

November 29, 2000

Ms. Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: **File No. SR-NASD-00-70** Amendment to Effective Date of Phase Three of Order
Audit Trail System Rules

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Stephanie Dumont, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8176; e-mail Stephanie.Dumont@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Alden S. Adkins
Senior Vice President
and General Counsel

Enclosures

File No. SR-NASD-00-70
Consists of 16 Pages

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”), NASD Regulation, Inc. (“NASD Regulation”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend Rule 6957 to extend the effective date of the implementation of Phase Three of the Order Audit Trail System (“OATS”) rules to 120 days after SEC approval of SR-NASD-00-23 (April 19, 2000),¹ which also proposes changes to the OATS rules.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

NASD SYSTEMS AND PROGRAMS

6950. ORDER AUDIT TRAIL SYSTEM

* * *

6957. Effective Date

The requirements of the Order Audit Trail System shall be effective in accordance with the following schedule:

(a) and (b) No Change

(c) Manual Orders

The requirements of the Order Audit Trail System shall be effective 120 days after SEC approval of SR-NASD-00-23 [on December 15, 2000], for all manual orders, provided that firms shall be required to report information item (18) specified in Rule 6954(b) only to the extent such item is

¹ See Exchange Act Release No. 43344 (September 26, 2000), 65 Fed. Reg. 59038 (October 3, 2000).

available to them and shall not be required to record and report information items (4) and (5) specified in Rule 6954(b) and information item (1) specified in Rule 6954(c).

(d) Rule 3110

The requirements of Rule 3110(h)(1)(A) and Rule 3110(h)(1)(B) shall be effective on March 1, 1999, and the requirements of Rule 3110(h)(1)(C) shall be effective 120 days after SEC approval of SR-NASD-00-23 [on December 15, 2000]. The requirements of Rule 3110(h)(2) and Rule 3110(h)(3) shall be effective on March 1, 1999.

* * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) On June 27, 1996, the NASD Board reviewed and ratified a rule change for the development and implementation of an order audit trail system and the filing by NASD Regulation staff of an appropriate rule change with the SEC. On July 10, 1997, the Executive Committee of the NASD Regulation Board approved the proposed rules in substantially the form contained in SR-NASD-97-56, which was filed with the SEC on July 29, 1997. The Nasdaq Stock Market was provided an opportunity to consult with respect to SR-NASD-97-56, pursuant to the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries. Section 1(a)(2) of Article VI of the NASD By-Laws permits the NASD Board of Governors to adopt NASD Rules without recourse to the membership for approval.

(b) Questions regarding this rule filing may be directed to Stephanie M. Dumont, Associate General Counsel, NASD Regulation, Office of General Counsel, at (202) 728-8176.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

On March 6, 1998, the SEC approved NASD Order Audit Trail System (“OATS”) Rules 6950 through 6957. OATS provides a substantially enhanced body of information regarding orders and transactions that improves NASD Regulation’s ability to conduct surveillance and investigations of member firms for violations of Association rules. In addition, OATS is intended to fulfill one of the undertakings contained in the order issued by the SEC relating to the settlement of an enforcement action against the NASD for failure to adequately enforce its rules.² Pursuant to the SEC Order, OATS is required, at a minimum, to (1) provide an accurate, time-sequenced record of orders and transactions, beginning with the receipt of an order at the first point of contact between the broker/dealer and the customer or counterparty and further documenting the life of the order through the process of execution, and (2) provide for market-wide synchronization of clocks used in connection with the audit trail.³

In general, OATS imposes obligations on member firms to record in electronic form and to report to NASD Regulation certain information with respect to orders originated, received, transmitted, modified, canceled, or executed (“reportable events”) by NASD members relating to a Nasdaq Stock

² See In the Matter of National Association of Securities Dealers, Inc., Exchange Act Release No. 37538, August 8, 1996; Administrative Proceeding File No. 3-9056 (“SEC Order”).

³ Id.

Market, Inc. (“Nasdaq”) equity security. This information is integrated with quote information and transaction information reported to the Automated Confirmation Transaction Service (“ACT”)⁴ to provide the Association with an accurate, time-sequenced record of orders and other transactions.

