

Notice to Members

APRIL 2004

SUGGESTED ROUTING

Legal & Compliance
Operations
Senior Management

KEY TOPICS

Quotations
Rule 4613A(e)(1)

GUIDANCE

Quotation Obligations

SEC Approves Amendments to Repeal Rule 4613A(e)(1)
Requiring Same-Priced Quotations on Multiple Markets;
Effective Date: March 12, 2004

Executive Summary

On March 12, 2004, the Securities and Exchange Commission (SEC) approved amendments to repeal Rule 4613A(e)(1), which requires members that display priced quotations for a Nasdaq Stock Market, Inc. (NASDAQ) security on multiple market centers to display the same-priced quotations on each market center.¹ Rule 4613A, as amended, is set forth in Attachment A. The amendments are effective as of March 12, 2004.

Questions/Further Information

Questions regarding this *Notice* may be directed to Grace Yeh, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-6939.

Background and Discussion

As originally adopted, Rule 4613A(e)(1) required members that display priced quotations for a NASDAQ security in two or more market centers to display the same priced quotations for that security in each market center. Pursuant to the Rule, members that chose to quote in multiple market centers were not permitted to display an inferior quote in any of those market centers. Rule 4613A(e)(1) was proposed as part of the Alternative Display Facility (ADF) pilot rules² because NASD believed it important to prevent fragmentation of quotations by a member (which might serve to

undermine the transparency of the best quotes in the market), given the increased potential that members might choose to dual quote on several market centers, including ADF. The provision was modeled closely after Rule 2320(g)(2), which applies to over-the-counter (OTC) securities, such as those securities quoted through the OTC Bulletin Board and the Electronic Pink Sheets.

Since its adoption, NASD has monitored the impact of Rule 4613A(e)(1) and concluded that the benefits of the same-priced quotation requirement to the trading in NASDAQ securities have been difficult to quantify. As an initial matter, the SEC's Vendor Display Rule (Rule 11Ac1-2 under the Exchange Act) generally requires that vendors provide a consolidated display of quotation information for NASDAQ securities from all reporting market centers. As such, the Vendor Display Rule ensures that quotations in NASDAQ securities from each market center are visible, thereby facilitating transparency in the market and best execution. A similar provision, however, does not apply to the OTC market, making it more important to require that members display the same priced quotation in multiple markets to promote transparency in that marketplace.

Further, Rule 4613A(e)(1) resulted in problems given recent market structure developments. For example, a member may have several completely distinct business units, such as a market making unit and an electronic communications network (ECN), which are used by different types of clients and, therefore, represent separate pools of liquidity. A member may choose to display quotations relating to its market making unit on NASDAQ and its ECN on ADF. Under such circumstances, compliance with Rule 4613A(e)(1) would, in effect, require the member to consolidate these distinct business units for purposes of displaying quotations on each market, which would be contrary to the business model of the firm since these quotes represent separate liquidity pools. As an alternative, the member could establish separate broker-dealers for each business unit, which NASD believes is overly burdensome for members given the marginal benefits associated with Rule 4613A(e)(1).

For the reasons discussed above, NASD has repealed Rule 4613A(e)(1). However, NASD will continue, as it currently does today, to monitor and surveil for any potentially collusive or manipulative conduct relating to quotation activity on markets under its regulatory authority.

Endnotes

- 1 See Securities Exchange Act Release No. 49413 (March 12, 2004), 69 Fed. Reg. 12882 (March 18, 2004) (File No. SR-NASD-2003-175) (SEC Approval Order).
- 2 Exchange Act Release No. 46249 (July 24, 2002), 67 Fed. Reg. 49822 (July 31, 2002). Subsequent to the initial approval of the ADF rules, the Commission approved an initial extension of the pilot until January 26, 2004, and a subsequent extension of the pilot until October 26, 2004. Exchange Act Release No. 47633 (April 10, 2003), 68 Fed. Reg. 19043 (April 17, 2003); Exchange Act Release 49131 (January 27, 2004), 69 Fed. Reg. 5229 (February 3, 2004).

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ATTACHMENT A

New language is underlined; deletions are in brackets.

4613A. Character of Quotations

(a) through (d) No change.

(e) Other Quotation Obligations

[(1) Members that display priced quotations on a real-time basis for Nasdaq securities in two or more market centers that permit quotation updates on a real-time basis must display the same priced quotations for the security in each market center.]

[(2)] As required by Rule 11Ac1-2(e) under the Exchange Act, a member that uses an ADF terminal or other approved ADF electronic interface shall be obligated to have available in close proximity to the ADF terminal or interface a quotation service that disseminates the bid price and offer price from all markets trading that Nasdaq security.