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Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 by the National Association of Securities Dealers, Inc. Relating to Amendments to the Corporate Financing Rule, The Nasdaq Stock Market Rules, and Over-the-Counter Bulletin Board Rules To Effect Compliance With SEC Regulation M

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on March 3, 1997, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change and Amendment No. 1. The proposed rule change and Amendment No. 1 are described in Items I, II, and III below, which Items have been prepared by the NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change and Amendment No. 1.

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

The NASD is proposing to amend the Corporate Financing Rule in Rule 2710, The Nasdaq Rules, and the Over-the-Counter Bulletin Board Rules of the Association to effect compliance with the Commission's Regulation M. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

2710. Corporate Financing Rule—Underwriting Terms and Arrangements

(a) No change.

(b) Filing Requirements—(1) through (10) No change.

(11) Request for Underwriting Activity Report. Notwithstanding the availability of an exemption from filing under subparagraph (b)(7) of this Rule, a member acting as a manager (or in a similar capacity) of a distribution of a publicly traded subject or reference security that is subject to SEC Rule 101

shall submit a request to the Corporate Financing Department for an Underwriting Activity Report with respect to the subject and/or reference security in order to facilitate compliance with SEC Rules 101, 103, or 104, and other distribution-related Rules of the Association. The request shall be submitted at the time a registration statement or similar offering document is filed with the Department, the SEC, or other regulatory agency or, if not filed with any regulatory agency, at least two (2) business days prior to the commencement of the restricted period under SEC Rule 101. The request shall include a copy of the registration statement or similar offering document (if not previously submitted pursuant to subparagraph (b)(5) of this Rule). If no member is acting as managing underwriter of such distribution, each member that is a distribution participant or an affiliated purchaser shall submit a request for an Underwriting Activity Report, unless another member has assumed responsibility for compliance with this subparagraph. For purposes of this subparagraph, SEC Rules 100, 101, 103, and 104 are rules of the Commission adopted under Regulation M and the following terms shall have the meanings as defined in SEC Rule 100: "distribution," "distribution participant," "reference security," "restricted period," and "subject security."

(c) No change.

4000. The Nasdaq Stock Market

4200. Definitions

(a) For purposes of the Rule 4000 Series, unless the context requires otherwise:

[(a)-(x)] (1)-(23)

[(y) "Penalty bid" means a stabilizing bid that permits the managing underwriter to reclaim a selling concession granted to a syndicate member in connection with the sale of securities in an underwritten offering when the syndicate member resells such securities to the managing underwriter.]

[(z) "Pre-effective stabilizing bid" means a stabilizing bid entered prior to the effective date of an offering.]

[(aa)] (24) "Reported security" means an equity security for which quotations are entered into the Consolidated Quotations Service.

(25) "SEC Rule 100", "SEC Rule 101", "SEC Rule 103", and "SEC Rule 104" mean the rules adopted by the Commission under Regulation M, and any amendments thereto.

[(bb)] (26) "Solicitation expenses" means direct marketing expenses incurred by a member in connection

with a limited partnership rollup transaction, such as telephone calls, broker/dealer fact sheets, members' legal and other fees related to the solicitation, as well as direct solicitation compensation to members.

[(cc)] (27) "Stabilizing bid" means [a bid entered for the purpose of supporting the price of a security to facilitate an offering of such security as permitted by SEC Rules 10b-6 and 10b-7.] the terms "stabilizing" or to "stabilize" as defined in SEC Rule 100.

[(dd)] (28) "Transaction costs" means costs incurred in connection with a limited partnership rollup transaction, including printing and mailing the proxy, prospectus or other documents; legal fees not related to the solicitation of votes or tenders; financial advisory fees; investment banking fees; appraisal fees; accounting fees; independent committee expenses; travel expenses; and all other fees related to the preparatory work of the transaction, but not including costs that would have otherwise been incurred by the subject limited partnerships in the ordinary course of business or solicitation expenses.

(29) "Underwriting Activity Report" is a report provided by the Corporate Financing Department of NASD Regulation, Inc. in connection with a distribution of securities subject to SEC Rule 101 pursuant to Rule 2710(b)(11) and includes forms that are submitted by members to comply with their notification obligations under Rules 4614, 4619, and 4623.

(b) For purposes of Rules 4614, 4619, and 4623, the following terms shall have the meanings as defined in SEC Rule 100: "affiliated purchaser," "distribution," "distribution participant," "independent bid," "net purchases," "passive market maker," "penalty bid," "reference security," "restricted period," "subject security," and "syndicate covering transaction".

4600. Nasdaq Market Maker Requirements

4614. Stabilizing Bids

(a) [Eligibility.]

[A market maker may enter a stabilizing bid in Nasdaq, which bid will be identified with the appropriate identifier on the Nasdaq quotation display.]

Market Maker Obligation/Identifier

A market maker that intends to stabilize the price of a Nasdaq security that is a subject of reference security under SEC Rule 101 shall submit a request to Nasdaq Market Operations

for the entry of a one-sided bid that is identified on Nasdaq as a stabilizing bid in compliance with the standards set forth in this Rule and SEC Rules 101 and 104.

(b) *Eligibility*

Only one market maker in an issue may enter a stabilizing bid.

(c) *Limitations on Stabilizing Bids*

(1) A stabilizing bid [will] *shall* not be [displayed] *entered in Nasdaq* unless at least one other market maker in addition to the market maker entering the stabilizing bid is registered as a market maker in the [issue] security and enter[s]ing quotations that are considered an independent bid under SEC Rule 104.

[(b)(2) [Character.]

[A stabilizing bid, pre-effective stabilizing bid, or a penalty bid may be entered in Nasdaq.] A stabilizing bid must be available for all freely tradeable outstanding securities of the same class being offered.

