

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49409; File No. SR-NASD-2004-035]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc., Extending Pilot Regarding the Issuance of Market Participant Identifiers

March 12, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 27, 2004, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. Nasdaq has designated the proposed rule change as "non-controversial" under section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposed rule change effective upon filing with the Commission. 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 through October 1, 2004, a pilot program that enables members that are registered as market makers or electronic communications networks ("ECNs") to request and receive a second market participant identifier ("MMID") with which to enter a second Attributable Quote/Order in the Nasdaq Quotation Montage. The text of the proposed rule change is set forth below. Proposed new language is in *italics*; proposed deletions are in [brackets].

\* \* \* \* \*

#### 4613. Character of Quotations

(a) Quotation Requirements and Obligations.

(1) No Change.

(2) For a six-month pilot period beginning [September 1, 2003] *March 1, 2004*, market makers and ECNs may request the use of a second MMID. A market maker may request the use of a

second MMID for displaying Attributable Quotes/Orders in the Nasdaq Quotation Montage for any security in which it is registered and meets the obligations set forth in subparagraph (1) of this rule. An ECN may request the use of a second MMID for displaying Attributable Quotes/Orders in the Nasdaq Quotation Montage for any security in which it meets the obligations set forth in Rule 4623. A market maker or ECN that ceases to meet the obligations appurtenant to its first MMID in any security shall not be permitted to use the second MMID for any purpose in that security.

(3) No Change.

(b)-(e) 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

An NASD member that registers as a market maker or ECN is permitted to enter one two-sided quotation per security in the Nasdaq Quotation Montage, and it is assigned a unique MMID with which to enter such quotations. The NASD 4600 Rule Series governs the character of such quotations and the rights and obligations of members that display quotations in the Nasdaq Quotation Montage via their MMIDs. The NASD Rule 4700 Series sets forth the rights and obligations of members that participate in the Nasdaq National Market Execution System ("SuperMontage"), including the entry of quotes and orders and the display of quotations. Numerous other NASD and Commission rules govern the conduct of members in their use of MMIDs to enter and execute orders and display quotes, including, for example, NASD IM-2110-2 (the "Manning Interpretation"), NASD Rule 6950 (the "Order Audit Trail System"), and NASD Rule 2320 (the "Best Execution" rule).

Effective July 1, 2003, Nasdaq amended NASD Rule 4613(a) for a two-month pilot period to permit market makers and ECNs to request the use of a second MMID for displaying Attributable Quotes/Orders in the Nasdaq Quotation Montage (the "Pilot").<sup>5</sup> Under the Pilot, a market maker may request the use of a second MMID for displaying Attributable Quotes/Orders in any security in which it is registered and meets the obligations set forth in NASD Rule 4613(a)(1), including the maintenance of a continuous two-sided quotation. The Pilot also provides that an ECN may request the use of a second MMID for displaying Attributable Quotes/Orders in the Nasdaq Quotation Montage for any security in which it meets the obligations set forth in NASD Rule 4623.

Through this rule filing, Nasdaq is proposing to extend the Pilot through October 1, 2004. Since the Pilot began, Nasdaq has granted five market makers' applications for second MMIDs for displaying additional Attributable Quotes/Orders. As of the date of this filing, Nasdaq represents that one market maker has begun displaying additional Attributable Quotes/Orders under the Pilot. In addition, three ECNs are authorized to use second MMIDs for displaying additional Attributable Quotes/Orders in SuperMontage. Nasdaq represents that those ECNs were authorized to use second MMIDs prior to the launch of the Pilot. However, Nasdaq determined that their continued use of the second MMIDs was subsumed within the later-filed Pilot. According to Nasdaq, two of those three ECNs are currently using second MMIDs for displaying additional Attributable Quotes/Orders in SuperMontage.

