

At times, changes in Commission priorities require alternations in the scheduling of meeting items. For further information and to ascertain what, if any, matters have been added, deleted or postponed, please contact:

The Office of the Secretary at (202) 942-7070.

Dated: January 27, 2000.

**Jonathan G. Katz,**  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42353; File No. SR-NASD-99-75]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to ECN/ATS Participation in the ITS/CAES System

January 20, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),<sup>1</sup> notice is hereby given that on December 27, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association") through its wholly owned subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("SEC" or "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 is proposing to amend Rules 5210, 5220 and 6320 of the Rules of the NASD, to permit ECNs and ATSs to register as market makers in listed securities through Nasdaq-provided quotation and trading facilities. Below is the text of the proposed rule change. Proposed new language is in italics.

\* \* \* \* \*

#### Rule 5210. Definitions

(a) through (d)—No changes.

(e) The term "ITS/CAES Market Maker" shall mean a member of the Association that is registered as a market maker with the Association for the purposes of participation in ITS through CAES with respect to one or

more ITS securities in which he is then actively registered. *The term "ITS/CAES Market Maker" shall also include a member of the Association that meets the definition of electronic communications of network ("ECN"), as defined in SEC Rule 11Ac-1-1(a)(8), or alternative trading system ("ATS"), subject to SEC Regulation ATS Rule 301(b), and has voluntarily chosen to register with Nasdaq and meets the terms of registration set forth in the Nasdaq-provided agreement linking ECNs and ATSs to the CAES system.* Registration as an ITS/CAES Market Maker is mandatory for all registered CQS market makers in securities eligible for inclusion in the ITS/CAES linkage.

\* \* \* \* \*

#### Rule 5220. ITS/CAES Registration

In order to participate in ITS, a market maker or ECN/ATS must be registered with the Association as an ITS/CAES market maker in each security in which a market will be made in ITS. Such registration shall be conditioned on the ITS/CAES Market Maker's continuing compliance with the following requirements:

(a)–(g) No change.

*(h) Election to participate in ITS/CAES through either automatic execution or order delivery. As a part of its contractual obligation required under subsection (i) below, Market Makers choosing order delivery status are required to satisfactorily demonstrate to Nasdaq the technical capacity to properly and timely respond to orders delivered through CAES.*

*(i) With respect to order delivery ITS/CAES Market Makers, execution of an addendum to the ITS/CAES Market Maker application agreement at least two business days prior to the requested date of operation.*

\* \* \* \* \*

#### Rule 6320. Registration as a CQS Market Maker

(a) No Change.

(b) An Association member, *including an operator of an ECN/ATS as defined in Rule 5210(e)*, seeking registration as a CQS market maker shall file an application with the Association. The application shall certify the member's good standing with the Association and shall demonstrate compliance with the net capital and other financial responsibility provisions of the Act. A member's registration as a CQS market maker shall become effective upon receipt by the member of notice of approval of registration by the Association.

#### 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. The self-regulatory organization has prepared summaries, set forth in Section 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 operates a trading system known as the Computer Assisted Execution System ("CAES"), which allows NASD member firms to direct orders in Consolidated Quotation System ("CQS") securities to Market Makers for execution. Through CAES, NASD order-entry firms and Market Makers can participate in the "Third Market"<sup>2</sup> by entering market and limit orders in exchange-listed securities to be executed against other market makers quoting at the best bid or offer in those securities. CAES also serves as the NASD's interface with the Intermarket Trading System ("ITS").<sup>3</sup>

The Third Market allows traditional market makers to actively make markets in a large number of New York Stock Exchange and American Stock Exchange listed stocks. While this market is currently utilized by many NASD member firms, Nasdaq believes that certain enhancements to CAES could provide more significant benefits to all NASD members. The enhancements

<sup>2</sup> Off-exchange trading of exchange-listed securities.

<sup>3</sup> ITS is a communication network designed to facilitate intermarket trading in exchange-listed securities by linking the NASD and the national securities exchanges. Operation of ITS is governed by a national market system plan known as the "Plan for the Purpose of Creating and Operating an Intermarket Communications Linkage Pursuant to Section 11A(a)(3)(B) of the Securities Exchange Act of 1934" ("ITS Plan"). Under the current ITS Plan, NASD members participating as ITS market makers must confine their market making to "Rule 19c-3 securities" (i.e., reported securities that were (1) not traded on a national securities exchange prior to April 26, 1979, or (2) traded on such an exchange on April 26, 1979, but which ceased to be traded on an exchange for any period of time thereafter. By Commission action on December 9, 1999, this limitation will be removed effective February 14, 2000. See Exchange Act Release No. 42212 (December 9, 1999), 64 FR 70297 (December 16, 1999).

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

would allow CAES market makers to compete more effectively with any and all markets operating today by providing the best possible executions for investors, therein contributing to a greater national market system.

Over the past three years, NASD members acting as ECNs in The Nasdaq Stock Market have provided increasingly more significant benefits to investors in Nasdaq securities. ECNs have helped to contribute to narrower spreads and have enhanced the ability for investors to control the prices at which they obtain executions. While these benefits have accrued to Nasdaq securities, ECNs have not traded in great measure in securities listed on traditional exchanges.