(3) *A market maker shall not enter a stabilizing bid at the same time that it is quoting any other bid or offer in the security.*

[(c)(d) [Notice] *Submission of Request to Association*

(1) A market maker that wishes to enter a stabilizing bid shall [so notify the] *submit a request to Nasdaq Market Operations [in writing prior to the first day on which the stabilizing bid is to appear in Nasdaq] for the entry in the Nasdaq quotation display of a one-sided bid identified as a stabilizing bid. The market maker shall confirm its request in writing no later than the end of the day on which the stabilizing bid is entered by submitting an Underwriting Activity Report to Nasdaq Market Operations that includes the information required by subparagraph (d)(2). [and the fact that the market maker is a manager of the distribution.]*

(2) *In lieu of submitting the Underwriting Activity Report as set forth in subparagraph (d)(1), [T] the market maker may provide written [notice] confirmation to Nasdaq Market Operations that shall include:*

(A) the [name] *identity* of the security and its Nasdaq symbol;

(B) [the date on which the security's registration will become effective, if it is already included in Nasdaq] *the contemplated effective date of the offering and the date when the offering will be priced;*

[(C) whether the stabilizing bid will be a penalty bid or a penalty-free bid]

(C) *the date and time that an identifier should be included on the Nasdaq quotation display; and*

(D) a copy of the *cover page of the preliminary or final prospectus [or shelf registration statement] or similar offering document*, unless the Association determines otherwise.

[(2) In the case of a pre-effective stabilizing bid, the notice shall include (A) the name of the security and its Nasdaq symbol; (B) the contemplated effective date of the offering; (C) whether it is contemplated that the pre-effective stabilizing bid will be converted to a stabilizing bid and, if so, whether the stabilizing bid will be a penalty bid or a penalty-free bid; and (D) a copy of the preliminary prospectus, unless the Association determines otherwise.]

[(3) A market maker that has provided the written notice prescribed above shall also contact Nasdaq Market Operations for authorization on the day the market maker wishes to enter the stabilizing bid.]

[(d) *Dual Bids in the Same Issue.* A market maker shall not enter a stabilizing bid at the same time that it is quoting any other bid or offer in the issue.]

[(e) *Volume Reporting for Stabilizing Bids.* A market maker entering a stabilizing bid shall report all purchases made on the stabilizing bid and enter "zero volume" for sales during the period in which the stabilizing bid is in effect.]

4619. *Withdrawal of Quotations and Passive Market Making*

(a)-(c) No change.

(d) Excused withdrawal status or passive market maker status may be granted to a market maker that is a distribution participant (or, in the case of excused withdrawal status, an affiliated purchaser) in order to comply with SEC Rules [10b-6] 101, [or Rule 10-6A] 103, or 104 under the Act on the following conditions:

(1) A [market maker] *member* acting as a manager (or in a similar capacity) of a distribution of a Nasdaq security that is a subject or reference security under SEC Rule 101 and any member that is a distribution participant or that is an affiliated purchaser in such a distribution that does not have a manager shall [: (A)] provide written notice to Nasdaq Market Operations [of the prospective distribution] *no later than the business day prior to the first entire trading session of the one-day or five-day restricted period under SEC Rule 101, unless later notification is necessary under the specific circumstances.*

[and the fact that the market maker is a manager of the distribution, the Nasdaq security or securities that are

subject to SEC Rule 10b-6 no later than 5 business days following the filing of a registration statement with the Association pursuant to Rule 2710, or, if the member is not required to file the registration statement with the Association, no later than 5 business days following the filing of offering documents with the appropriate regulatory authority; and, (B) no later than noon Eastern Time on the business day prior to the beginning of the cooling off period:]

[(i)] (A) [request] *The notice required by subparagraph (d)(1) of this Rule shall be provided by submitting a completed Underwriting Activity Report that includes a request on behalf of each market maker that is a distribution participant or an affiliated purchaser to withdraw[al of] the market maker[s]'s quotations, or [identification of] that includes a request on behalf of each market maker that is a distribution participant that its [the market makers'] quotations be identified as those of a passive market maker [by providing written notice to Nasdaq Market Operations of the identity of the market makers that are distribution participants], and includes the contemplated date and time of the commencement of the [cooling off period] restricted period. [and the identity of the market makers that intend to act as passive market makers; and]*

[(ii)] (B) *The managing underwriter shall advise [the] each market maker that [they have] it has been identified as a distribution participant[s] or an affiliated purchaser to Nasdaq Market Operations and that [their] its quotations will be automatically withdrawn or identified as passive market maker quotations, [upon the request made by the manager] unless [they submit to] a market maker that is a distribution participant notifies [the Association the notice specified in] Nasdaq Market Operations as required by subparagraph [(3)] (d)(2), below.*

[(2) If the security is being distributed pursuant to an offering for which no registration statement or offering document is required to be filed, each market maker that is a distribution participant shall, no later than noon Eastern Time on the business day prior to the beginning of the cooling off period, provide written notice to Nasdaq Market Operations of its participation in the distribution, the contemplated date and time of the commencement of the cooling off period, the Nasdaq security or securities that are subject to SEC Rule 10b-6, and request withdrawal of its quotations or identification as a passive market maker.]

([3] 2) A market maker that has been identified to Nasdaq Market Operations as a distribution participant shall [provide written notice to] promptly notify Nasdaq Market Operations and the manager of its intention not to participate in the prospective distribution or not to act as a passive market maker [no later than 4:00 p.m. Eastern Time on the business day prior to the beginning of the cooling off period] in order to avoid having its quotations withdrawn or identified as the quotations of a passive market maker, or in order to have its excused withdrawal status rescinded.

(3) If a market maker that is a distribution participant withdraws its quotations in a Nasdaq security in order to comply with the net purchases limitation of SEC Rule 103 or with any other provision of SEC Rules 101, 103, or 104 and promptly notifies Nasdaq Market Operations of its action, the withdrawal shall be deemed an excused withdrawal. Nothing in this subparagraph shall prohibit the Association from taking such action as is necessary under the circumstances against a member and its associated persons for failure to contact Nasdaq Market Operations to obtain an excused withdrawal as required by subparagraphs (a) and (d) of this Rule.

(4) [In the event the manager of a distribution is not a market maker, each market maker that is a distribution participant shall comply with paragraph (d)(1) unless another market maker has assumed responsibility for compliance.] The quotations of a passive market maker shall be identified on Nasdaq as those of a passive market maker.

