

**Securities Industry Association**

120 Broadway, New York, NY 10271-0080, (212) 608-1500, Fax (212) 608-1604
1401 Eye Street, NW, Washington, DC 20005-2225, (202) 296-9410, Fax (202) 296-9775
info@sia.com, <http://www.sia.com>

August 14, 1997

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549

Re: Securities Exchange Act Release No. 34-38872; File No. SR-NASD-97-26

Dear Mr. Katz:

The Trading Committee ("Committee") of the Securities Industry Association ("SIA")¹ appreciates this opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") regarding the National Association of Securities Dealers, Inc.'s ("NASD") proposal to expand the Actual Size pilot program from the current 50 stocks to an additional 100 stocks, and to extend the pilot until March 27, 1998. ² For the reasons discussed below, the Committee strongly supports the proposal.

In a letter dated December 26, 1996, the Committee supported the elimination of minimum quotation size requirements.³ The Committee continues to believe that the new order-driven nature of the Nasdaq market brought about by the Order Handling Rules⁴ obviates the need for mandatory quotation size requirements. Indeed, the justification for minimum quotation size requirements, *i.e.*, to ensure an acceptable level of market liquidity and depth in an environment where Nasdaq market makers were the only market participants who could impact quotation prices, is no longer valid. The Order Handling Rules have given investors the ability to compete with market maker quotations and affect the size of bid-ask spreads. The display of customer limit orders has enhanced the depth, liquidity, and stability of the market, and has contributed to narrower quoted spreads. Consequently, the regulatory necessity for mandatory quotation size requirements no longer exists. Notably, no other primary market in the U.S. mandates minimum quotation size requirements that are larger than 100 shares for its market makers and specialists.

The Commission initially approved the Actual Size Rule on a three-month pilot basis to evaluate the impact of reduced quotation sizes on liquidity, volatility, and quotation spreads.⁵ On June 3, 1997, the NASD provided the Commission with its economic analysis of the operation of the Actual Size Rule for the group of 50 stocks in the pilot. The study, requested by the Commission, examines the effects of the removal of the 1,000-share quote size rule on market quality. ⁶

The study reveals that the pilot stocks and non-pilot stocks have experienced virtually the same improvements in market quality since implementation of the Order Handling Rules. Specifically, the NASD found no statistically significant basis to conclude that the market quality of the pilot stocks has been affected as a result of the removal of the 1,000-share quote size rule. In addition, the NASD found that investors in the pilot stocks continue to have substantial and reasonable access to market maker capital through both the Small Order Execution System ("SOES") and market makers' proprietary automatic execution systems.

The empirical evidence demonstrates that the Actual Size Rule has not harmed investors or the quality of the Nasdaq market. The Committee therefore believes that mandatory quotation size requirements are an unnecessary regulatory burden on market makers that should be eliminated. In fact, the Committee believes that rescinding the artificial minimum quote size requirements will ultimately benefit investors. Permitting market makers to quote in size commensurate with their own freely determined trading interest should enhance the pricing efficiency of the Nasdaq market and the independence and competitiveness of dealer quotes. The Committee believes that an efficient market structure is best achieved through aggressive competition without artificial regulatory constraints such as minimum quotation requirements. We would therefore support extending the Actual Size Rule to all Nasdaq securities as soon as practicable.

Thank you for the opportunity to comment. If the Committee can provide further information, please contact the undersigned, or Judith Poppalardo, SIA Assistant General Counsel, at 202-296-9410.

Sincerely,

Bernard L. Madoff
Chairman
Trading Committee

cc: Dr. Richard Lindsey, Director, Division of Market Regulation
Alfred R. Berkeley, III, President, The Nasdaq Stock Market

Footnotes

1 The Securities Industry Association ("SIA") is the trade association representing the business interests of about 750 securities firms in North America. Its members include securities organizations of virtually all types - investment banks, brokers, dealers, and mutual fund companies, as well as other firms functioning on the floors of the exchanges. SIA members are active in all exchange markets, in the over-the-counter markets, and in all phases of corporate and public finance. Collectively, they provide investors with a full spectrum of securities and investment services and account for 90% of securities firm revenue in the United States.

2 NASD Rule 4613(a)(1)(C) ("Actual Size Rule") allows market makers to quote their actual size by reducing the minimum quotation size requirement for market makers in certain securities listed on Nasdaq to one normal unit of trading.

3 See Letter from Bernard L. Madoff, Chairman, SIA Trading Committee, to Jonathan G. Katz,

Secretary, U.S. Securities and Exchange Commission, dated December 26, 1996, commenting on proposed amendments to, among other rules, Rule 4613 regarding minimum quotation size requirements.

⁴On August 29, 1996, the Commission promulgated a new rule, the Limit Order Display Rule (17 CFR 240.11Ac1-4), and adopted amendments to the Quote Rule (17 CFR 240.11Ac1-1) which together are designed to enhance the quality of published quotations for securities, promote competition, improve price discovery, and increase market depth and liquidity in the U.S. securities markets. Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290.

⁵See Securities Exchange Act Release No. 38156 (January 10, 1997), 62 FR 2415.

⁶*Effects of the Removal of Minimum Sizes for Proprietary Quotes in The Nasdaq Stock Market, Inc., Evidence from the Fifty Stock Pilot Period: January 20 to April 18, 1997*, NASD Economic Research Department (June 5, 1997).