The effective dates for OATS requirements are set forth in Rule 6957, which provides for different phases of implementation. All members were required to synchronize their computer system clocks and all mechanical clocks that record times for regulatory purposes by August 7, 1998, and July 1, 1999, respectively. In addition, the implementation schedule required that electronic orders received at the trading department of a member that is a market maker in the subject securities and those received by electronic communications networks (“ECNs”) be entered into OATS as of March 1, 1999 (“Phase One”). Not all information relating to electronic orders received by market makers was required to be reported to OATS during Phase One. Information items relating to all electronic orders, however, was required to be reported to OATS by August 1, 1999 (“Phase Two”). Under the current implementation schedule, the OATS rules would apply to all manual orders on December 15, 2000 (“Phase Three”).⁵

Since the implementation of OATS, NASD Regulation has been closely reviewing OATS activities with the goal of identifying ways in which to improve OATS and enhance the effectiveness of OATS as a regulatory tool. In this regard, NASD Regulation has proposed certain changes to OATS

⁴ ACT is an automated system owned and operated by Nasdaq that captures transaction information in real-time.

⁵ The original effective date for Phase Three was July 31, 2000. On March 9, 2000, NASD Regulation filed a proposed amendment with the SEC for immediate effectiveness to extend the implementation date of Phase Three from July 31, 2000 to October 31, 2000. (See Exchange Act Release No. 42515, File No. SR-NASD-00-09 (March 10, 2000), 65 FR 14638 (March 17, 2000).) On August 30, 2000, NASD Regulation filed a proposed amendment with the SEC for immediate effectiveness to extend the implementation date of Phase Three to December 15, 2000. (See Exchange Act Release No. 43263 (September 8, 2000), File No. SR-NASD-00-53 (August 30, 2000), 65 FR 55661 (September 14, 2000).)

that it believes will enhance NASD Regulation's automated surveillance for compliance with trading and market making rules such as the NASD's Limit Order Protection Interpretation, the SEC's Order Handling Rules and a member firm's best execution obligations.⁶

Several of these proposed amendments would change the requirements that will become effective as part of Phase Three under current OATS Rules. For example, one proposed change would require that a different order origination and receipt time be recorded and reported for certain orders. Another proposed amendment would change the definition of reporting member, which would eliminate OATS reporting requirements for certain firms. To provide adequate time for these proposed changes to be considered and potentially acted upon, NASD Regulation is proposing that the effective date of Phase Three implementation be 120 days after SEC approval of SR-NASD-00-23.⁷ NASD Regulation believes that by linking the effective date of Phase Three to SEC approval of pending proposed changes to OATS rules, members will be provided sufficient time to implement internal systems programming and other changes resulting from the rule change.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules be

⁶ See SR-NASD-00-23 (April 19, 2000).

⁷ In response to the *Federal Register* publication of SR-NASD-00-23, commenters indicated that members will require 90 days from the date the OATS Technical Specifications are amended to incorporate necessary systems changes resulting from SEC approval of SR-NASD-00-23 (April 19, 2000). In this regard, NASD Regulation believes that the OATS Technical Specifications will be amended to reflect changes resulting from SR-NASD-00-23 within 30 days of SEC approval of SR-NASD-00-23. Accordingly, NASD Regulation believes that 120 days after the date of SEC approval of SR-NASD-00-23 should provide adequate time for the OATS Technical Specifications to be amended and published and for members to make necessary systems and programming changes.

designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD Regulation believes that extending the effective date of Phase Three implementation of OATS will provide the additional time necessary to fully analyze and consider the proposed changes to OATS rules and determine whether the proposed rule changes are appropriate.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change would result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. 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.

6. Extension of Time Period for Commission Action

NASD Regulation does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(6) of Rule 19b-4 thereunder, in that the proposed rule change does not significantly affect the protection of investors or the public interest and does not impose any significant burden on competition. In accordance with Rule 19b-4(f)(6)(iii), NASD Regulation submitted written notice of its intent to file the proposed rule change along with a brief description and text of the proposed rule change prior to the date of filing. In that notice of intent, NASD Regulation requested that the

Commission waive the requirement that the rule change, by its terms, not become operative for 30 days after the date of the filing as set forth in Rule 19b-4(f)(6)(iii), as consistent with the protection of investors and the public interest. The Commission agreed to waive that requirement. Therefore, the proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD Regulation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD REGULATION, INC.