[For purposes of this Rule, the term "cooling off period" refers to the periods specified in SEC Rule 10b-6(a)(4)(xi), the terms "distribution" and "distribution participant" refers to these terms as defined in SEC Rule 10b-6(c)(5) and (c)(6) and the term "passive market maker" refers to this term as defined in SEC Rule 10b-6A(T).]

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4623. Penalty Bids and Syndicate Covering Transactions

(a) A market maker acting as a manager (or in a similar capacity) of a distribution of a Nasdaq security that is a subject or reference security under SEC Rule 101 shall provide written notice to the Corporate Financing Department of NASD Regulation, Inc. of its intention to impose a penalty bid on syndicate members or to conduct syndicate covering transactions pursuant to SEC Rule 104 prior to imposing the penalty bid or engaging in

the first syndicate covering transaction. A market maker that intends to impose a penalty bid on syndicate members may request that its quotation be identified as a penalty bid on Nasdaq pursuant to paragraph (c) below.

(b) The notice required by paragraph (a) shall include:

(1) the identity of the security and its Nasdaq symbol;

(2) the date the member is intending to impose the penalty bid and/or conduct syndicate covering transactions; and

(3) the amount of the syndicate short position, in the case of syndicate covering transactions.

(c) Notwithstanding paragraph (a), a market maker may request that its quotation be identified as a penalty bid on Nasdaq display by providing notice to Nasdaq Market Operations, which notice shall include the date and time that the penalty bid identifier should be entered on Nasdaq and, if not in writing, shall be confirmed in writing no later than the end of the day on which the penalty bid identifier is entered on Nasdaq.

(d) The written notice required by paragraphs (a) and (c) of this Rule may be submitted on the Underwriting Activity Report by including the information required by subparagraphs (b)(1) and (b)(2) or paragraph (c).

6500. OTC Bulletin Board Service

6540. Requirements Applicable to Market Makers

(a) No change.

(b) No change.

(1) Permissible Quotation Entries

(A)-(C) No change.

(D) Any member that intends to be a distribution participant in a distribution of securities subject to SEC Rule 101, or is an affiliated purchaser in such distribution, and is entering quotations in an OTCBB-eligible security that is the subject or reference security of such distribution shall, unless another member has assumed responsibility for compliance with this paragraph:

(i) provide written notice to Nasdaq Market Operations prior to the pricing of the distribution that includes the intended date and time of the pricing of the offering;

(ii) Withdraw all quotations in the OTCBB-eligible security to comply with the applicable restricted period under SEC Rule 101 and not enter a stabilizing bid pursuant to SEC Rule 104 in the OTCBB; and

(iii) provide written notice to the Corporate Financing Department of NASD Regulation, Inc. of its intention to

impose a penalty bid or to conduct syndicate covering transactions pursuant to SEC Rule 104 prior to imposing the penalty bid or engaging in the first syndicate covering transaction. Such notice shall include information as to the date the penalty bid or first syndicate covering transaction will occur and the amount of the syndicate short position.

(E) The written notice required by subparagraphs (b)(1)(D)(i) and (iii) of this rule may be submitted on the Underwriting Activity Report provided by the Corporate Financing Department of NASD Regulation, Inc. by including the information required by those subparagraphs.

(F) For purposes of subparagraph (D), SEC Rules 100, 101, 103 and 104 are rules of the Commission adopted under Regulation M and the following terms shall have the meanings as defined in SEC Rule 100: "affiliated purchaser," "distribution," "distribution participant," "penalty bid," "reference security," "restricted period," "stabilizing," "subject security," and "syndicate covering transaction."

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

In its filing with the Commission, NASD Regulation, Inc. ("NASD Regulation") 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 III below. NASD Regulation 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

(a) On December 20, 1996, the Commission approved new Regulation M to replace Rules 10b-6, 10b-6A, 10b-7, 10b-8 and 10b-21 under the Act (the "trading practice rules").¹ Regulation M, which consists of SEC Rules 100 through 105, governs the activities of underwriters, issuers, selling security-holders, their respective affiliated purchasers, and others that have an interest in the outcome of an offering of securities. New Regulation M will be effective March 4, 1997, with the

¹ Securities Exchange Act Release No. 38067 (December 20, 1996), 62 FR 520 (January 3, 1997).

exception that the Commission's recordkeeping requirements related to penalty bids and syndicate covering transactions will become effective April 1, 1997.

The NASD is proposing to amend the rules of The Nasdaq Stock Market ("Nasdaq"), the Over-the-Counter Bulletin Board ("OTCBB"), and the Corporate Financing Rule (NASD Rule 2710) (collectively "NASD rules") to clarify certain of the provisions and to implement the requirements of Regulation M in SEC Rules 101, 103, and 104 as they apply to members of the Association. In general, the amendments to the NASD rules establish a new requirement for members to obtain an Underwriting Activity Report from the Corporate Financing Department of NASD Regulation with respect to a proposed distribution subject to SEC Rule 101; modify current Nasdaq requirements with respect to the entry of stabilizing and penalty bids and requests for excused withdrawal of quotations or designation of quotations as those of a passive market maker; and establish new requirements for notification with respect to penalty bids and syndicate covering transactions for Nasdaq and OTCBB securities.

General

The NASD is proposing to amend the Nasdaq Rules to eliminate the requirement that members submit their request to enter a stabilizing or penalty bid, for an excused withdrawal of quotations, or for the identification of quotations as those of a passive market maker on the day prior to the requested action. Further, in connection with stabilizing and penalty bids, the proposed rule change replaces the current requirement for written notification with a requirement for notification followed by written confirmation. These changes are made in order to permit the Association to respond to the quicker timetable that is increasingly characteristic of securities distributions and to, particularly, provide members the maximum flexibility required for shelf offerings.

In addition, the proposed rule change amends Nasdaq and OTCBB Rules to distinguish between the obligations of members that are distribution participants and members that are affiliated purchasers (as those terms are defined in SEC Rule 100 adopted under Regulation M). While a member that is a distribution participant may stabilize the price of a security and engage in passive market making, a member that is considered an affiliated purchaser to the issuer is not permitted to conduct

these market-related activities during a distribution.

