

March 9, 2000

Katherine A. England, Esq.  
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-00-09**- Amendment to Effective Date of Phase Three of Order  
Audit Trail System Rules

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed is 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,

Joan Conley  
Senior Vice President  
and Corporate Secretary

Enclosures

File No. SR-NASD-00-09  
Consists of 15 Pages

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C.

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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 October 31, 2000.

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
- (c) Manual Orders

The requirements of the Order Audit Trail System shall be effective on October 31, 2000 [July 31, 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).

(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 on October 31, 2000 [July 31, 2000]. The requirements of Rule 3110(h)(2) and Rule 3110(h)(3) shall be effective on March 1, 1999.

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(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.

The NASD will announce the proposed rule change in a Notice to Members to be published no later than 30 days after the date of the filing.

(b) Questions regarding this rule filing may be directed to Stephanie M. Dumont, Assistant 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.<sup>1</sup> Pursuant to the SEC Order, OATS was 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.<sup>2</sup>

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 equity securities traded on The Nasdaq Stock Market, Inc. ("Nasdaq"). This information is integrated with quote information and transaction information reported to the Automated

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<sup>1</sup> 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").

<sup>2</sup> Id.

Confirmation Transaction Service ("ACT")<sup>3</sup> 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 will apply to all manual orders on July 31, 2000 ("Phase Three"). With respect to manual orders and all orders received by ECNs, however, the data required to be electronically recorded and transmitted to the OATS is limited to information that is expected to be readily available at the trading desk.<sup>4</sup>

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<sup>3</sup> ACT is an automated system owned and operated by Nasdaq that captures transaction information in real-time.

<sup>4</sup> Specifically, with respect to manual orders, information item (18) (type of account for which the order is submitted) of Rule 6954(b) would be required to be reported only to the extent that such information item is available. Information items (4) (identification of any department or the identification number of any terminal where an order is received) and (5) (identification of the department of the member originating an order) of Rule 6954(b) and (1) (recordkeeping requirements for orders transmitted to another department within the member) specified in Rule 6954(c) would not be required to be recorded and reported with respect to manual orders. In addition, information items (4) (identification of any department or identification number of any terminal where an order is received), (5) (the identification of the department of the member that originates the order), (9) (the designation of the order as a short sale), (14) (any request by a customer that an order not be displayed or that a block size order be displayed, pursuant to Rule 11Ac1-4(c)), (17) (the identification of the order as related to a Program Trade or an Index Arbitrage Trade), and (18) (the type of account for which the

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 is considering 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 Execution Rules and a member firm's best execution obligations.

Several of these enhancements that the staff is considering would change the requirements that will become effective as part of Phase Three under current OATS Rules. To provide NASD Regulation adequate time to fully analyze and consider these changes and determine whether further proposed rule changes are appropriate, NASD Regulation is proposing that the effective date of Phase Three implementation be extended from July 31, 2000 to October 31, 2000.

**(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 NASD Regulation adequate time to fully analyze and

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order is submitted) specified in Rule 6954(b) would not be required to be recorded and reported by ECNs receiving orders either electronically or manually.

consider certain potential enhancements to OATS and determine whether further 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; does not impose any significant burden on competition; and does not become operative for 30 days after the date of filing. In accordance with Rule 19b-4, the NASD 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.

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: \_\_\_\_\_  
Joan Conley, Senior Vice President and Corporate Secretary

Date: March 9, 2000

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-] ; File No. SR-NASD-00-09)

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”)<sup>1</sup>, 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,<sup>2</sup> 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 Commission (“SEC” or “Commission”) a proposed rule change to amend Rule 6957 to extend

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

<sup>2</sup> 17 CFR § 240.19b-4.

the effective date of the implementation of Phase Three of the Order Audit Trail System (“OATS”) Rules to October 31, 2000.

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

(c) Manual Orders

The requirements of the Order Audit Trail System shall be effective on October 31, 2000 [July 31, 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).

(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 on October 31, 2000 [July 31, 2000]. The requirements of Rule 3110(h)(2) and Rule 3110(h)(3) shall be effective on March 1, 1999.

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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.<sup>3</sup> Pursuant to the SEC Order, OATS was 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

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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.<sup>4</sup>

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 equity securities traded on The Nasdaq Stock Market, Inc. ("Nasdaq"). This information is integrated with quote information and transaction information reported to the Automated Confirmation Transaction Service ("ACT")<sup>5</sup> 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").

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by ECNs, however, the data required to be electronically recorded and transmitted to the OATS is limited to information that is expected to be readily available at the trading desk.<sup>6</sup>

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 is considering 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 Execution Rules and a member firm's best execution obligations.

Several of these enhancements that the staff is considering would change the requirements that will become effective as part of Phase Three under current OATS Rules. To provide NASD Regulation adequate time to fully analyze and consider these changes and determine whether further proposed rule changes are appropriate, NASD Regulation is proposing that the effective date of Phase Three implementation be extended from July 31, 2000 to October 31, 2000.

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<sup>6</sup> Specifically, with respect to manual orders, information item (18) (type of account for which the order is submitted) of Rule 6954(b) would be required to be reported only to the extent that such information item is available. Information items (4) (identification of any department or the identification number of any terminal where an order is received) and (5) (identification of the department of the member originating an order) of Rule 6954(b) and (1) (recordkeeping requirements for orders transmitted to another department within the member) specified in Rule 6954(c) would not be required to be recorded and reported with respect to manual orders. In addition, information items (4) (identification of any department or identification number of any terminal where an order is received), (5) (the identification of the department of the member that originates the order), (9) (the designation of the order as a short sale), (14) (any request by a customer that an order not be displayed or that a block size order be displayed, pursuant to Rule 11Ac1-4(c)), (17) (the identification of the order as related to a Program Trade or an Index Arbitrage Trade), and (18) (the type of account for which the order is submitted) specified in Rule 6954(b) would not be required to be recorded and reported by ECNs receiving orders either electronically or manually.

**(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 NASD Regulation adequate time to fully analyze and consider certain potential enhancements to OATS and determine whether further proposed rule changes are appropriate.

**(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.<sup>7</sup> Consequently, because the foregoing proposed rule change does not significantly affect the protection of investors or the public interest, does not impose any significant burden on competition, and does not become operative until 30 days after the date on which it was filed, and because NASD Regulation provided the Commission with

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<sup>7</sup> 17 CFR § 240.19b-4(f)(6)

written notice of its intent to file the proposed rule change prior to the filing date, the proposed rule change has become effective 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.

#### 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