

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50149; File No. SR-NASD-2004-099]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Permitting ITS/CAES Market Makers To Use the Automatic Quote Refresh Functionality for ITS Securities

August 5, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 25, 2004, the National Association of Securities Dealers, Inc. (“NASD”), through its subsidiary, The Nasdaq Stock Market, Inc. (“Nasdaq”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. Nasdaq has filed this proposed rule change pursuant to section 19(b)(3)(A)(ii) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

Nasdaq proposes to amend NASD Rule 4701 (“Definitions”) and NASD Rule 4710 (“Participant Obligations in the Nasdaq Market Center”) to allow market makers that trade Intermarket Trading System securities (“ITS/CAES market makers”) to use the Automatic Quote Refresh functionality. The text of the proposed rule change appears below. New language is in italics. Deleted text is in brackets.

\* \* \* \* \*

#### 4701. Definitions

Unless stated otherwise, the terms described below shall have the following meaning:

(a)–(d) No Change.

(e) The term “automatic refresh size” shall mean the default size to which a Nasdaq Market Maker’s or ITS/CAES Market Maker’s quote will be refreshed pursuant to NASD Rule 4710(b)(2), if the market maker elects to utilize the

Quote Refresh Functionality and does not designate to Nasdaq an alternative refresh size, which must be at least one normal unit of trading. The automatic refresh size default amount shall be 1,000 shares.

(f)–(uu) No Change.

\* \* \* \* \*

#### 4710. Participant Obligations in the Nasdaq Market Center

(a) No Change.

(b) Non-Directed Orders

(1) No Change.

(2) Refresh Functionality

(A) No Change.

(B) Auto Quote Refresh (“AQR”)—

Once a Nasdaq Market Maker’s or ITS/CAES Market Maker’s Displayed Quote/Order size and Reserve Size on either side of the market in the security has been decremented to an amount less than one normal unit of trading due to Nasdaq Market Center executions, the Nasdaq Market Maker or ITS/CAES Market Maker may elect to have The Nasdaq Stock Market refresh the market maker’s quotation as follows:

(i) Nasdaq will refresh the market maker’s quotation price on the bid or offer side of the market, whichever is decremented to an amount less than a normal unit of trading, by a price interval designated by the Nasdaq Market Maker or ITS/CAES Market Maker; and

(ii) Nasdaq will refresh the market maker’s displayed size to a level designated by the Nasdaq Market Maker or ITS/CAES Market Maker, or in the absence of such size level designation, to the automatic refresh size.

(iii) This functionality shall produce an Attributable Quote/Order.

(iv) The AQR functionality described in this subparagraph shall only be available for use in connection with a Nasdaq Market Maker’s or ITS/CAES Market Maker’s “Legacy Quote.” This functionality shall be available only to Nasdaq Market Makers or ITS/CAES Market Makers.

[(v) The AQR functionality shall not be available to any participant for any ITS Security.]

(3)–(8) No Change.

(c)–(e) No Change.

\* \* \* \* \*

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

In its filing with the Commission, Nasdaq included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed

rule change. The text of these statements may be examined at the places specified in Item IV below. Nasdaq has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

##### 1. Purpose

On March 2, 2004, the Commission approved Nasdaq’s proposal to transition the trading of exchange-listed securities in the Nasdaq Market Center to the same platform that Nasdaq uses for trading Nasdaq-listed securities.<sup>5</sup> Currently, NASD Rule 4710(b)(2)(B) allows market makers in Nasdaq securities to have their quote refreshed automatically in the event that the existing quote, on either side of the market, is decremented to less than one normal unit of trading (*i.e.*, 100 shares) following an execution. This functionality, known as “Auto Quote Refresh” or “AQR,” refreshes the market maker’s quote to a price level and size that is designated by the market maker in advance.<sup>6</sup> According to Nasdaq, market makers use AQR to manage their quotations and to fulfill their quotation obligations.<sup>7</sup> In the absence of AQR, market makers manage their quotes manually or via their firm’s own quote management system. Nasdaq states that AQR is completely voluntary, but widely used in the trading of Nasdaq securities.

