

recent reports will continue to be available for examination, also free of charge, at the Board's Public Access Facility in Alexandria, VA.

#### Implementation Schedule

The enhanced report will be available to subscribers as soon as practical after Commission approval of the proposed rule change. It is estimated that the period between approval and implementation will not exceed two weeks.

#### II. Summary of Comments

The Commission did not receive any comment letters addressing the Board's proposed rule change, but the Board had earlier received a comment letter from The Bond Market Association ("TBMA").<sup>8</sup> TBMA sent the comment letter in reference to the August 2002 change to the comprehensive daily report, in which TBMA also commented on the Board's announced plan to lower the threshold to two trades.<sup>9</sup> In its letter, TBMA expressed its continued support for the Board's steps to expand transparency in the municipal securities market. TBMA also stated its belief that T+1 dissemination of information on bonds that have traded at least twice a day "would provide useful information to investors and other market participants and is not likely to have a deleterious impact on the market for such bonds or mislead investors."<sup>10</sup> TBMA did state a reservation regarding the method of counting trades toward the reporting threshold. TBMA believes that when a dealer "matches or crosses purchase and sale transactions," this constitutes a single trade because this is the economic reality of such transactions, regardless of whether dealers report two transactions to the MSRB.<sup>11</sup>

Consistent with the Board's previous decisions,<sup>12</sup> the transaction reporting

<sup>8</sup> See letter from Frank Chin, Chair, Municipal Executive Committee, The Bond Market Association, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated August 8, 2002.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*, at 2.

<sup>11</sup> *Id.*

<sup>12</sup> In 1994, a commentator made a similar suggestion with reference to the Board's filing that initiated the transaction reporting program. The commentator, a brokers' broker, suggested that the Board should count as one transaction the situation in which a brokers' broker purchases securities from a dealer and sells them to another dealer. The Board noted in its reply that these are "riskless principal" transactions and that other dealers may also do riskless principal transactions. The Board noted that its transaction reporting system would treat the sale to the intermediate dealer (e.g., the brokers' broker) and the intermediate dealer's subsequent sale as two transactions, and that it would treat these trades like any other trades.

system will continue to treat two transactions that constitute "matched" or "crossed" transactions like other trades. In the general case, only the dealer that effects a purchase and subsequent sale could identify the two trades as crossed agency trades or matched riskless principal transactions. The transaction reporting system does not require dealers to match the two sides of agency trades nor specifically to match or identify riskless principal transactions. Therefore, it is not possible to count those trades differently in the current system for purposes of the T+1 reporting threshold.

#### III. Discussion

The Commission must approve a proposed MSRB rule change if the Commission finds that the proposal is consistent with the requirements set forth under the Act and the rules and regulations thereunder, which govern the MSRB.<sup>13</sup> The language of Section 15B(b)(2)(C) of the Act requires that the MSRB's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principals of trade, to foster cooperation and coordination with persons engaged in regulating, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.<sup>14</sup>

The MSRB does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act in that it applies equally to all dealers in municipal securities.

After careful review, the Commission finds that the MSRB's proposed rule change relating to Rule G-14, on reports of sales or purchases, meets the requisite statutory standard. The Commission believes that this proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder. In addition, the Commission finds that the proposed rule is consistent with the requirements of section 15B(b)(2)(C) of the Act, as set forth above.

#### IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Exchange Act,<sup>15</sup>

<sup>13</sup> Additionally, in approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>14</sup> 15 U.S.C. 78o-4(b)(2)(C).

<sup>15</sup> 15 U.S.C. 78s(b)(2).

that the proposed rule change (File No. SR-MSRB-2002-10) be and hereby is, approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

Jill M. Peterson,

Assistant Secretary.

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46806; File No. SR-NASD-2002-115]

#### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. To Amend Nasdaq's Transaction Credit Pilot Program for Exchange-Listed Securities To Allocate Credits To Liquidity Providers

November 8, 2002.

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 August 19, 2002, 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. 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 proposes to amend NASD Rule 7010 to modify Nasdaq's transaction credit pilot program for exchange-listed securities. Nasdaq will implement the proposed rule change as soon as practicable following Commission approval. The text of the proposed rule change is below. Proposed additions are in italics; proposed deletions are in brackets.<sup>3</sup>

7010. System Services

<sup>16</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> The text is marked to show changes from the language of the rule as proposed to be amended by SR-NASD-2002-111, and assumes that the Commission will approve SR-NASD-2002-111 before approving SR-NASD-2002-115. If the Commission determines that SR-NASD-2002-111 should not be approved, Nasdaq will submit an amendment to SR-NASD-2002-115 to reflect the disposition of SR-NASD-2002-111.

(a)–(b) No change.

(c)(1) No change.

