS and obtain automatic executions for proprietary and agency orders in NNM securities; (3) reduce the current 17-second delay between executions against the same market maker to five seconds; (4) enable NNM orders to interact automatically with a market maker's displayed size and reserve size3 in 4 For quotations at the same price level, NNMS would yield priority to all displayed quotations over reserve size, so that NNMS would execute against displayed quotations in time priority and then against reserve size in time priority. 2 price/time priority;4 (5) eliminate the No Decrementation ("No Dec") feature for NNM securities, which currently allows continuous

executions against a market maker's quote at the same price without decrementing the quoted size; and (6) eliminate the SOES preferencing feature for NNM securities. Nasdaq is eliminating the use of most SelectNet liability orders and re-establishing SelectNet as an order delivery and negotiation system through rule changes requiring the use of "oversized" preferenced SelectNet orders. Specifically, subject to a few exceptions, Nasdaq is revising its rules to implement an "oversized order requirement," which will prohibit members from directing a SelectNet preferenced order to an NNMS market maker, unless the preferenced order is designated as either: (1) "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 (2) "Minimum Acceptable Quantity" with a MAQ 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 that fail to satisfy these requirements. In Nasdaq's view, the oversized order requirement will ensure that market makers are not subject to liability under the Firm Quote Rule for SelectNet preferenced orders directed to them. Nasdaq therefore believes that the proposal will reduce instances of dual liability resulting from the receipt of orders through separate systems. Ari Burstein Assistant Counsel Attachment

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