The proposed rule change also clarifies that the requirements for stabilizing, excused withdrawal, passive market making, penalty bids, and syndicate covering transactions in a Nasdaq or OTCBB security apply regardless of whether a Nasdaq or OTCBB security is the subject of the distribution or is a reference security (as those terms are defined in SEC Rule 100 adopted under Regulation M). Similarly, the requirement that a member request an Underwriting Activity Report, as discussed below, from the Corporate Financing Department of NASD Regulation applies regardless of whether a publicly traded security is a subject or reference security under SEC Rule 101. Thus, a member that is a distribution participant or an affiliated purchaser in a private placement of a security that is convertible to a publicly traded security will be required to request an Underwriting Activity Report with respect to the reference security. Moreover, if the reference security is listed on Nasdaq the member will be obligated to comply with the provisions of Rules 4614, 4619, and 4623 or if the reference security is quoted in the OTCBB, the member will be obligated to comply with the provisions of Rule 6540. The same analysis would apply if the privately placed security is the same security as that traded in the public markets.

Amendments to the Nasdaq Rules

Definitions

The proposed rule change would reorganize Rule 4200 of the NASD Rules applicable to Nasdaq into two paragraphs, with the result that the current definitions in paragraphs (a) through (dd) would be consecutively numbered as subparagraphs of paragraph (a). In addition, the Association is proposing to adopt a definition as new subparagraph (a)(25) of Rule 4200 that would clarify that references in the Nasdaq Rules to SEC Rule 100, SEC Rule 101, SEC Rule 103, and SEC Rule 104 means those rules adopted by the SEC under Regulation M, and any amendments thereto.

The definition of "penalty bid" in current paragraph (2) to Rule 4200 is proposed to be deleted because SEC Rule 100 adopted under Regulation M contains a definition of penalty bid. Moreover, for purposes of Rule 4614, a penalty bid will no longer be treated as a form of stabilizing bid by the NASD.

The definition of "stabilizing bid" in renumbered subparagraph (a)(27) is proposed to be amended to refer to the

definition of "stabilizing" in SEC Rule 100 adopted under Regulation M. Unlike SEC Rule 104 adopted under Regulation M, the Association's rules have differentiated between a pre-effective stabilizing bid and a stabilizing bid entered after the pricing and effectiveness of an offering. The Association is deleting the definition of pre-effective stabilizing bid as unnecessary and confusing.

Moreover, the NASD is proposing to adopt, for purposes of the Nasdaq Rules, a definition of the term "Underwriting Activity Report" in subparagraph (a)(29) of Rule 4200 to reference the report to be provided by the Corporate Financing Department of NASD Regulation to the managing underwriter of a distribution of a publicly traded subject or reference security that is subject to SEC Rule 101. The requirement that members obtain the Report is proposed to be adopted in Rule 2710(b)(11). The Report will provide members participating in the offering with information on whether the security meets the average daily trading volume ("ADTV") and public float value requirements for the one-day or five-day restricted periods under SEC Rule 101 and whether the ADTV of the market makers participating in the offering meet the requirements of SEC Rule 103 for passive market making. In addition, the Report permits a member to provide the requisite notifications to the NASD with respect to the member's request for excused withdrawal of quotations from Nasdaq and designation of Nasdaq quotations as those of a passive market maker, as well as information on the member's request to stabilize and, under Nasdaq and OTCBB Rules, impose a penalty bid or conduct syndicate covering transactions. Thus, the Report permits the Association to provide information to the underwriting syndicate to facilitate compliance with SEC Rules 101 and 103 and can be used by members to submit information to the Association to comply with the member's obligations under Nasdaq and OTCBB Rules and SEC Rules 101, 103 and 104.

Finally, the Association is proposing to adopt new paragraph (b) or Rule 4200 to incorporate the definitions of important terms from SEC Rule 100 adopted under Regulation M for purposes of the Nasdaq Rules, including affiliated purchase, distribution, distribution participant, independent bid, net purchases, passive market maker, penalty bid, reference security, restricted period, subject security, and syndicate covering transaction. Incorporating the SEC's definitions of these terms will avoid the need for the

Association to amend its rules as these terms are amended by the SEC.

Stabilizing Bids

SEC Rule 104 adopted under Regulation M replaces Rule 10b-7 under the Act to regulate stabilization activities during a distribution. The new rule retains the requirement that only one stabilizing bid is permitted in any market at the same price at the same time, that the market be notified of the intent to enter a stabilizing bid, and that the stabilizing bid be disclosed. Rule 4614 of the Nasdaq Rules currently includes provisions that meet the requirements of prior SEC Rule 10b-7 and new Rule 104. However, the NASD is proposing to amend Rule 4614 to clarify certain of its provisions, delete obsolete provisions, and modify the procedural requirements for notification and the information required to be submitted to Nasdaq in order for a market maker to enter a stabilizing bid.

The NASD is proposing to amend Rule 4614 of the Nasdaq Rules by adding new paragraph (a) that requires a market maker that intends to stabilize the price of a Nasdaq security in compliance with SEC Rule 104 to submit a request to Nasdaq Market Operations to enter a one-sided bid identified on Nasdaq as a stabilizing bid. Paragraph (b) retains the requirement that only one market maker in an issue may enter a stabilizing bid. Several provisions that impose limitations on stabilizing bids have been organized under a new heading in paragraph (c).

The notice provisions in renumbered subparagraph (d)(1) have been revised to permit submission to Nasdaq Market Operations of a market maker's request to enter a stabilizing bid at any time. Currently, Rule 4614 requires that Nasdaq Market Operations be notified on the day prior to the first day on which the stabilizing bid is to appear. This requirement is no longer necessary. Since a one-sided bid identified as a stabilizing bid can only be entered on Nasdaq by the staff of Nasdaq Market Operations, there is no need to set a particular time period for providing notification. System changes now permit the staff of Nasdaq Market Operations to enter a stabilizing bid with the appropriate identifier with only a short period of notification prior to the opening of the market or any other time during the trading session for the entry of the bid requested by the member. Moreover, a member may determine, and is permitted by SEC Rule 104, to enter a stabilizing bid at any time during a trading session. Thus, it is the obligation of the member to

provide the staff sufficient time to enter its one-sided stabilizing bid on Nasdaq and the staff of Nasdaq Market Operations will enter a member's stabilizing bid as soon as possible after receipt of the request from the member.