The reason for this is, in part, that NASD Rules currently do not clearly provide that ECNs can register as CQS and CAES market makers. In addition, CAES functionality currently permits only automatic executions in accessing the market maker's quotation. ECNs, which, to date, have functioned only within order delivery systems (*i.e.*, SelectNet for Nasdaq securities), have been reluctant to participate in CAES due to this system feature.

Nasdaq is now proposing to modify the CAES rules and system to allow ECN/ATSs to register as market makers in listed securities through CAES. Nasdaq believes that ECN/ATS participation in CAES would have a positive impact upon this market by significantly increasing order flow, thereby contributing to a more active and liquid market to the benefit of all CAES users, and, ultimately, to investors. Furthermore, Nasdaq is unable to discern any reason why ECN/ATSs should be denied the opportunity to participate in the Third Market on an equal basis with other NASD members who choose to register as ITS/CAES Market Makers.

Accordingly, Nasdaq proposes to allow ECN/ATSs to choose to be deemed ITS/CAES Market Makers by amending NASD Rules 5210(e), 5220 and 6320, thereby including ECN/ATSs within the definition of "ITS/CAES Market Maker" and "CQS Market Maker," and requiring the execution of an ECN/ATS addendum to the ITS/CAES Market Maker application agreement. These changes would allow any ECN/ATS to compete on an equal basis with other Market Makers, yet also require such ECN/ATS to assume the additional obligations and restrictions imposed upon ITS/CAES Market Makers by the ITS Plan and NASD rules. An ECN/ATS that chooses to exercise this option of registration, consequently, would be required to post two-sided

quotations, be firm for the price and size of those quotations, and participate in the CAES execution service on the same footing as other non-ECN/ATS ITS/CAES market makers.<sup>4</sup> This selection would also impose the additional compliance duties traditionally required of market makers participating in ITS/CAES, including, for example, the rules concerning pre-opening application, trade through, locked and crossed markets, and block transactions.<sup>5</sup> ECN/ATSs would assume the added responsibility for implementing any and all technological and programming modifications to their internal systems to demonstrate compliance with such requirements.

In registering ECN/ATSs as ITS/CAES Market Makers, ECN/ATS CAES Market Makers will be required to operate on terms that are the same as traditional CAES Market Makers. In particular, within the ITS/CAES market, there will be an absolute prohibition against quote access fees. Because ECN/ATSs would be registered as market makers, the Commission's interpretation of its firm quote rule which prohibits quote access fees by market makers would apply to ECN/ATS market makers as it does with traditional ITS/CAES market makers.<sup>6</sup> This prohibition will eliminate the inequitable position that currently exists within the Nasdaq market in which ECN/ATSs, unlike market makers, are permitted to charge quote access fees.<sup>7</sup> Furthermore, Nasdaq believes that, due to the CAES interface with ITS, the implementation of quote access fees

would be entirely infeasible within CAES and would negatively affect the terms of the ITS plan.

In addition, as discussed above, modifications must be made to the operation of the CAES system itself to technologically accommodate ECN/ATS participation. In the current CAES environment, all orders are executed against market makers through an automatic execution process. That is, the system delivers a report of a completed execution at the market maker's quoted price and size when another CAES market participant or ITS Exchange chooses to access that market maker's quote. In an effort to conform to the stated necessity of ECN/ATSs wherein they would be unable to participate within the current automatic execution environment, Nasdaq would modify CAES to facilitate order delivery interaction for any ITS/CAES Market Maker that chooses to operate in an order delivery mode as long as the firm automates its response to the delivered orders. The change would make it clear that either an ECN/ATS or non-ECN/ATS Market Maker could receive the delivery of an order (as opposed to an execution report), and immediately accept or decline that delivery by automated means.<sup>8</sup> A decline would be permissible only if it were consistent with the SEC's and NASD's firm quote rules.

Nasdaq contends that this modification will allow market makers to operate effectively and rapidly in fast moving markets. Indeed, in comparing the proposed CAES order delivery system with the ITS configuration, Nasdaq anticipates CAES order delivery market makers to be capable of responding to CAES and ITS orders in approximately 2–5 seconds.<sup>9</sup>

Further, Nasdaq believes the CAES order delivery system to be entirely consistent with the ITS Plan, in that the ITS/CAES market will continue to require automated responses to all ITS commitments sent by other exchange participants to the Third Market. In fact, the only variation between the current and proposed CAES interface to ITS is that, in certain situations, the automated

<sup>4</sup> With respect to the two-sided quotation obligation, ECN/ATS CAES Market Makers will be permitted to auto-quote in 100 share lots away from the national best bid and offer to the extent that a particular ECN or ATS does not have a customer order to represent. If an ECN/ATS CAES Market Maker quotation is accessed because such quotation becomes the national best bid or offer or is subject to another rule requiring its execution, the ECN/ATS CAES Market Maker will be required to assume a proprietary position in that security.

<sup>5</sup> NASD Rules 5240, 5262, 5263, and 5264, respectively.