The AQR functionality is not currently available to market makers in ITS securities. Nasdaq states that when it proposed the new platform for the trading of ITS securities, it decided not to offer the AQR functionality to expedite the launch of the system. Nasdaq believes that removing the AQR functionality for ITS securities allowed Nasdaq to focus on the modification of the trading platform to accommodate the requirements of the ITS Plan, as well as on the functionality that Nasdaq believed was critical to market participants. Nasdaq believes that it is now able to add the AQR functionality

<sup>5</sup> See Securities Exchange Act Release No. 49349 (March 2, 2004), 69 FR 10775 (March 8, 2004) (approving SR-NASD-2003-149).

<sup>6</sup> Market makers may designate their quotes in round lots only. Telephone conversation between Jeffrey S. Davis, Associate Vice President and Associate General Counsel, Nasdaq, and Lisa N. Jones, Special Counsel and Marisol Rubecindo, Attorney, Division of Market Regulation, Commission, on August 3, 2004.

<sup>7</sup> Nasdaq notes that for purposes of Rule 11Ac1-1(c) under the Act, quotes generated by the AQR functionality are considered firm. 17 CFR 11Ac1-1(c).

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

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

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

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

to the tools available for trading ITS securities. Nasdaq believes that the AQR functionality should benefit investors by assisting ITS/CAES market makers in maintaining continuous two-sided quotes and providing added liquidity to the market following an execution.<sup>8</sup>

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of section 15A of the Act,<sup>9</sup> in general and with section 15A(b)(6) of the Act,<sup>10</sup> in particular, which requires that the rules of the NASD be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to a free and open market and a national market system, and, in general, to protect investors and the public interest. Nasdaq believes that the current proposal is consistent with those objectives in that it increases transparency, liquidity and order interaction in ITS securities in the Nasdaq Market Center.

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

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

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

Written comments were neither solicited nor received.

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

Because the foregoing proposed rule change does not:

- (i) significantly affect the protection of investors or the public interest;
- (ii) impose any significant burden on competition; and
- (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, it has become effective pursuant to section 19(b)(3)(A) of the Act<sup>11</sup> and Rule 19b-4(f)(6) thereunder.<sup>12</sup> At any time within 60 days of the filing of the proposed rule

change, the Commission may summarily abrogate the proposed rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

## 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. Comments may be submitted by any of the following methods:

### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2004-099 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2004-099. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 the filing also will be available for inspection and copying at the principal office of NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2004-099 and should be submitted on or before September 2, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50157; File No. SR-NASD-2004-095]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Adopting a Fingerprinting Program for NASD Employees and Independent Contractors in the State of New York, and, as Dictated by Business Need, in Other Jurisdictions

August 5, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 18, 2004, the National Association of Securities Dealers, Inc. ("NASD"), 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 NASD. The NASD filed the proposed rule change under paragraph (f)(3) of Rule 19b-4 under the Act.<sup>3</sup> 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

Pursuant to New York State law, the NASD proposes to adopt a program for conducting fingerprint-based background checks of NASD employees and independent contractors in the State of New York, and in other jurisdictions as business need may dictate.

Below is the text of the proposed rule change. Proposed new language is *italicized*.

\* \* \* \* \*

#### *Policy To Conduct Fingerprint-Based Background Checks of NASD Employees and Independent Contractors*

*(a) In accordance with the requirements of the law of the State of*

<sup>8</sup> Nasdaq notes that it will notify market participants of the operative date of the proposal via Head Trader Alert on [www.nasdaqtrader.com](http://www.nasdaqtrader.com).

<sup>9</sup> 15 U.S.C. 78o-3.

<sup>10</sup> 15 U.S.C. 78o-3(b)(6).

<sup>11</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>12</sup> 17 CFR 240.19b-4(f)(6).

<sup>13</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> 17 CFR 240.19b-4(f)(3).