The Association is also proposing to delete the requirement in subparagraph (d)(1) of Rule 4614 that the request for entry of a stabilizing bid be in writing and replace it by a requirement that the request be confirmed in writing by the end of the day of which the stabilizing bid is entered. In light of the speed at which many secondary offerings and shelf distributions are priced and distributed and the volatility of the market, the Association believes it important that members be provided the ability to move quickly in response to changing market conditions and the requirements of such offerings. The information required to be provided to the staff of Nasdaq Market Operations by subparagraph (d)(2) is easily conveyed in a conversation by telephone.

Subparagraph (d)(1) of Rule 4614 is also proposed to be amended to permit a member to provide its written request by submitting an Underwriting Activity Report provided by the Corporate Financing Department of NASD Regulation, with the requisite information included in the Report that is set forth in subparagraph (d)(2). In lieu of the Underwriting Activity Report, a member is also permitted under subparagraph (d)(2) to provide written notice to Nasdaq Market Operations that contains the information related to its request to stabilize the price of a security. The information required to be included in the Underwriting Activity Report or in a separate request has been revised in order to clarify and simplify the requirements. Thus, the requirement to provide a copy of the preliminary prospectus has been replaced with a requirement to provide the cover page of the prospectus, because only the information on the cover page is necessary to Nasdaq Market Operations staff and is easily transmitted by fax to the Association.

Excused Withdrawals and Passive Market Making

Market makers are not permitted by the Nasdaq Rules to withdraw their market making quotations unless the withdrawal is excused. In the absence of obtaining an excused withdrawal, a member is prohibited by Nasdaq Rules from acting as a market maker in the security for 20 business days. Rule 4619 of the Nasdaq Rules regulates requests for excused withdrawals of quotations

by market makers and the request by market makers for identification of their quotations as those of a passive market maker.

SEC Rule 101 adopted under Regulation M has replaced the current "cooling-off" periods of Rule 10b-6 that are triggered by the anticipated commencement of the distribution with a three-tier "restricted period" that is calculated from the time of pricing the subject security. Actively-traded securities, i.e., securities with an ADTV of at least \$1 million and a public float value of at least \$150 million, are no longer subject to any restricted period. Securities with an ADTV of at least \$100,000, with a public float value of at least \$25 million, are subject to a restricted period of one business day prior to the date on which the subject security's price is determined and all other securities that do not meet the ADTV and public float value tests are subject to a restricted period of five business days.

SEC Rule 103 adopted under Regulation M, which replaces Rule 10-6A under the Act, permits "passive" market making activity in Nasdaq stocks in connection with fixed-price offerings that are underwritten on a firm-commitment basis and permits all Nasdaq stocks to qualify for passive market making. The new SEC rule also allows passive market making throughout the restricted period, in contrast to Rule 10b-6A, which prohibited passive market making upon the commencement of offers and sales.

The NASD is proposing to revise Rule 4619 in subparagraph (d)(1) to: (1) Distinguish between the obligations of a member that is a distribution participant and a member that is an affiliated purchaser; (2) clarify that the primary obligation to obtain excused withdrawal and/or identification of quotations as those of a passive market maker is imposed on the managing underwriter of the distribution, regardless of whether the managing underwriter is also a Nasdaq market maker in the security; (3) clarify that the rule applies regardless of whether the Nasdaq security is a subject or reference security; (4) replace the cooling-off periods of Rule 10b-6 with the one-day and five-day restricted periods of SEC Rule 101; and (5) clarify that passive market making quotations must be identified on Nasdaq.

In addition, the amendments to subparagraph (d)(1) of Rule 4619 provide that notification to Nasdaq Market Operations must occur no later than the business day prior to the first entire trading session of the one-day or five-day restricted period under SEC

Rule 101 of Regulation M. This amendment deletes the provision that previously required notification to Nasdaq Market Operations by noon Eastern Time on the business day prior to the beginning of the cooling-off period. It is anticipated that members will provide notification as follows: If a one-day restricted period commences at the close of Nasdaq at 4:00 p.m. (ET) on Monday, notice should be provided to Nasdaq Market Operations with respect to excused withdrawal or passive market making status for Tuesday by 6:00 p.m. on Monday, with the offering being priced and sold after 4:00 p.m. (ET) on Tuesday. The five-day restricted period is calculated in a similar manner.² The provision permits notification to be received later than the day prior to the first entire trading session of the restricted period if such later notification is necessary under the specific circumstances, so long as the Association will be able to maintain its regulatory program to provide surveillance of excused withdrawals and passive market making.

Subparagraph (d)(1) of Rule 4619 continues to require that a member submit in writing its request for excused withdrawal or identification of quotations as those of a passive market maker. The request is required under subparagraph (d)(1)(A) to be submitted in the form of the Underwriting Activity Report that is obtained from the Corporate Financing Department of NASD Regulation pursuant to a proposed rule change to Rule 2710(b)(11). As set forth above, the Underwriting Activity Report will be issued to the managing underwriter of every distribution of a publicly traded subject or reference security that is subject to SEC Rule 101 and will provide ADTV information that will facilitate compliance by the underwriting syndicate with the restricted periods of SEC Rule 101 and the passive market making requirements of SEC Rule 103.

Subparagraph (d)(1)(A) of Rule 4619 requires that the Underwriting Activity Report that was previously provided to the managing underwriter by the Corporate Financing Department be submitted to Nasdaq Market Operations and include the managing underwriter's request on behalf of each market maker that is a distribution participant or an affiliated purchaser that the quotations of the market maker be withdrawn. Alternatively, with respect to

distribution participants, the managing underwriter may request that the quotations of the market maker be identified as those of a passive market maker.

Subparagraph (d)(1)(B) of Rule 4614 will continue to require that the managing underwriter then advise each market maker that is a distribution participant or affiliated purchaser that its quotations will be automatically withdrawn. In addition, market makers that are distribution participants must be advised if their quotations will be identified as those of a passive market maker. A market maker that is a distribution participant has the option to notify Nasdaq Market Operations, pursuant to subparagraph (d)(2), that it does not intend to be a participant in the distribution or does not intend to engage in passive market making.