(2) Exchange-Listed Securities Transaction Credit

For a pilot period, NASD members that trade securities listed on the NYSE (“Tape A”) and Amex (“Tape B”) in over-the-counter transactions [reported by the NASD to the Consolidated Tape Association] may receive from the NASD transaction credits based on the number of [trades so reported] *transactions attributed to them. A transaction is attributed to a member if (i) the transaction is executed through CAES or ITS and the member acts as liquidity provider (i.e., the member sells in response to a buy order or buys in response to a sell order) or (ii) the transaction is not executed through CAES or ITS and the member is identified as the executing party in a trade report submitted to the NASD that the NASD submits to the Consolidated Tape Association.* An NASD member may earn credits from one or both pools maintained by the NASD, each pool representing 40% of the revenue paid by the Consolidated Tape Association to the NASD for each of Tape A and Tape B transactions. An NASD member may earn credits from the pools according to the member’s pro rata share of [the NASD’s] *all over-the-counter [trade reports] transactions attributed to NASD members* in each of Tape A and Tape B for each calendar quarter, ending with the calendar quarter starting on October 1, 2002.

(d)–(r) 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

Nasdaq’s InterMarket is a quotation, communication, and execution system that allows NASD members to trade stocks listed on the New York Stock

Exchange (“NYSE”) and the American Stock Exchange (“Amex”).<sup>4</sup> The InterMarket competes with regional exchanges like the Chicago Stock Exchange (“CHX”) and the Cincinnati Stock Exchange (“CSE”) for retail order flow in stocks listed on the NYSE and the Amex. InterMarket comprises the Computer Assisted Execution System (“CAES”), a system that facilitates the execution of trades in listed securities between NASD members that participate in InterMarket, and the Intermarket Trading System (“ITS”), a national market system plan that permits trades between NASD members and specialists on the floors of national securities exchanges that trade listed securities.<sup>5</sup>

Nasdaq is proposing to modify the InterMarket Transaction Credit Pilot Program (the “Program”) that it began in 1999.<sup>6</sup> Under the Program, Nasdaq shares a portion of the tape revenues that it receives (through the NASD) from the Consolidated Tape Association (the “CTA”), by providing a transaction credit to members who engage in OTC trading activity in NYSE and Amex securities. The Program helps InterMarket market makers and investors lower costs associated with trading listed securities. The Program is also a tool for Nasdaq to compete against other exchanges (particularly CSE and CHX) that offer similar programs.<sup>7</sup>

Under the Program, Nasdaq calculates two separate pools of revenue from which credits can be earned: One representing 40% of the gross revenues received from the CTA for providing trade reports in NYSE-listed securities executed in the InterMarket for dissemination by the CTA (“Tape A”), the other representing 40% of the gross

revenue received from the CTA for reporting Amex trades (“Tape B”). Eligibility for transaction credits is based on concurrent quarterly trading activity.<sup>8</sup>

Hitherto, trade reports of ITS and CAES transactions, which are reported to Nasdaq automatically, have been attributed to the sell side of the trade.<sup>9</sup> As an added encouragement for members to provide liquidity for executions through ITS and CAES, however, Nasdaq is modifying the Program to attribute ITS and CAES trades to a member that provides liquidity (*i.e.*, that sells in response to an order to buy or that buys in response to an order to sell). Nasdaq believes that by encouraging the provision of liquidity by InterMarket participants, the proposed rule change will increase the efficiency of InterMarket transactions and enhance the competitiveness of InterMarket vis-a-vis the exchanges with which it competes.

It should be noted that the NASD receives revenue from the CTA for ITS transactions in which an NASD member is the selling party, and under the Program as currently in effect, Nasdaq shares a portion of the revenue with members that are selling parties. By contrast, under the proposed rule change, Nasdaq would share 40% of the revenue it receives from the CTA with NASD members that provide liquidity in a transaction. As a result, in instances where an NASD member executes a sell order that it receives through the ITS, Nasdaq will provide a transaction credit to the NASD member even though NASD receives no revenue from the CTA with respect to the transaction. Similarly, in instances where an NASD member sends a sell order to an exchange through the ITS, Nasdaq would not provide a transaction credit to the NASD member even though NASD does receive revenue from the CTA with respect to the transaction. The total pool of revenue shared with NASD members (40% of Tape A revenue and 40% of Tape B revenue) will not change, however. Moreover, since there is no requirement that Nasdaq share any

<sup>4</sup> Nasdaq’s InterMarket formerly was referred to as Nasdaq’s Third Market. See Securities Exchange Act Release No. 42907 (June 7, 2000); 65 FR 37445 (June 14, 2000) (SR–NASD–00–32).

<sup>5</sup> See CAES/ITS User Guide, p. 5, at [www.intermarket.nasdaqtrader.com](http://www.intermarket.nasdaqtrader.com).

