

INFORMATIONAL

Decimalization Testing

Nasdaq Announces Additional Decimalization Testing Dates

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KEY TOPICS

- Decimalization

Executive Summary

Recently the National Association of Securities Dealers, Inc. (NASD®) announced that selected NASD member firms must participate in decimalization testing. Mandated firms have until February 24, 2001 to satisfy this requirement. (Note: A list of mandated firms is posted on the NASD Decimalization Web Pages at <http://www.nasd.com/news/Decimalization/testing.html>.) In this *NASD Notice to Members*, Nasdaq® announces additional testing opportunities for NASD member firms, and provides details about the tests. Also, a summary of the industry-critical dates is provided.

Questions/Further Information

Questions regarding this *Notice* may be directed to the NASD Decimalization Program Management Office (DPMO) toll free at: (888) 227-1330 or via e-mail at decimals@nasd.com.

For the most recent decimalization news and developments, visit the NASD Web Site (www.nasd.com) and click on the decimalization link. Additional decimalization information is available on the Securities Industry Association's (SIA) Web Site located at www.sia.com.

Decimalization Testing

The Decimal Pricing Test Program is designed to fulfill the NASD mission of investor protection and market integrity, and to mitigate the risk of market disruptions after conversion to decimal pricing. Testing has been mandated for certain, selected NASD member firms. Those member firms that are not mandated to conduct testing may do so on a voluntary basis. All firms are encouraged to test with Nasdaq, and any firms

wishing to test on a voluntary basis should complete the registration process.

Successful completion of either Point-to-Point or Extended Point-to-Point Testing will satisfy the mandate (NASD Rule 3420). Mandated testing should be completed on or before February 24, 2001. Any firms failing to comply with the mandate may be subject to fines and/or disciplinary action.

Nasdaq Decimalization Testing

New Testing Dates - Nasdaq has added more opportunities for member firms to test decimalization changes. One additional Production test has been scheduled for February 17, 2001. One additional Extended Point-to-Point test has been scheduled for February 24, 2001. Specific times for each test are noted below.

Testing Registration - Registration is required for Point-to-Point, Extended Point-to-Point, and Saturday Production testing. A registration form can be found by visiting the NASD Web Site (www.nasd.com), clicking on the decimalization link, and then the testing button. This form is also included in the Nasdaq Decimalization Guidelines found on the Nasdaq Trader Web Site (<http://www.nasdaqtrader.com/trader/hottopics/decimalguidelines.pdf>). Firms must register at least 48 hours in advance of the date they wish to test on Nasdaq's Customer Subscriber Test (CST) facility.

Point-To-Point - Full Point-to-Point testing began January 2, 2001, and will continue through April 6, 2001, via the Customer Subscriber Test (CST) facility for CTCI and API/NWII participants. Testing of decimal-priced securities in both penny and nickel minimum price variations (MPVs), as well as fractional-priced securities, will

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occur. A *Head Trader Alert* was issued by Nasdaq and can be found on the Nasdaq Trader Web Site under Hot Topics, Decimalization.

Extended Point-to-Point - Testing will take place the mornings of January 27, February 10 and 24, 2001, and will be scripted. Systems will be available at approximately 9:00 a.m., Eastern Time (ET). The simulated open will be approximately 10:00 a.m., ET, with the test running until 12:00 p.m., ET. Nasdaq will confirm the testing times in an *Alert* closer to the dates of the tests.

Test scripts have been posted and are available on the NASD Web Site, (www.nasd.com) click on the decimalization page, and then the testing page; on the Nasdaq-Trader Web Site (www.nasdaq-trader.com), click on Hot Topics, and then decimalization; as well as on the Securities Industry Association (SIA) Decimalization Web Site (www.sia.com).

In order to complete some of the testing scenarios, firms will be required to coordinate testing with another firm (a "buddy"). See the table below for partner requirements by product.

Nasdaq Production Tests - Testing will take place the afternoons of January 27 and February 10, 2001 from approximately 1:00 p.m.-3:00 p.m., ET, and will be unscripted. Production testing will also be available Saturday, February 17, 2001, from approximately 10:00 a.m.-2:00 p.m., ET. Nasdaq will confirm the testing times in an *Alert* closer to the dates of the tests.

Proxy Testing And Exemptions - The NASD is accepting proxy testing where feasible for firms that rely on service providers or software purchased from vendors. Your firm's specific testing requirements, stated on the NASD Web Site, or in the NASD letter mandated firms received, will show where proxy testing is acceptable.