BY: _____

Alden S. Adkins
Senior Vice President and General Counsel

Date: November 29, 2000

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-] ; File No. SR-NASD-00-70)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to the Extension of the Effective Date of Phase Three for Order Audit Trail System (“OATS”) Rules

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹, notice is hereby given that on _____, the National Association of Securities Dealers, Inc. (“NASD”), through its wholly owned subsidiary, NASD Regulation, Inc. (“NASD Regulation”) 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 NASD Regulation. NASD Regulation has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,² which renders the proposal effective upon receipt of this filing by 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

Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”), NASD Regulation, Inc. (“NASD Regulation”) is filing with the Securities and Exchange

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR § 240.19b-4.

Commission (“SEC” or “Commission”) a proposed rule change to amend Rule 6957 to extend the effective date of the implementation of Phase Three of the Order Audit Trail System (“OATS”) rules until 120 days after SEC approval of SR-NASD-00-23 (April 19, 2000),³ which also proposes changes to OATS rules.

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

NASD SYSTEMS AND PROGRAMS

6950. ORDER AUDIT TRAIL SYSTEM

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6957. Effective Date

The requirements of the Order Audit Trail System shall be effective in accordance with the following schedule:

(a) and (b) No Change

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The requirements of the Order Audit Trail System shall be effective 120 days after SEC approval of SR-NASD-00-23 [on December 15, 2000], for all manual orders, provided that firms shall be required to report information item (18) specified in Rule 6954(b) only to the extent such item is available to them and shall not be required to record and report information items (4) and (5) specified in Rule 6954(b) and information item (1) specified in Rule 6954(c).

³ See Exchange Act Release No. 43344 (September 26, 2000), 65 Fed. Reg. 59038 (October 3, 2000).

(d) Rule 3110

The requirements of Rule 3110(h)(1)(A) and Rule 3110(h)(1)(B) shall be effective on March 1, 1999, and the requirements of Rule 3110(h)(1)(C) shall be effective 120 days after SEC approval of SR-NASD-00-23 [on December 15, 2000]. The requirements of Rule 3110(h)(2) and Rule 3110(h)(3) shall be effective on March 1, 1999.

* * *

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD Regulation 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.

NASD Regulation 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

(a) **Purpose**

On March 6, 1998, the SEC approved NASD Order Audit Trail System ("OATS") Rules 6950 through 6957. OATS provides a substantially enhanced body of information regarding orders and transactions that improves NASD Regulation's ability to conduct surveillance and investigations of member firms for violations of Association rules. In addition, OATS is intended to fulfill one of the undertakings contained in the order issued by the SEC relating to the settlement of an enforcement

action against the NASD for failure to adequately enforce its rules.⁴ Pursuant to the SEC Order, OATS is required, at a minimum, to (1) provide an accurate, time-sequenced record of orders and transactions, beginning with the receipt of an order at the first point of contact between the broker/dealer and the customer or counterparty and further documenting the life of the order through the process of execution, and (2) provide for market-wide synchronization of clocks used in connection with the audit trail.⁵

In general, OATS imposes obligations on member firms to record in electronic form and to report to NASD Regulation certain information with respect to orders originated, received, transmitted, modified, canceled, or executed (“reportable events”) by NASD members relating to a Nasdaq Stock Market, Inc. (“Nasdaq”) equity security. This information is integrated with quote information and transaction information reported to the Automated Confirmation Transaction Service (“ACT”)⁶ to provide the Association with an accurate, time-sequenced record of orders and other transactions.

The effective dates for OATS requirements are set forth in Rule 6957, which provides for different phases of implementation. All members were required to synchronize their computer system clocks and all mechanical clocks that record times for regulatory purposes by August 7, 1998, and July 1, 1999, respectively. In addition, the implementation schedule required that electronic orders received at the trading department of a member that is a market maker in the subject securities and those received by electronic communications networks (“ECNs”) be entered into OATS as of March 1, 1999

⁴ See In the Matter of National Association of Securities Dealers, Inc., Exchange Act Release No. 37538, August 8, 1996; Administrative Proceeding File No. 3-9056 (“SEC Order”).