Subparagraph (a) of Rule 4619 requires that the market maker request withdrawal of its quotations for any purpose, including compliance with Regulation M, through Nasdaq Market Operations. The action of a market maker to withdraw its quotations from Nasdaq is treated as unexcused and is subject to the 20-day penalty. In considering a member's obligations to comply with new Regulation M, the Association has determined that it should revise its procedures and rules to facilitate members' compliance with the restricted periods, and restrictions on stabilizing and passive market making—without the member being subject to the 20-day penalty for taking an action intended to ensure compliance with its regulatory obligations.

The NASD is, therefore, proposing to adopt new subparagraph (d)(3) of Rule 4619 to permit the Association to treat as an excused withdrawal the action of a market maker to withdraw its quotations, if the withdrawal is necessary to ensure compliance with its obligations as a stabilizer, passive market maker, or to comply with the restricted periods of SEC Rule 101. Thus, this provision will permit a member that exceeds its "net purchases" limitation as a passive market maker to immediately withdraw its quotations. In addition, the provision would permit a member to immediately withdraw a stabilizing bid and would treat as an excused withdrawal the immediate withdrawal of quotations to comply with the one or five-day restricted periods of Regulation M. Finally, the provision also requires that the market maker immediately notify Nasdaq Market Operations of its action. In order, however, to ensure that members understand that they remain obligated to request withdrawal of their

quotations through Nasdaq Market Operations and should only rely on this provision in an unanticipated situation, the provision clarifies that the granting of such an excused withdrawal does not prevent the Association from taking such action as is necessary (including, initiating a disciplinary action) against the member and its associated persons for failure to comply with the requirement of Rule 4619 to withdraw quotations through Nasdaq Market Operations.

Penalty Bids and Syndicate Covering Transactions

New SEC Rule 104 adopted under Regulation M requires that the primary market for a security be notified on any penalty bid or syndicate covering transaction in connection with an offering of securities. Paragraph (a) of new Rule 4623 of the Nasdaq Rules would require submission of this notification to the Corporate Financing Department of NASD Regulation with respect to a Nasdaq security prior to imposing the penalty bid or engaging in the first syndicate covering transaction. The written notification is required under paragraph (b) to include the identity of the security and its Nasdaq symbol, the date and time the member is intending to impose the penalty bid and/or conduct syndicate covering transactions, and a statement of the amount of the syndicate short position. If the SEC delays effectiveness of the notification requirements for penalty bids and syndicate covering transactions to a future date, the effectiveness of this provision will also be delayed until that date.

Although not required by SEC Rule 104, a market maker has the option to request that Nasdaq Market Operations include an identifier with respect to a penalty bid in order to advise the market of the member's exercise of its contractual right. Where a member requests that its quotations be identified as a penalty bid, paragraph (c) under Rule 4623 requires that the member must provide notification to Nasdaq Market Operations (not the Corporate Financing Department) and, if the notice is not in writing, must confirm the notice in writing no later than the end of the day on which the penalty bid identifier is entered in Nasdaq. The requirements of this provision will be effective March 4, 1997.

Finally, paragraph (d) under Rule 4623 permits, but does not require, a member to provide the notification required under paragraphs (a) and (c) by submitting an Underwriting Activity Report that includes the requisite information.

² See definition of "business day" in SEC Rule 100 for purposes of calculating the restricted period under SEC Rule 101. The term "business day" for purposes of the Nasdaq Rules refers to a calendar day on which trading occurs on Nasdaq.

Amendments to OTCBB Rules

The OTCBB system does not include a feature that permits the entry of an identifier in connection with a member's quotations in the system. Therefore, a member that is a distribution participant or an affiliated purchaser with respect to an OTCBB-eligible security in which it is entering quotations cannot engage in stabilizing transactions in that security in the OTCBB and cannot request identification of its post-offering bid as a penalty bid.

The NASD is proposing to amend subparagraph (b)(1) of rule 6540 of the OTCBB Rules to require that a member that is to be a distribution participant or is an affiliated purchaser in a distribution of OTCBB-eligible securities subject to SEC Rule 101 must provide written notice to Nasdaq Market Operations prior to the pricing of the offering that includes the intended date and time of pricing of the offering—unless another member assumes responsibility for the member's compliance. In addition, the member must withdraw its quotations to comply with the restricted periods of Regulation M, and is prohibited from entering a stabilizing bid in the OTCBB.

Moreover, similar to the new requirements in Rule 4623 with respect to Nasdaq securities, the member is required under rule 6540 to provide written notice to the Corporate Financing Department of NASD Regulation of its intention to impose a penalty bid or engage in syndicate covering transactions prior to imposing the penalty bid or engaging in the first syndicate covering transactions. In the latter case, the member is required to provide advice on the amount of the syndicate short position. If the SEC delays effectiveness of the notification requirements to a future date, the notification regarding penalty bids and syndicate covering transactions under rule 6540 will also be delayed until that date.

Finally, the NASD is proposing that members be permitted, but not required, to provide the notice to Nasdaq Market Operations or the Corporate Financing Department, as required by the new provisions, by submitting an Underwriting Activity Report that includes the requisite information.

Amendments to the Corporate Financing Rule

As set forth above, a member that is a market maker in a distribution of a Nasdaq security that is a subject or reference security under SEC Rule 101 adopted under Regulation M, is required

to request excused withdrawal of its quotations or identification of its quotations as those of a passive market maker by submitting information in an Underwriting Activity Report that is provided by the Corporate Financing Department of NASD Regulation. Moreover, a member has the option to use the Underwriting Activity Report to request the entry of a stabilizing bid for a Nasdaq security, or to provide advice of the member's intention to enter a penalty bid or to engage in syndicate covering transactions for a Nasdaq or OTCBB security, or to request an identifier be associated with the member's penalty bid in Nasdaq. The Underwriting Activity Report has previously been used, with the title of "Passive Market Making Report," by the Corporate financing Department to provide information to Nasdaq market makers as to whether the security met the price and float requirements for the two-day or nine-day cooling-off periods under rule 10b-6 and whether the ADTV of the market makers participating in the offering met the requirement for passive market making under Rule 10b-6A.