<sup>6</sup> See Securities Exchange Act Release No. 41174 (Mar. 16, 1999), 64 FR 14034 (Mar. 23, 1999) (SR–NASD–99–13). The SEC issued notice of subsequent extensions of the Program. See Securities Exchange Act Release Nos. 42095 (Nov. 3, 1999), 64 FR 61680 (Nov. 12, 1999) (SR–NASD–99–59); 42672 (Apr. 12, 2000), 65 FR 21225 (Apr. 20, 2000) (SR–NASD–00–10); 42907 (June 7, 2000), 65 FR 37445 (June 14, 2000) (SR–NASD–00–32); 43831 (Jan. 10, 2001), 66 FR 4882 (Jan. 18, 2001) (SR–NASD–00–72); 44098 (Mar. 23, 2000), 66 FR 17462 (Mar. 30, 2001) (SR–NASD–01–15); 44734 (Aug. 22, 2001), 66 FR 4537 (Aug. 26, 2001) (SR–NASD–2001–42); 45273 (Jan. 14, 2002), 67 FR 2716 (Jan. 18, 2002) (SR–NASD–2001–92); and 46232 (July 19, 2002), 67 FR 48691 (July 25, 2002) (SR–NASD–2002–94).

<sup>7</sup> See Securities Exchange Act Release No. 38237 (Feb. 4, 1997), 62 FR 6592 (Feb. 12, 1997) (SR–CHX–97–01) and Securities Exchange Act Release No. 39395 (Dec. 3, 1997), 62 FR 65113 (Dec. 10, 1997) (SR–CSE–97–12).

<sup>8</sup> Under the current Program, a member must print an average of 500 daily trades of Tape A securities during a quarter to qualify for Tape A sharing and must print an average of 500 daily trades of Tape B securities during a quarter to qualify for Tape B sharing. Nasdaq has filed a separate proposed rule change to seek Commission approval for the elimination of these thresholds, effective retroactively as of July 1, 2002. SR–NASD–2002–111 (Aug. 9, 2002).

<sup>9</sup> Non-ITS/CAES trades that are reported to Nasdaq are attributed to the member identified in the trade report as the executing party, which is either the reporting party or a “give up” on whose behalf the trade is reported. The crediting of non-ITS/CAES trades remains unchanged.

of its tape revenue, Nasdaq does not believe that there is any requirement that a plan for sharing tape revenue with NASD members must use the same formula as the plan under which NASD receives the revenue. Indeed, by providing transaction credits to liquidity providers, Nasdaq hopes to encourage members to commit capital to transactions through InterMarket and/or to allow customer orders to interact with orders that they receive through InterMarket. Accordingly, Nasdaq believes that the proposed rule change will foster the provision of additional liquidity through InterMarket, thereby enhancing its efficiency by increasing the likelihood that InterMarket orders will be promptly executed. By contrast, the current program grants credits solely on the basis of whether a member happens to be selling in a particular transaction.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the Act, including section 15A(b)(5) of the Act,<sup>10</sup> which requires that the rules of the NASD provide for the equitable allocation of reasonable fees, dues, and other charges among members and issuers and other persons using any facility or system which the NASD operates or controls. The proposed rule change will lower the cost of conducting business through InterMarket for members that provide liquidity through ITS or CAES. Nasdaq believes that encouraging members to provide liquidity will enhance the efficiency of InterMarket and benefit investors whose trades are routed to InterMarket by increasing the likelihood that they will be promptly executed.

### *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, 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. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i)

as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the NASD consents, the Commission will:

A. By order approve such proposed rule change, or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, 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. 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 number SR-NASD-2002-115 and should be submitted by December 10, 2002.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46818; File No. SR-NASD-2002-147]

### **Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment Nos. 1 and 2 by the National Association of Securities Dealers, Inc. Sunsetting Revisions to NASD By-Laws Regarding the Regulatory Fee and SEC Section 31 Transaction Fee Made in SR-NASD-2002-98**

November 12, 2002.

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 October 18, 2002, 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 NASD. On November 5, 2002, the NASD amended the proposal.<sup>3</sup> The NASD again amended the proposed rule change on November 8, 2002.<sup>4</sup> The Association filed the proposal pursuant to section 19(b)(3)(A) of the Act,<sup>5</sup> and Rule 19b-4(f)(3) thereunder<sup>6</sup> as being concerned solely with the administration of the self-regulatory organization, which renders the proposal effective upon filing with the Commission.<sup>7</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The NASD proposes to: (1) Amend Schedule A of the NASD By-Laws to

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

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

<sup>3</sup> See November 4, 2002 letter from Barbara Z. Sweeney, Senior Vice President ("SVP") and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, and attachments ("Amendment No. 1"). Amendment No. 1 completely replaced and superseded the original proposed rule change.

<sup>4</sup> See November 7, 2002 letter from Barbara Z. Sweeney, SVP and Corporate Secretary, NASD, to Katherine A. England, Assistant Director, Division, Commission, and attachments ("Amendment No. 2"). Amendment No. 2 completely replaced and superseded Amendment No. 1 and the original filing.

<sup>5</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>6</sup> 17 CFR 240.19b-4(f)(3).

<sup>7</sup> For purposes of calculating the 60-day abrogation period, the Commission considers the period to have commenced on November 8, 2002, the date the NASD filed Amendment No. 2.

<sup>10</sup> 15 U.S.C. 78o-3(b)(5).

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