⁵ Id.

("Phase One"). Not all information relating to electronic orders received by market makers was required to be reported to OATS during Phase One. Information items relating to all electronic orders, however, was required to be reported to OATS by August 1, 1999 ("Phase Two"). Under the current implementation schedule, the OATS rules would apply to all manual orders on December 15, 2000 ("Phase Three").⁷

Since the implementation of OATS, NASD Regulation has been closely reviewing OATS activities with the goal of identifying ways in which to improve OATS and enhance the effectiveness of OATS as a regulatory tool. In this regard, NASD Regulation has proposed certain changes to OATS that it believes will enhance NASD Regulation's automated surveillance for compliance with trading and market making rules such as the NASD's Limit Order Protection Interpretation, the SEC's Order Handling Rules and a member firm's best execution obligations.⁸

Several of these proposed amendments would change the requirements that will become effective as part of Phase Three under current OATS Rules. For example, one proposed change would require that a different order origination and receipt time be recorded and reported for certain orders. Another proposed amendment would change the definition of reporting member, which would eliminate

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⁷ The original effective date for Phase Three was July 31, 2000. On March 9, 2000, NASD Regulation filed a proposed amendment with the SEC for immediate effectiveness to extend the implementation date of Phase Three from July 31, 2000 to October 31, 2000. (See Exchange Act Release No. 42515, File No. SR-NASD-00-09 (March 10, 2000), 65 FR 14638 (March 17, 2000).) On August 30, 2000, NASD Regulation filed a proposed amendment with the SEC for immediate effectiveness to extend the implementation date of Phase Three to December 15, 2000. (See Exchange Act Release No. 43263 (September 8, 2000), File No. SR-NASD-00-53 (August 30, 2000), 65 FR 55661 (September 14, 2000).)

⁸ See SR-NASD-00-23 (April 19, 2000).

OATS reporting requirements for certain firms. To provide adequate time for these proposed changes to be considered and potentially acted upon, NASD Regulation is proposing that the effective date of Phase Three implementation be 120 days after SEC approval of SR-NASD-00-23.⁹ NASD Regulation believes that by linking the effective date of Phase Three to SEC approval of pending proposed changes to OATS rules, members will be provided sufficient time to implement internal systems programming and other changes resulting from the rule change.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD Regulation believes that extending the effective date of Phase Three implementation of OATS will provide the additional time necessary to fully analyze and consider the proposed changes to OATS rules and determine whether the proposed rule changes are appropriate.

⁹ In response to the *Federal Register* publication of SR-NASD-00-23, commenters indicated that members will require 90 days from the date the OATS Technical Specifications are amended to incorporate necessary systems changes resulting from SEC approval of SR-NASD-00-23 (April 19, 2000). In this regard, NASD Regulation believes that the OATS Technical Specifications will be amended to reflect changes resulting from SR-NASD-00-23 within 30 days of SEC approval of SR-NASD-00-23. Accordingly, NASD Regulation believes that 120 days after the date of SEC approval of SR-NASD-00-23 should provide adequate time for the OATS Technical Specifications to be amended and published and for members to make necessary systems and programming changes.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation 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

The proposed rule change has been filed by the Association as a “non-controversial” rule change under Rule 19b-4(f)(6) under the Act.¹⁰ In accordance with Rule 19b-4(f)(6)(iii), prior to the filing date, NASD Regulation submitted written notice of its intent to file the proposed rule change along with a brief description and text of the proposed rule change. In that notice of intent, NASD Regulation requested that the Commission waive the requirement that the rule change, by its terms, not become operative for 30 days after the date of the filing, as consistent with the protection of investors and the public interest. The Commission agreed to waive that requirement. Accordingly, the proposed rule change will become effective upon filing pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

At any time within 60 days of this filing, the Commission may summarily abrogate this proposal 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.

¹⁰ 17 CFR § 240.19b-4(f)(6)

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. 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. 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 the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary