

**Securities Industry Association**

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December 26, 1996

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

Re: Securities Exchange Act Release No. 34-38008; File No. SR-NASD-96-43

Dear Mr. Katz:

The Trading Committee ("Committee") of the Securities Industry Association ("SIA")¹ appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") regarding the National Association of Securities Dealers, Inc.'s ("NASD") proposed rule changes relating to implementation of the SEC's order handling rules. The NASD is proposing to amend a variety of NASD rules and The Nasdaq Stock Market's ("Nasdaq") Small Order Execution System ("SOES") and SelectNet Service to conform to the Commission's new limit order display rule, Rule 11Ac1-4 under the Securities Exchange Act of 1934 ("Display Rule")² and amendments to Rule 11Ac1-1(c)(5) under the Act ("ECN Rule").³ The amendments will reflect the order-driven nature of the Nasdaq market that will be brought about by implementation of the Display Rule and ECN Rule. The Committee strongly supports the proposed rule changes and urges the Commission to approve them promptly in order for market participants to adequately prepare for implementation in January.

In order to facilitate the display of customer limit orders, the NASD proposes to amend Rules 4613 and 6330 to eliminate minimum quotation size requirements. Market makers will be able to display a quotation for one normal unit of trading (100 shares) or a larger multiple thereof to reflect the actual size of a customer limit order. Without these rule changes, a market maker displaying a customer limit order smaller than the applicable minimum quote size requirement when its proprietary quote is inferior to the limit order price, would be required to execute trades at a price superior to its proprietary quote for a size greater than the size of the limit order. In light of the new order-driven nature of the Nasdaq market that will be brought about by the Display Rule, the Committee firmly believes that Nasdaq market makers, like exchange specialists, should have no mandatory quote size requirements. To provide otherwise would be unfair and would create a disincentive for firms to function as market makers.

For the reasons stated above, the Committee also generally supports the proposed modifications to SOES that allow for unpreferred market orders to be executed against market makers' displayed quotation size instead of SOES tier sizes. Other proposed changes provide for the decrementation of displayed quotation sizes after unpreferred SOES

executions. This is extremely important because it will preclude a market maker from receiving multiple SOES executions for greater than its displayed size because it displayed a customer's limit order at a price superior to the market maker's proprietary quote, or increased its quote size because of the limit order. The Committee believes, however, that there is no valid justification for treating preferenced orders any differently than unpreferenced orders as it relates to executions against displayed size versus tier size. We therefore believe that the rule change should apply to both types of orders. Finally, while we agree that it is appropriate to allow SOES market makers to enter agency orders into SOES, we believe that a riskless principal trade is the economic equivalent of an agency trade. Accordingly, we believe the proposed changes should be applicable to riskless principal trades as well. We also reiterate the position we have stated in a previous comment letter, that, in order to prevent trade-throughs and locked and crossed markets, market makers should be able to access other market makers' quotes in any market system for the price and size displayed.⁴

In order to facilitate a way for ECNs to comply with the ECN display alternative under the ECN Rule, the NASD has developed an interim approach, the SelectNet Linkage, that relies on SelectNet as the means of accessing ECN prices. The Committee has reviewed the rule changes that provide for Nasdaq's display of ECN price information and access to such prices, as well as those that address the minimal obligations required of ECNs that take advantage of the SelectNet Linkage. We also have reviewed the changes to the SOES Rules that permit the system to reject orders entered when an ECN or Unlisted Trading Privileges ("UTP") Exchange alone sets the inside price. The Committee supports these rule changes and believes the SelectNet Linkage provides a reasonable interim approach for the ECN display alternative.

Despite our strong support for the proposed rule changes, we are concerned about the possible disruption to the market caused by the inability to make all of the necessary software changes required for implementation of these rules on January 10, 1997. According to the NASD, in order to comply with standard industry practices regarding the implementation of new, or substantially revised software, Nasdaq and Commission staff have agreed that the new software should be implemented over a weekend. Therefore, the existing SOES Rules will be operative and the ECN display alternative will not be available until Monday, January 13, 1997. We believe that it is important that all systems modifications be completed and tested before implementation and, therefore, we urge the Commission to delay the effective date for the rules until January 13, 1997.

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 17 CFR 240.11Ac1-4.

³ 17 CFR 240.11Ac1-1.

⁴ **See** [Letter](#) to Jonathan G. Katz, Secretary, Securities and Exchange Commission, from A.B. Krongard, Chairman, SIA Board of Directors, and Bernard L. Madoff, Chairman, SIA Trading Committee, dated August 1, 1996.

For more information, please contact [Judith Poppalardo](#)