The NASD is proposing to expand the use of the Underwriting Activity Report to permit the Association to provide information to members (not just Nasdaq market makers) to assist them in complying with the restricted periods of SEC Rule 101. Thus, the Association intends to calculate the ADTV for each subject and reference security that is publicly traded prior to an offering to determine, and to so advise the managing underwriter, whether the security qualifies under SEC Rule 101 as a actively-traded security or for the one-day or five-day restricted periods. The NASD is intending to provide members the option of using the Underwriting Activity Report to submit the member's request to stabilize a Nasdaq security, provide notification of the member's intent to impose a penalty bid or conduct syndicate covering transactions with respect to Nasdaq securities, and to request an identifier be associated with a penalty bid in a Nasdaq security. In addition, a member may use the Underwriting Activity Report to provide the notification of an offering and of its intention to impose a penalty bid or conduct syndicate covering transactions with respect to OTCBB securities.

The NASD is proposing to amend the filing requirements of the Corporate Financing Rule in Rule 2710 to add new subparagraph (b)(11) that would require that a member acting as a manager (or in a similar capacity) of a distribution of securities subject to SEC Rule 101 submit a request to the Corporate

Financing Department for an Underwriting Activity Report. If no member is acting as managing underwriter, each member that is a distribution participant or an affiliated purchaser is required to submit the request unless another member has assumed responsibility for compliance with the requirement.

The request must be submitted with respect to any security considered a subject or reference security under SEC Rule 101 that is publicly traded. Thus, the requirement to request an Underwriting Activity Report applies to follow-on or secondary distributions of a publicly traded security (*i.e.*, the publicly traded security is the subject security under SEC Rule 101) and to publicly traded securities that are reference securities in a distribution subject to SEC Rule 101. The latter situation would arise where a private placement is proposed of a security for which a publicly traded security is a reference security. In this case, distribution participants and affiliated purchasers would be subject to compliance with SEC Rule 101 with respect to the publicly traded security. In addition, it is important to note, that the requirement to request an Underwriting Activity Report applies to every offering regardless of whether the subject or reference security is listed on Nasdaq, quoted in the OTCBB, traded in the non-Nasdaq over-the-counter market, or listed on a stock exchange. Finally, the requirement to submit a request for an Underwriting Activity Report applies regardless of the availability of an exemption from filing of a public offering in subparagraph (b)(7) of the Corporate Financing Rule in Rule 2710.

Proposed subparagraph (b)(11) of Rule 2710 states that the purpose of the request for the Underwriting Activity Report is to facilitate compliance with SEC Rules 101, 103, and 104 and other distribution-related rules of the Association. Such other rules include the Free-Riding and Withholding Interpretation in IM-2110-1 and the directed commissions provision of Rule 2740. The proposed provision requires that the request be submitted at the time a registration statement or similar offering document is filed with the Department, the SEC, or other regulatory agency. If no offering document is required to be filed with a regulatory agency, the request must be submitted at least two business days prior to the commencement of the restricted period under SEC Rule 101.

Transmission of Regulatory Notices Under Regulation M

NASD Regulation is proposing to standardize the information content of notices required to be submitted under SEC Rules 101, 103, and 104, *i.e.*, notification of withdrawal of quotations, identification of quotations as those of a passive market maker, request for entry of a stabilizing bid, and notification of penalty bids and syndicate covering transactions. The individual notices are required to be submitted to Nasdaq Market Operations or the Corporate Financing Department, as applicable, as an attachment to the Underwriting Activity Report issued by the Corporate Financing Department and will consist of two additional notification forms, the Regulation M Restricted Period Commencement Notification form and the Regulation M Trading Notification form. Moreover, the Report will be able to be requested by the submission of a Request for Underwriting Activity Report form.

In an effort to provide greater efficiency to syndicate managers and other distribution participants, the NASD has engaged CommScan, Inc. ("CommScan"), a New York based company that owns and operates an electronic communications system that currently connects the syndicate departments of approximately 450 subscriber firms, to establish an electronic system for transmission of the Underwriting Activity Report between the regulatory organizations and broker/dealers. The NASD previously analyzed CommScan's system and engaged CommScan to develop a software application known as NASDesk/Compliance Desk, that facilitates electronic communication between lead managers and all syndicate members and the NASD's Corporate Financing Department prior to and during a public offering of securities³ for the purpose of compliance with the Free-Riding and Withholding Interpretation under IM-2110-1.⁴ The NASD is proposing to expand the use of NASDesk/Compliance Desk to provide electronic communications and database capability with respect to compliance with NASD Rules that implement SEC Regulation M and to add a link to Nasdaq Market Operations. NASDesk/Compliance Desk permits the NASD to communicate with members through a preexisting electronic communication

system known as SynWire. As a result, the electronic communications transmitted through this system are generally referred to as wires. When the NASD transmits a wire to a member firm, the member is able to download the wire into a pre-formatted database known as SynDesk. Similar to the procedures for the Free-Riding and Withholding Interpretation, NASDesk/Compliance Desk will provide members with pre-formatted wire templates that permit the member firm to fill in data fields with pertinent distribution-related compliance information required by the NASD Rules related to Regulation M. Once the wire templates are completed with the information required by the proposed rule change, the communication protocol designed into NASDesk/Compliance Desk will permit the member firm to access the SynWire transmission system and send the information directly to the Corporate Financing Department and Nasdaq Market Operations.

Thus, the notifications described below that are intended to provide compliance with NASD Rules and SEC Rules 101, 103, and 104 will be able to be electronically transmitted to the NASD and will provide real-time notice and audit trail information to the NASD and to broker/dealers. Initially, at the advent of this program, if a member is not a NASDesk/Compliance Desk subscriber, it may submit the information by fax to CommScan, Inc., which will manually input the information into the notification form and transmit it to the NASD. Moreover, until the NASDesk/Compliance Desk system for Regulation M compliance is implemented, members will provide the required notifications by faxing, directly to Nasdaq Market Operations or Corporation Finance, the notification forms provided by the Association in hard copy.