Nasdaq believes the Pilot, though not yet widely used by NASD members, will prove to be an important step in the evolution of its marketplace. Nasdaq represents that trading of Nasdaq securities has changed rapidly and dramatically due to increasingly sophisticated routing and linkage systems that are available to public investors, institutions, broker/dealers, and vendors. Nasdaq believes that the ability to enter quotes and orders and to display quotations under a second MMID would help Nasdaq keep pace with recent changes and allow it to offer functionality that market participants

<sup>5</sup> For a more detailed explanation of the pilot rule change, see Securities Exchange Act Release Nos. 47954 (May 30, 2003), 68 FR 34017 (June 6, 2003) (SR-NASD-2003-87) (notice of filing and immediate effectiveness of Pilot); and 48619 (October 9, 2003), 68 FR 59832 (October 17, 2003) (SR-NASD-2003-137) (extension of Pilot for a six-month period beginning September 1, 2003).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

already find elsewhere today. Nasdaq believes that the Pilot should also improve the quality of executions within Nasdaq by enabling members to contribute more liquidity to the market and add to the transparency of trading interest. Due to the surveillance procedures described below, Nasdaq believes that the Pilot should also improve the regulation of trading in Nasdaq securities to the extent members consolidate more of their trading activity in Nasdaq.

Nasdaq believes that it is essential to maintain its regulation of trading on Nasdaq at the same high level of compliance with NASD and Commission rules that it has achieved to date. Except as noted in the proposed rule, members that use a second MMID would be required to comply with all NASD and Commission rules applicable to their current use of a single MMID. Members would be prohibited from using a second MMID to accomplish indirectly what they are prohibited from doing directly through a single MMID. For example, members would not be permitted to use a second MMID to avoid their Manning obligations under NASD IM-2110-2, best execution obligations under NASD Rule 2320, or their obligations under the Commission's Order Handling Rules. Members would be required to continue to comply with the firm quote rule, the OATS rules, and the Commission's order routing and execution quality disclosure rules. In addition, NASD Rule 4613(a) specifically prohibits firms from displaying a second Attributable Quote/Order to engage in passive market making or to enter stabilizing bids because this could violate NASD Rules 4614 and 4619 and Regulation M under the Act. To the extent that the allocation of second MMIDs were to create regulatory confusion or ambiguity, every inference would be drawn against the use of a second MMID in a manner that would diminish the quality or rigor of the regulation of the Nasdaq market.

Nasdaq represents that it, in conjunction with the NASD, has developed procedures to maintain a high level of surveillance and member compliance with its rules with respect to members' use of both Primary and Secondary MMIDs to display quotations in Nasdaq systems. Nasdaq and NASD have implemented a review process to ensure that firms utilizing second MMIDs under the pilot would do so in accordance with the terms under which use of the second MMID was granted.

Further, Nasdaq represents that new, fully automated surveillance technology has been developed to enable NASD

systems to analyze trading and generate alerts at the firm level (*i.e.*, aggregating activity across all MMIDs for a firm into one primary MMID) or the individual MMID level (*i.e.*, treating each MMID separately), depending on the particular surveillance requirements. Nasdaq believes that the use of firm-level information is essential to detecting market participants that may exceed certain surveillance thresholds at the firm level, but would otherwise go undetected at the individual MMID level. Further, Nasdaq believes that the ability to aggregate data and analyze data at the firm level is critical to identifying instances where a firm is using different MMIDs to engage in conduct such as marking-the-close and trading ahead, among other things. Conversely, Nasdaq believes that the use of specific MMID information is critical for the surveillance of individual quotes, trades, and orders for compliance with firm quote obligations, among other things.

If it were to be determined that a Secondary MMID issued under the Pilot was being used improperly, Nasdaq would withdraw its grant of the Secondary MMID for all purposes for all securities.<sup>6</sup> In addition, if a market maker or ECN were no longer to fulfill the conditions appurtenant to its Primary MMID (*e.g.*, by being placed into an unexcused withdrawal), it would not be permitted to use the Secondary MMID for any purpose in that security.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the Act, including section 15A(b)(6) of the Act,<sup>7</sup> which requires, among other things, that a national securities association's rules be designed 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 mechanisms of a free and open market and a national market system, and, in general to protect investors and the public interest. Nasdaq believes that the proposed rule change is consistent with these requirements because it would facilitate transactions in securities, remove impediments to a free and open market, and protect investors by improving the

transparency and efficiency of transactions.

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

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

## 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 Act<sup>8</sup> and Rule 19b-4(f)(6) thereunder.<sup>9</sup> 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 that the Commission waive the 5-day pre-filing notification and the 30-day operative delay. The Commission believes that waiving the 5-day pre-filing notification and the 30-day operative delay is consistent with the protection of investors and the public interest, because it will allow Nasdaq to continue the Pilot without interruption. For these reasons, the Commission designates the proposal to be effective and operative upon filing with the Commission.<sup>10</sup>

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing,

<sup>8</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>9</sup> 17 CFR 240.19b-4(f)(6).