To the extent possible, firms should test their systems in their own environment. However, it is not always feasible for firms that rely on service providers (serviced firms) or software purchased from vendors (turnkey firms) to test in their own environment. For this reason, firms may rely on proxy tests conducted by service providers. Proxy testing is a term used to refer to testing that is conducted on 'like' systems and with

'like' interfaces for the purpose of not having to repeat identical tests that would provide the identical results. Firms utilizing the proxy should ensure that the proxy testing was conducted with a firm of similar complexity and size as their firm, using similar operating systems and software. Since the objective of mandated firms is to conduct all testing and preparations necessary to transition its business to decimal pricing, each member should evaluate and determine when and where proxy testing is appropriate for its organization and risk profile. Listed below are a few helpful hints that firms should consider when evaluating the applicability of proxy testing:

- Proxy tests are conducted using the same version of decimal-ready software that will be used to service the firm.
- Proxy tests are conducted using the same hardware and operating systems that are used by the firm. Where there are differences, the firm should verify and document how the differences would affect processing.
- A firm also should test systems and interfaces under its direct control and those functions not

Nasdaq quotation system	A testing partner is not required to test market making, quote update functionality.
ACES Pass Thru SM	A partner is required for order routing. Firms will need to ensure that the partner that they will route to is participating in the same test.
ACT SM	For open order submission, no partner is required, although a contra party must be identified. However, for clearing and settlement acceptance, a partner with an established clearing arrangement will be required.
SelectNet [®]	In order to receive an execution on a directed order, a partner will be required.
SOES SM /SuperSOES	For auto-execution partners will not be required. However, a prior relationship needs to have been established in order to preference a SmallCap order.

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covered in the proxy testing. These include items unique to the firm, as well as those for which there are an insufficient number of common users to develop acceptable proxy tests.

Testing Strategy - During full Point-to-Point testing, Extended Point-to-Point testing, and Production testing, Nasdaq will establish a list of securities for decimal testing with either an MPV of \$0.05 or \$0.01. The list of the Nasdaq 100 after the 2000 year-end re-ranking will be divided into two groups. The first 50, alphabetically, will be

set to an MPV = \$0.01 and the remaining 50 securities will be set to an MPV = \$0.05. Nasdaq has released a list of the test securities with their associated MPVs which can be found on the Nasdaq Trader Web Site, under Hot Topics, Decimalization. Due to the possibility of additions and deletions, there is no guarantee that this list will remain static, and that all of these securities will be available for testing. If one of these securities is no longer available, it will not be replaced. Nasdaq is confident that such changes will be

minimal and that a majority of these securities will be available.

Requests for exemptions from the NASD testing mandate should have been made in writing and forwarded to the NASD Decimalization Program Management Office at 9513 Key West Avenue, Rockville, MD 20850 by January 10, 2000. The request must have been signed by an officer of the organization. The NASD Decimalization Program Management Office will review all requests and reply to each firm.

Key Dates For Industry Implementation

Checkpoint/Phase	Action	Date
Checkpoint I	Pre-Implementation Evaluation	August 15, 2000
Phase I	Limited Exchange-Listed Issues and Options	August 28, 2000
Checkpoint II	Determine Readiness for Additional Exchange-Listed Issues and Options	September 19, 2000
Phase IIA	Additional Exchange-Listed Issues and Options	September 25, 2000
Checkpoint III	Determine Readiness for Full Implementation of Exchange-Listed Issues and/or All Options	November 1, 2000
Phase IIA-2 ¹	Additional NYSE Equities and Associated Options	December 4, 2000
Phase IIB	Full Conversion Exchange-Listed Issues and Associated Options	January 29, 2001
Checkpoint IV	Limited Nasdaq Issues and Associated Options	March 5, 2001
Phase III	Limited Nasdaq Issues and Associated Options	On or Before March 12, 2001
Checkpoint V	Determine Readiness for All Markets, Full Implementation	April 2, 2001
Phase IV	All Markets, Full Implementation	On or Before April 9, 2001

To view the complete Exchange Committee Implementation Plan submitted to the Securities and Exchange Commission (SEC), visit the SEC Web Site located at <http://www.sec.gov/rules/other/decimalp.htm>. The SEC has not given final approval to the plan.

¹ Phase IIA-2 was not part of the original submission to the SEC. At Checkpoint III, held November 1, 2000, a decision was made to begin trading additional New York Stock Exchange equities and their associated options in decimals.

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