The Regulation M Restricted Period Commencement Notification form is required to be filed with Nasdaq Market Operations by the managing underwriter with respect to a Nasdaq security in order to request an excused withdrawal on behalf of the distribution participants and affiliated purchasers and whether a distribution participant proposes, instead, to engage in passive market making, in order to comply with the member's requirements under Rule 4619(d)(1). In addition, the Notification is required to be filed with Nasdaq Market Operations by members participating in an offering of an OTCBB security under Rule 6540 in order to provide the intended date and time of the pricing of the offering. (This form is intended to replace the Passive Market

Making Activity Report currently used by the Corporate Financing Department.)

The Regulation M Trading Notification form is required to be filed with the Corporate Financing Department under Rule 4623 and Rule 6540 by a member to provide advice on penalty bids and syndicate short covering transactions for Nasdaq and OTCBB securities. In addition, the form is to be used for a request for the entry of a stabilizing bid or an identifier for a penalty bid on Nasdaq security that is directed to Nasdaq Market Operations. In addition, this form will be provided to the managing underwriter of a distribution of securities listed on a national securities exchange when a request for an Underwriting Activity Report is received and is required to be submitted to the Corporate Financing Department with the time and date of the pricing and the pricing amount in order to permit the NASD to carry out its surveillance obligations with respect to such offerings.

In addition, a Request of the Underwriting Activity Report form can be submitted through CommScan by the underwriting manager of an offering not otherwise subject to the filing requirements of the Corporate Financing Rule in order to obtain the Underwriting Activity Report from the Corporate Financing Department. The Regulation M Restricted Period Commencement Notification form or the Regulation M Trading Notification form is required to be attached to the Underwriting Activity Report received by the member when the applicable notification is submitted to Nasdaq Market Operations or the Corporate Financing Department.

The fees to be charged by CommScan for each wire (*i.e.*, each notification or request) sent over their system will be assessed a typical cost of \$15 or \$20 per wire, and could be less or more depending on the amount of information contained in the wire. The NASDesk/Compliance Desk charges are treated by the managing underwriter as expenses of the underwriting and are charged back to the syndicate.

(b) The NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(2) of the Act⁵ in that the proposed rule change will enforce and facilitate compliance by NASD members with the requirements of SEC Regulation M. In addition, the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act in that the proposed rule change to amend the Nasdaq and OTCBB Rules and establish

³ CommScan's data system provides the NASD with information on all offerings filed with the Commission.

⁴ See Notice to Members 96-18 (March 1996) for a more complete discussion of the operation of CommScan and SynWire.

⁵ 15 U.S.C. § 78o-3.

a requirement under the Corporate Financing Rule for members to obtain an Underwriting Activity Report will prevent fraudulent and manipulative acts and practices, promote just and equitable principals of trade, and protect investors and the public interest.

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

The NASD 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, as amended.

(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. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. 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 the file number in the caption above and should be submitted by April 1, 1997.

IV. Commission's Findings and Order Granting Accelerated Approval of the Proposed Rule Change

The Commission finds that the NASD's proposal is consistent with the Act and the rules and regulations thereunder applicable to a registered national securities association. Specifically, the provisions of Section 15A(b)(2) of the Act which requires that an association enforce compliance with Securities Exchange Act Rules in addition to the rules of the association. The Commission believes that the NASD proposal will enforce and facilitate compliance by NASD members

with the requirements of Regulation M, SEC Rules 100 through 105.

In addition, the Commission finds that the NASD's proposal is consistent with the provisions of Section 15A(b)(6) of the Act which requires, in part, that an association have rules that are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and in general, to protect investors. The Commission believes that the NASD's proposal is consistent with Section 15A(b)(6) of that Act in that the amendments to the Nasdaq and OTCBB Rules, in addition to the establishment of a requirement for members to an Underwriting Activity Report, provide a regulatory framework that will assist members in complying with the obligations under Regulation M. The Commission, therefore, finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁶ that the proposed rule change and Amendment No. 1 (SR-NASD-97-15) be and hereby is approved. The proposed rule change is effective March 4, 1997, with the exception of the provisions Rule 4623 and Rule 5460 that implement the notification requirements adopted under Regulation M with respect to penalty bids and syndicate covering transactions that will become effective on the date that the notification requirements under SEC Rule 104 become effective.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 97-5979 Filed 3-10-97; 8:45 am]

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[Release No. 34-38354; File No. SR-NASD-97-13]

February 28, 1997.

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Elimination of the NASD's Excess Spread Rule Applicable to Market Maker Quotations in Nasdaq SmallCap Securities

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934

⁶ 17 U.S.C. § 78s(b)(2) (1988).

⁷ 17 CFR 200.30-3(a)(12) (1996).

("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on February 24, 1997, the National Association of Securities Dealers, Inc. ("NASD" or "Association") 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 the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to grant accelerated approval to the proposed rule change.

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

The NASD proposes to amend NASD Rule 4613(d) to exclude market maker quotations in Nasdaq SmallCap securities from coverage under the Rule. As a result, Rule 4613(d) will apply only to quoted spreads by registered market makers in Nasdaq National Market securities. The text of the proposed rule change is as follows [new text is italicized; deleted text is bracketed]:

* * * * *

NASD Rule 4613 Character of Quotations

(d) Reasonably Competitive Quotations

A registered market maker in a *Nasdaq National Market* security [listed on The Nasdaq Stock Market] will be withdrawn as a registered market maker and precluded from re-registering as a market maker in such issue for 20 business days if its average spread in the security over the course of any full calendar month exceeds 150 percent of the average of all dealer spreads in such issue for the month. *This subparagraph shall not apply to market makers in Nasdaq SmallCap securities.*

(1) If a registered market maker has not satisfied the average spread requirement set forth in this subparagraph (d) for a particular Nasdaq *National Market* security, its registration in such issue shall be withdrawn commencing on the next business day following the business day on which the market maker was sent notice of its failure to comply with the requirement. A market maker may request reconsideration of the withdrawal notification. Requests for reconsideration will be reviewed by the Market Operations Review Committee, whose decisions are final and binding on the members. A request for

¹ 15 U.S.C. § 78s(b)(1).

² 17 CFR 240.19b-4.