<sup>6</sup> Nasdaq represents that it has had no occasion to withdraw the grant of a Secondary MMID due to improper usage under the Pilot.

<sup>7</sup> 15 U.S.C. 78o-3(b)(6).

<sup>10</sup> For purposes only of waiving the 30-day operative delay of the proposed rule change the Commission considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-NASD-2004-035. This file number should be included on the subject line if e-mail is used. To help the Commission process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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 File No. SR-NASD-2004-035 and should be submitted by April 12, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

[FR Doc. 04-6265 Filed 3-19-04; 8:45 am]

BILLING CODE 8010-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49422; File No. SR-NSCC-2003-20]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change To Eliminate the Higher Capital Requirements Imposed on Members for Processing Investment Fund Transactions Through NSCC's Mutual Fund Services

March 16, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on October 9, 2003, the National Securities

Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") and on October 22, 2003, amended the proposed rule change described in Items I, II, and III below, which items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

The purpose of the proposed rule change is to amend the standards of financial responsibility required for certain NSCC applicants and members using NSCC's Mutual Fund and Insurance Services. Specifically, the proposed rule change will delete Addendum V to NSCC's Rules thereby eliminating the higher capital requirements imposed on NSCC Mutual Fund/Insurance Services Members and Fund Members processing Investment Funds transactions through NSCC's Mutual Fund Services.

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

In its filing with the Commission, NSCC 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. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>2</sup>

##### (A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Mutual Fund Services are non-guaranteed services offered by NSCC under NSCC Rule 52. In November 2000, NSCC expanded the types of products eligible for processing through NSCC's Mutual Fund Services to include "Investment Funds."<sup>3</sup> An Investment Fund is defined in Rule 1 of NSCC's Rules as a "fund or investment entity subject to regulation under applicable federal and state banking and/or insurance laws." Examples of such funds include stable value funds, guaranteed investment contracts which

are regulated as group annuities, and collective bank investment trusts.

NSCC adopted Addendum V, "Financial Standards for Applicants and Participants Processing Investment Fund Transactions through Mutual Fund Services," in connection with making Investment Fund products eligible for processing at NSCC. Addendum V modified the standards of financial responsibility and operational capability set forth in Addenda B and I<sup>4</sup> of NSCC's Rules to impose more stringent capital requirements on Mutual Fund/Insurance Services Members and Fund Members that process Investment Funds through NSCC's Mutual Fund Services. The more stringent financial standards were adopted because of NSCC's unfamiliarity with the product. Since its introduction, however, this service has been actively used and each day brings new requests by firms to become participants in order to take advantage of the services. NSCC has experienced no member defaults in the processing of Investment Funds through NSCC's Mutual Fund Services.

NSCC has determined that the current financial standards are an unnecessary barrier to entry. Based on NSCC's experience to date, the stringency of the financial criteria applicable to members doing transactions in Investment Funds is not commensurate with the associated risks.

Although NSCC is proposing to reduce the financial requirements imposed on all Mutual Fund/Insurance Services Member and Fund Member applicants and members seeking to process Investment Fund transactions at NSCC by deleting Addendum V, such applicants and members shall remain subject to the criteria set forth in Addenda B and I.

NSCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act<sup>5</sup> and the rules and regulations thereunder applicable to NSCC because it will promote the prompt and accurate clearance and settlement of securities transactions by facilitating more direct access by NSCC members to NSCC Mutual Fund Services for Investment Funds.

##### (B) Self-Regulatory Organization's Statement on Burden on Competition

NSCC believes that the proposed rule change will not impose a burden on

<sup>2</sup> The Commission has modified the text of the summaries prepared by NSCC.

<sup>3</sup> Securities Exchange Act Release No. 43606 (November 21, 2000), 65 FR 71182 (November 29, 2000) [File No. SR-NSCC-00-05].

<sup>4</sup> Addendum B applies to Mutual Fund/Insurance Services Members processing mutual funds through NSCC's Mutual Fund Services, and Addendum I applies to Fund Members processing mutual funds through NSCC's Mutual Fund Services.

<sup>5</sup> 15 U.S.C. 78q-1.

<sup>11</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).