<sup>6</sup> Specifically, the Commission has stated in response to a request for "no action relief" that SEC Rule 11Ac1-1(c)(2) ("SEC Firm Quote Rule") does not permit a market maker posting a quote to impose a fee on market participants that customarily trade with the market maker at its quote without a markup. See letter from Robert L.D. Colby, Deputy Director, SEC Division of Market Regulation, to M. Joseph Messina, Vice President, M.H. Meyerson & Co., Inc., dated May 5, 1998. ECN/ATSs, though not classified within the Nasdaq market as market makers (NASD Rule 4623), will be classified as market makers within the ITS/CAES market.

<sup>7</sup> See, *e.g.*, letter from Richard R. Lindsey, Director, SEC Division of Market Regulation, to Charles R. Hood, Senior Vice President and General Counsel, Instinet Corporation, dated January 17, 1997, granting "no action relief" for ECNs that impose quote access fees upon non-customer broker-dealers.

<sup>8</sup> If order delivery is selected, the ITS/CAES market maker (ECN or non-ECN) would be required to demonstrate to Nasdaq its ability to conform to system specifications which would mandate an automated and immediate acceptance or rejection, consistent with SEC and NASD firm quote obligations.

<sup>9</sup> The ITS Plan does not have any requirement related to response times. In fact, in ITS, when one participant forwards a commitment to another, the commitment has a life of one minute or two minutes. The responding market is not required by system or rule to respond to that message, except in so far as the firm quote rule requires a response.

response to the ITS commitment will incorporate an automated response by the CAES participant to CAES, followed, in succession, by an automated response from CAES to ITS. This fully automated response procedure, as with all others contained in this proposal, will be in compliance with every aspect of the ITS Plan.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Sections 11A(a)(1)(C), 11A(a)(1)(D), 11A(a)(2) and 15A(b)(c) of the Act. Section 11A(a)(1)(C) provides that it is in the public interest and appropriate for the protection of investors and the maintenance of air and orderly markets to assure: (1) Economically efficient execution of securities transactions; (2) fair competition among brokers and dealers; (3) the availability to brokers, dealers and investors of information with respect to quotations and transactions in securities; (4) the practicability of brokers executing investors' orders in the best market; and (5) an opportunity for investors' orders to be executed without the participation of a dealer. Section 11A(a)(1)(D) states that the linking of all markets for qualified securities through communications and data processing facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers and investors, facilitate the offsetting of investor's orders and contribute to best execution of such order. Section 11A(a)(2) directs the Commission to facilitate the establishment of a national market system for qualified securities. Section 15A(b)(6) requires that the rules of a registered national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, 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 and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

Nasdaq believes that the proposed rule specifically promotes the objectives of these sections of the Act by encouraging participation in the National Market System for listed securities and providing fair and unburdened access for all NASD members, to the ultimate benefit of

member firms and public customers alike.

## 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

No written comments were either solicited or received.

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

Within 35 days of the 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 self-regulatory organization consents, the Commission will:

(A) by order approve the proposed rule change, or

(B) institute proceedings to determine where 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. In particular, commenters are invited to address whether ATSS (in addition to ECNs) should be included in the proposal. The Commission also notes that the proposed rule change will have an effect on the operation of the ITS pre-opening application. Generally, under ITS rules, an exchange specialist is required to accept those pre-opening responses sent to the exchange by market makers from other participant markets prior to the opening of their markets for trading in the security. If, however, one or more market makers from other participant markets have already opened trading in a security, the exchange specialist is not required to (but may in his discretion) accept preopening responses from that other participant market for the purpose of including them in the opening transaction.<sup>10</sup> Because a pre-opening response from the ITS/CAES Third

<sup>10</sup> The same procedure applies for re-openings following trading halts. See Exhibit A of the ITS Plan, "Pre-Opening Application Rule," Sec. (b)(iii)(B).

Market is sent in aggregate form—that is, pre-opening third market buy and sell interest from all third market makers is sent as one response, it is possible that an ECN/ATS CAES Market Maker trading a security before the opening will trigger the exception to the requirement that the exchange specialist accept a pre-opening response from the third market. The Commission requests that interested persons provide written comment on this aspect of the proposal.

Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 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 at the Commission's Public Reference Room, located at the above address. 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 No. SR-NASD-99-75 and should be submitted by February 22, 2000.

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

Margaret H. McFarland,  
Deputy Secretary.

[FR Doc. 00-2117 Filed 1-31-00; 8:45 am]

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## DEPARTMENT OF STATE

[Public Notice 3209]

## Amendment to Culturally Significant Objects Imported for Exhibition; Determinations: "Ancient Faces: Mummy Portraits from Roman Egypt"

DEPARTMENT: United States Department of State.

ACTION: Notice.

SUMMARY: On January 7, 2000, Public Notice 3196 was published at page 1219 of the **Federal Register** (65 FR 1219) by the United States Department of State pursuant to Pub. L. 89-259 relating to the exhibit "Ancient Faces: Mummy Portraits from Roman Egypt." I hereby determine that an additional work of art

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