

INFORMATIONAL

Weighted Average And Special Pricing Formula Trades

SEC Approves Changes To Transaction Reporting Procedures For Weighted Average And Special Pricing Formula Trades; **Effective Date: July 17, 2000**

SUGGESTED ROUTING

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Legal & Compliance
- Trading & Market Making
- Training

KEY TOPICS

- Transaction Reporting

Executive Summary

On May 31, 2000, the Securities and Exchange Commission (SEC) approved changes to National Association of Securities Dealers, Inc. (NASD[®]) Rules 4632(a)(6), 4642(a)(6), and 6420(a)(6) regarding transaction reporting procedures for weighted average and other special pricing formula trades.

NASD Rules 4632(a)(6), 4642(a)(6), and 6420(a)(6), as now amended, require all transactions, not just agency crosses, in Nasdaq[®]-listed and exchange-listed securities that are traded on a weighted-average basis or effected based on other special pricing formula, to be reported with the .W modifier. Prior to the rule change, only agency cross transactions – not principal or riskless principal transactions – that were effected at an average price or based on a special pricing formula were required to be reported with the .W modifier.

The rule changes are included with this *Notice* in Attachment A. These changes will go into effect on July 17, 2000.

Questions/Further Information

Questions concerning this *Notice* may be directed to: Nasdaq MarketWatch at (800) 211-4953; John F. Malitzis, Nasdaq Office of General Counsel, at (202) 728-8245; Thomas P. Moran, Nasdaq Office of General Counsel, at (202) 728-8401; or Legal Section, Market Regulation Department, NASD RegulationSM, at (301) 590-6410.

Background

NASD Rule 6420 sets forth NASD member reporting obligations for transactions in exchange-listed

securities effected in the over-the-counter market (*i.e.*, third market transactions). NASD Rules 4632 and 4642 set forth NASD reporting obligations for transactions in Nasdaq-listed securities. These three rules require members to append a special indicator (.W) to a trade report when a member is effecting an agency cross transaction at prices based on a weighted-average price or other special pricing formula. The NASD adopted these rules, in part, because these weighted-average trades were being effected in the third market and Nasdaq at a price that did not relate to the closing price on the primary exchange or Nasdaq, but such trades affected the reporting of the last sale in the exchange-listed security to the media and vendors. Pursuant to Rules 4632, 4642, and 6420, these weighted average or special pricing formula trades, when reported with the .W modifier, do not affect the last sale price.

When adopted, the scope of Rules 4632(a)(6), 4642(a)(6), and 6420(a)(6) were limited to agency cross trades effected on a weighted-average basis or other special pricing formula because a majority of the trades at the time were being effected on an agency cross basis. Since these rules were adopted, the market has changed in many ways. In particular, a number of NASD rules have been amended recently to allow Nasdaq, including the Automated Confirmation Transaction ServiceSM (ACTSM), to stay open until 6:30 p.m., Eastern Time, to facilitate after hours trading. As part of this initiative, Nasdaq amended Rules 4632, 4642, and 6420 to require members to report transactions effected between 9:30 a.m. and 6:30 p.m., ET, within 90 seconds. One effect of this rule change has been to subject transactions that

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previously were reported on an “as of” basis T+1 — because they were effected between 5:15 p.m. and 6:30 p.m. — to 90-second trade reporting requirements. The NASD and Nasdaq have learned that a number of trades effected during the 5:15 p.m. and 6:30 p.m. time period are volume-weighted transactions, which are effected on a principal and riskless principal basis. These volume-weighted trades are often effected at a price unrelated to the close — or, if effected during the trading day, the

last sale — on the primary exchange. Because these trades are not done as agency crosses and thus not subject to the .W reporting requirement in Rules 4632(a)(6), 4642(a)(6), and 6420(a)(6), they are reported without a modifier and may affect the reporting to the media and vendors of the last sale in the exchange-listed security. As a result, there is a potential for investor confusion and disorderly markets. In light of this, the NASD and Nasdaq recently proposed —

and the SEC approved — amendments to NASD Rules 4632(a)(6), 4642(a)(6), and 6420(a)(6) to require all transactions, not just agency crosses, in Nasdaq and exchange-listed securities that are based on a weighted average or other special pricing formula, to be reported with the .W modifier. Note that the price does not necessarily have to be away from the prevailing market when using the .W modifier.

ATTACHMENT A**Text Of Amendments**

(Note: Deletions are bracketed.)

Rule 4632. Transaction Reporting

(a) (1) - (5) No Change

(6) All members shall report [agency cross] transactions occurring at prices based on average-weighting or other special-pricing formulae to Nasdaq using a special indicator, as designated by the Association and set out in the Symbol Directory.

(7) - (8) No Change

(b) - (f) No Change

Rule 4642. Transaction Reporting

(a) (1) - (5) No Change

(6) All members shall report [agency cross] transactions occurring at prices based on average-weighting or other special-pricing formulae to Nasdaq using a special indicator, as designated by the Association and set out in the Symbol Directory.

(7) - (8) No Change

(b) - (f) No Change

Rule 6420. Transaction Reporting

(a) (1) - (5) No Change

(6) All members shall report [agency cross] transactions at prices based on average-weighting or other special pricing formulae unrelated to the current or closing price of the security on the primary market to Nasdaq using a special indicator, as designated by the Association.

(b) - (e) No Change

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